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MEMBER REGULATION NOTICE

CONFLICTS OF INTEREST – MFDA RULE 2.1.4

This Notice is intended to clarify the obligations of Members and Approved Persons with respect to the management of conflicts of interest in accordance with MFDA Rule 2.1.4.

Recent Amendments to Rule 2.1.4

MFDA Rule 2.1.4 has been amended to clarify the role of Approved Persons in the management of conflicts of interest by Members. Approved Persons are important points of contact with clients and play an important role in ensuring that conflicts that arise in dealing with clients are properly managed. As such, it is important that Approved Persons notify the Member when they identify a potential conflict of interest and support the Member in taking appropriate action to ensure that the conflict is addressed in the best interests of the client.

Application of Rule 2.1.4

Rule 2.1.4 is intended to function as a rule of general application with respect to the treatment of conflicts. It is meant to provide Members with a broad principle under which specific standards are to be created to manage and resolve conflicts, whether real or perceived, that Members and Approved Persons may encounter. It is important to note that there are two distinct aspects to Rule 2.1.4. There is a requirement that written disclosure be provided to clients regarding potential conflicts that have been identified. There is also an obligation to address the conflict by the exercise of responsible business judgment, influenced only by the best interests of the client.

In applying the rule in practice, MFDA staff takes the position that the concept of materiality is implicit in the rule. MFDA staff does not expect Members to anticipate every potential conflict, regardless of the remoteness of a problem arising, and provide written disclosure to clients of such conflicts. However, written disclosure must be provided in all cases where there is a reasonable likelihood that a client would consider the conflict important when entering into a proposed transaction. For example, this would include a situation where an Approved Person refers a client to a company in which the Approved Person has an ownership interest for tax preparation services. In some cases, general disclosure to clients at one point in the relationship

may be enough. In other cases, ongoing disclosure, or disclosure specifically related to the timing of a transaction, may be required.

Exercise of Responsible Business Judgment

As noted in Member Regulation Notice #0047 (*Personal Financial Dealings with Clients*), the exercise of responsible business judgment required to address a conflict of interest will depend on the nature of the conflict and the client's circumstances. In some cases, the exercise of responsible business judgment may not require action beyond providing disclosure to clients. In other cases, the Member may decide to implement additional policies and procedures, such as requiring clients to obtain independent legal advice or creating specific supervisory procedures to monitor certain activities. In situations involving a particularly significant conflict of interest, the appropriate course of action may require a prohibition on the type of transaction giving rise to the conflict. For example, MFDA staff would expect that transactions involving borrowing from clients would generally be prohibited.

Effect of Other Disclosure Requirements

MFDA Rules and provincial securities legislation provide specific conflict disclosure requirements in certain cases. Compliance with these specific requirements will often be sufficient to discharge the disclosure responsibilities of Members and Approved Persons under Rule 2.1.4. However, in all cases involving conflicts or potential conflicts of interest, the Member must apply the exercise of responsible business judgment. For example, securities legislation requires registrants to provide disclosure to clients when selling securities of a related issuer. Compliance with these requirements would be sufficient to meet the Member's disclosure requirements under MFDA Rule 2.1.4. In some cases, such as the sale by a Member of an affiliate's prospectus qualified mutual fund, no additional steps may be required. However, where the Member is selling an exempt security of an affiliated issuer with no track record, it may be necessary to implement other additional procedures to address the conflict of interest or refrain from selling the security.

Conflicts Related to Outside Business Activities

With respect to outside business activities, in accordance with MFDA Rule 1.2.1(d), MFDA staff expects Members to consider issues relating to potential conflicts of interest prior to approving any such activities. As stated in Member Regulation Notice #0040 (*Outside Business Activities*), this would include consideration of compensation to be paid under the arrangement, the nature of the relationship between the Approved Person and the outside entity, and any other potential conflicts that are identified. If any conflict cannot be properly managed in accordance with Rule 2.1.4, the outside activity should not be permitted. Members also have an ongoing obligation to monitor outside business activities for conflicts of interest that may arise.