



Mutual Fund Dealers Association of Canada
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MR-0047
October 3, 2005

MEMBER REGULATION NOTICE

PERSONAL FINANCIAL DEALINGS WITH CLIENTS

This Notice is intended to clarify the obligations of Members and Approved Persons regarding personal financial dealings with clients.

General Principles Relating to Personal Financial Dealings

MFDA Rule 2.1.1 requires that each Member and each Approved Person deal fairly, honestly and in good faith with clients; observe high standards of ethics and conduct in the transaction of business; and refrain from engaging in any business conduct or practice which is unbecoming or detrimental to the public interest.

Under Rule 2.1.4, Members and Approved Persons must be aware of the possibility of conflicts of interest arising in connection with business conducted by them for clients. Any conflict or potential conflict of interest that arises must be immediately disclosed in writing to the client prior to the Member proceeding with the proposed transaction giving rise to the conflict or potential conflict. Any such conflicts or potential conflicts of interest must be addressed by the exercise of responsible business judgment influenced only by the best interests of the client. Responsible business judgment requires the use of reasonable care and diligence as necessary in the circumstances to address the conflict or potential conflict in the best interests of the client. The appropriate course of action will depend on the nature of the conflict of interest and the client's circumstances. In situations involving a potentially significant conflict of interest, the exercise of responsible business judgment may require a prohibition on the type of transaction giving rise to the conflict.

Specific Situations

a) Borrowing from Clients

Borrowing from a client by either the Member or Approved Person raises a significant and direct conflict that in almost all cases will be impossible to resolve in favour of the client. While such activity is not explicitly prohibited under MFDA Rules, MFDA staff are unaware of any circumstances where Members or Approved Persons proposing to enter into any such arrangements would be able to demonstrate that the conflict has been properly dealt with.

b) Lending to Clients

Lending or extending credit to clients or permitting the purchase of securities by clients on margin is generally prohibited under MFDA Rule 3.2.1. Level 2, 3 or 4 Members are permitted to advance mutual fund redemption proceeds to clients if the conditions of Rule 3.2.3 are satisfied. However, Approved Persons are prohibited in any case from directly or indirectly entering into arrangements that involve lending to clients.

c) Private Investment Schemes with Clients

MFDA staff have become aware of situations where Approved Persons have become involved with clients in various private investment schemes that raise significant and direct conflicts of interest where the exercise of responsible business judgment would require prohibition of the arrangements. These include:

- investment clubs, where the Approved Person and clients invest together, with the Approved Person making decisions on behalf of the investment club;
- arrangements where client funds are put into investments that are to be directly or indirectly managed by the Approved Person;
- co-investment by the Approved Person and his or her clients in pyramid-like schemes or other questionable investments.

In addition to conflict of interest issues, these types of arrangements also raise concerns with respect to compliance with MFDA Rule 1.1.1, which requires that all securities-related business be conducted through the Member. Such arrangements have also involved, in some cases, Approved Persons engaging in activities that exceed the limits of their registration under securities legislation.

d) Personal Involvement in Approved Outside Business Activity

An Approved Person may under certain circumstances properly be involved in a business arrangement as a partner, shareholder, director or officer of a business owned, co-owned or controlled by the client. Members are directed to Member Regulation Notice MR-0040 for additional information relating to business activities carried on outside of the Member.

e) Monetary or Non-Monetary Benefits to/from Clients

Non-monetary benefits such as gifts or charitable donations can be used to circumvent the guidelines and rules noted above. For example, they can be used as a way of negotiating private settlements aimed at concealing a breach of MFDA requirements on the part of the Approved Person. They may also be used as off book compensation for activities being carried on in an inappropriate way. Substantial gifts to clients in exchange for referrals may be used to employ clients to engage in registerable activity.

All monetary and non-monetary benefits provided directly or indirectly to or from clients must flow through the Member. The Member must be notified of any such arrangements, so that the Member is in a position to determine the significance of the benefit and to monitor the activity. With respect to the resolution of complaints, in accordance with MFDA Policy 3, no Approved Person may enter into any settlement agreement with a client without the prior written consent of the Member.

In general, monetary and non-monetary benefits provided to or from clients that are of nominal value do not present concerns regarding conflicts of interest. As an exception to the above requirements, Approved Persons may provide monetary or non-monetary benefits of a nominal nature to the client without notice to the Member, provided this is done in accordance with procedures established by the Member.

Member Policies and Procedures

Each Member must develop policies and procedures to ensure that it is aware in advance of any personal financial or business dealings between Approved Persons and clients. These would include situations where it is proposed that:

- an Approved Person be involved with any type of credit arrangement with clients;
- an Approved Person enter into joint account or other arrangement that is equivalent to a joint investment with a client;
- any form of “client appreciation” arrangement be entered into where the monetary or non-monetary benefit is more than nominal value.

The Member’s procedures must also identify guidelines or criteria for determining which activities of the Member or the Approved Person may or may not be properly carried on under the Rules. Written disclosure to clients regarding the arrangements must be tailored to the particular situation, so that the client understands the nature and extent of all relevant conflicts of interest.

Member procedures must be effectively communicated to all Approved Persons, supervisory personnel and appropriate officers of the Member and the Member must have controls in place to monitor and supervise compliance with those procedures.

Members must create guidelines to identify what will be considered a nominal monetary or non-monetary benefit and provide some form of definition as to where the nominal value threshold lies. In the context of cooperative marketing practices, non-monetary benefits of nominal value are permitted under section 5.6 of National Instrument 81-105 if the provision of the benefits is neither so extensive nor so frequent as to cause a reasonable person to question whether the provision of the benefits will improperly influence the advice given by the representative to his or her clients. Members may use this as guidance in defining the threshold to apply to personal dealings with clients.

Existing Arrangements

Members must, if they have not done so to date, make reasonable inquiry to identify any situations that could be in contravention of the above requirements, and deal with those situations appropriately.

Doc #67866v1