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Securities Regulation in British Columbia

WORKING TO MAKE BC THE BEST PLACE TO INVEST & THE BEST PLACE TO RAISE CAPITAL

Guide for **Dealers and Advisers**

British Columbia Securities Commission

BCSC

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Introduction

This Guide is to help you understand what is expected of dealers, advisers, and their representatives under British Columbia securities laws and to give you guidance on how to comply with those laws. Our system of securities regulation is designed to protect investors and clients while minimizing the regulatory burden on industry. We have:

- established principles of regulation to focus registrants on their responsibilities to their clients and the market
- imposed requirements only to the extent they are necessary for the protection of investors and markets
- designed outcomes-based regulatory requirements with the flexibility to suit a wide range of business models and client relationships

We think it is important that people like you, who must comply with the requirements, are able to do so using your own judgment and experience. There is no avoiding the fact that securities regulation is a complex area, so there will be times when you need to get professional advice. However, we believe that this should not be necessary for routine compliance matters. The system should be simple enough to understand so that you are able to make better judgments about when to get professional advice, and are able to better instruct your professional advisers when you do so. To create this sort of regulatory environment, we have:

- kept the rules as few and as simple as possible
- written them in plain language
- established guidance and created training programs for dealers, advisers, and other market participants

We have adopted this approach because we believe it works. Clients get the information and protection they need, and dealers and advisers do a better job of compliance because they understand what is expected of them.

How to use this Guide The Guide should be read together with the *Securities Act* and the *Securities Rules*.

The Act and Rules define and interpret certain words. Many of these words are used in this Guide. To draw your attention to these words, we have italicized them the first time they appear in a Section of the Guide. Unless indicated otherwise, the definitions for the italicized words are in section 1 of the Act or section 1 of the Rules.

To help the reader's understanding of the regulatory regime, this Guide often repeats or paraphrases requirements in the Act, Rules, and other instruments. However, your compliance will be judged against the text in those instruments, so you should refer to them directly.

How to navigate the Act and Rules Parts 1 to 9 of the Act and Rules correspond, in terms of subject matter, to the same parts of the Canadian Securities Administrators (CSA) national numbering system.

How to get more help This Guide is only part of our system of guidance for dealers and advisers. If you have specific questions that are not answered in this Guide, you can get answers by contacting us by phone or e-mail in the manner described on our website, **www.bcsc.bc.ca**. The website also has the text of the Act, Rules, forms, and other regulatory instruments.

I. Application

A APPLICANTS REGISTERED IN OTHER PROVINCES

Interface exemptions Most dealers and advisers are subject to securities regulation in more than one province ("province" includes the territories). To avoid imposing different requirements on those who are subject to the securities legislation in other provinces, the Rules include "interface" exemptions that generally allow those dealers and advisers to satisfy the requirements in British Columbia by complying with the requirements of another province.

The "requirements" of the other province include blanket exemptions from regulatory requirements issued by that province. They do not include discretionary exemption orders that apply only to you but not to registrants generally in that province. If you want the same discretionary relief in British Columbia, you must apply for it.

The Rules contain an interface exemption for dealers and advisers covering most ongoing firm requirements (Rules, section 44).

If you are a dealer or adviser registered elsewhere in Canada and are registering in British Columbia, we ask for your firm's contact information and will verify that you are registered and in good standing in your home province [new Form 31-903F]. If you are in compliance with that province's securities regulations, you are registered immediately. If you are not in compliance, we will consider whether your registration should be conditioned or restricted, or whether it is appropriate to grant registration at all.

If you are a representative registered elsewhere in Canada and you are registering in British Columbia, you make your application through the National Registration Database (NRD) system, just as you do today.

Exceptions All registrants, including those whose home province is not British Columbia, must comply with the Code of Conduct (Rules, section 31). There is no interface exemption.

There are three areas in which the Code imposes a higher standard in British Columbia than elsewhere in Canada – client disclosure, conflicts of interest, and hiring practices. We think it is good policy to require compliance with these higher standards.

B FOREIGN REGISTRANTS

In British Columbia, there are exemptions for foreign registrants and mutual fund companies when they deal with pre-existing clients or accept orders that were not solicited. These exemptions are contained in BC Instrument 71-502 *Exemptions for Foreign Market Participants*. See Part II, Sections B-1 and B-2 of this Guide.

II. Overview of the Registration Regime

Unless exempted under the Rules, anyone who *trades* in *securities* or acts as an *adviser* must register with the Commission (Act, section 14). *Trading* covers a broad range of activities including:

- buying or selling securities, including derivatives
- acting as an intermediary for buyers and sellers
- any "…act, advertisement, solicitation, conduct, negotiation or transaction in direct or indirect furtherance of buying or selling securities"

Not everyone needs to be registered — there are a number of exemptions to deal with routine commercial practice. For example, no one who trades through a registered dealer needs to be registered (otherwise, all your clients would have to be registered) (Rules, section 47). And no one has to be registered to buy a security because the protections offered by the registration requirement are intended to regulate the conduct of sellers, not buyers (Rules, section 46).

Some derivatives are excluded from the definition of *derivative*. For example, contracts providing for physical delivery and compensation arrangements are excluded (Rules, sections 2 and 3).

Advising means engaging in, or holding out as engaging in, the business of:

- managing investment portfolios on behalf of clients
- advising on investments or trading in securities

Professional advisers in the business of providing legal, accounting, or other advice related to but not directly about trading, do not fall within this definition. An adviser provides advice on trading, not the law, accounting practice, or some other discipline. This is why the formerly available exemption for providing advice solely incidental to one's professional business was unnecessary and has been eliminated in this legislation.

Please note that the term *representative* is not used in other Canadian jurisdictions. Instead, you will see terms like "salesperson" or "advising employee." Those are equivalent terms.

Other exemptions are explained in more detail in Part II, Section B of this Guide.

A REGISTRATION REQUIREMENTS

1. Categories

There are eight registration categories in British Columbia: investment dealer and investment dealer representative; mutual fund dealer and mutual fund dealer representative; restricted dealer and restricted dealer representative; and adviser and adviser representative (Rules, section 21(1)).

Investment dealer An investment dealer may trade in all securities, advise clients in connection with those trades or investing in securities, and act as an underwriter (Rules, section 21(2)). Investment dealers must be members of the Investment Dealers Association of Canada (IDA) (Rules, section 24(1)).

Mutual fund dealer A mutual fund dealer can only trade in, and only advise clients in connection with trades in:

- mutual fund securities
- the exempt market
- scholarship plan units
- employee venture capital corporation and labour-sponsored fund securities (under certain conditions)
- venture capital corporation securities (under certain conditions) (Rules, section 21(2))

A mutual fund dealer must be a member of the Mutual Fund Dealers Association of Canada (MFDA)(Rules, section 24(2)).

Restricted dealer A restricted dealer may only trade, and may only advise on trades in, the securities specified in the conditions attached to its registration (Rules, section 21(2)). Restricted dealers will have individual conditions of registration established by the Capital Markets Regulation Division. Restricted dealers include those who were previously registered as scholarship plan dealers and exchange contracts dealers.

Adviser A registered adviser may manage investment portfolios on behalf of clients or advise clients on investing or trading in particular securities (Act, section 1 (definition of *adviser)* and Rules, section 21(2)). If you were previously registered as investment counsel or a portfolio manager, you are now registered as an adviser. Whether you have a discretionary management agreement with your client depends on your relationship with your client.

Representative A dealer's or adviser's representatives may trade or advise on those securities they have the proficiency and qualifications to trade and advise on, but cannot have greater trading authority than the dealer or adviser whom they represent.

2. Firm Responsibilities

As a registered firm, you are responsible for ensuring that your representatives have the character and qualifications necessary to trade or act as advisers, and that they comply with all regulatory requirements, including the Code of Conduct (see Part IV, Section A of this Guide). Your firm and its partners, *directors*, and *officers* are responsible to regulators, and subject to civil liability (at common law and under the insider trading and front running prohibitions in the Act) for the actions of your representatives. Your hiring and supervision practices are critical to successful compliance and risk management.

Representatives of your firm can be your employees or can independently contract with you through a corporation or some other entity such as a partnership. Since you are responsible for the conduct of those who are your representatives, regardless of the business structures they use, you will want to consider what safeguards are appropriate in these circumstances for the protection of your firm and its clients.

For example, you should consider what your needs are for supervisory and audit purposes, especially if the representative is involved in other businesses or works off-site. You may also want to put additional or different requirements in place to manage any risk or conflict arising from a particular arrangement. If the representative is involved in another business, you may have expectations about how the representative will ensure ongoing proficiency and devote adequate time to your business.

Depending on your firm's line of business, there may be many additional factors you should consider in making arrangements with representatives who are not your employees. You might consider, for example, getting an acknowledgement from your independent contractors of your expectation that they are bound by and will follow rules set by your *marketplace*, *self-regulatory organization*, or *regulatory organization*.

To make sure that you can get the information you need when making a hiring decision, the Rules have an information-sharing regime for this purpose (Rules, sections 27, 28, and 29).

Under that regime, which is designed to meet the requirements of federal and provincial personal information protection laws, you can ask any registered firm with whom the representative was previously employed to give you information it has about the representative's engagement with that firm. The firm must provide you with all information that is relevant to judging the representative's suitability to work as a representative. You may use that information to decide whether to hire or terminate the representative, and to manage that representative's conduct. The representative's consent to the disclosure is not required.

Examples of relevant information include the prospective candidate's proficiency, competence, and past conduct (in light of the requirements of the Code). Regulatory history and client complaints are related to past conduct. The representative application form information provides additional guidance about relevant topics (see Form 33-109F4). If you receive an inquiry that does not relate to the representative's proficiency, competence, or past conduct, the requested information is likely not protected under the information-sharing regime.

A prospective employer may want to know other personal information typically relevant to the hiring decision but that does not relate directly to suitability to work in the industry (for example, punctuality, people skills, and so on). This kind of information is not covered by the information-sharing regime in the Rules, and the usual requirements of employment and personal information protection laws would apply.

When you provide information about a current or former representative to another firm under the information-sharing regime in the Rules, you have a qualified privilege defence if the representative sues you for defamation. This is a defence against liability even if the personal information you share is untrue or otherwise defamatory, as long as you do not act maliciously.

You can only use the information you get under the information-sharing system in the Rules to make a decision whether to hire or terminate a person as a representative or to manage the person (Rules, section 29(1)). You cannot disclose that information to anyone, other than:

- a *regulator* or its delegate
- a marketplace, self regulatory organization, or regulatory organization (if you are a *regulated person*)
- a person empowered by law (Canadian or otherwise) to regulate financial services
- if required or permitted by law (Rules, section 29(2))

For further information, please see the discussion under Code of Conduct, section 22.

3. Permanent Registration

Once registered, you do not have to renew your registration. On an annual basis and before December 31 each year, registered firms must ensure there are sufficient funds in their NRD accounts to cover their annual fee assessments, for the firm and for each representative (see the Fee Schedule, on our website, for details). If a registered firm does not pay its annual registration fee, its registration is automatically suspended (Rules, section 22).

Your registration continues in force until you choose to surrender it, it expires, or it is suspended or revoked by the Commission (or the IDA, in the case of investment dealers) (Act, section 15(3)).

If you are an individual, your registration is automatically suspended when:

- your dealer or adviser suspends your trading or advising privileges
- your dealer or adviser terminates you
- your annual registration fee is not paid (Rules, sections 22(1) and (2))

Registration of a representative is automatically revoked if the representative was terminated and is not engaged by a new dealer or adviser within 90 days (Rules, section 22(3)).

B EXEMPTIONS

The legislation includes many exemptions from the registration requirement for raising capital through private placements, to facilitate issuer transactions, and for other circumstances in which it is appropriate not to impose the registration requirement.

The exemptions described here are those particularly relevant to registrants. Other exemptions are described in the Issuer Guide (see our website).

1. Exemptions for Dealers and Their Representatives

Pre-existing relationships with residents of British Columbia A registered dealer from another Canadian jurisdiction or from a foreign jurisdiction, and its representative, does not have to be registered in British Columbia to deal with a client who is already a client of the dealer and later becomes resident in British Columbia (either temporarily or permanently) (Rules, section 74(a); BC Instrument 71-502, section 2(a)).

Unsolicited trades with residents of British Columbia A registered dealer from another jurisdiction in Canada or from a foreign jurisdiction, and its representative, does not have to be registered in British Columbia as long as they:

- do not advertise or engage in promotional activity directed at British Columbia residents in the six months prior to the trade
- do not pay anyone other than a client or purchaser or a representative outside British Columbia in connection with trading in British Columbia (Rules, section 74(b); BC Instrument 71-502, section 2(b))
- do provide the client with disclosure (see below)

You would be directing your advertising or promotion at residents of British Columbia if you target British Columbia residents (either specifically or as part of a Canada-wide marketing

initiative). For example, a web page on the registrant's website dedicated to services offered to British Columbia residents or setting up an office in British Columbia is directed marketing or promotion, as are broadcast or print campaigns on a Canada-wide basis. General marketing information that is accessible to a British Columbia resident, but is not specifically directed to the British Columbia market, is not directed marketing or promotion. Payments that would offend this rule include commissions, referral fees, or any payments made to someone other than the client or a purchaser or a representative outside British Columbia in connection with trading activities in British Columbia.

A dealer from a foreign jurisdiction must also provide the client with prescribed disclosure. The prescribed disclosure in Form 71-502F1 warns clients of the risks inherent in dealing with a dealer outside Canada. The form is available on our website.

2. Exemptions for Advisers and Their Representatives

IDA members An investment dealer, or its representative, does not have to be registered to act as an adviser if it follows the rules of the IDA relating to portfolio management services (Rules, section 82).

General advice There is no need to register if you advise only about investments generally, rather than about specific securities. Nor do you need to register if you provide advice through publications or other media but do not hold yourself out as tailoring the advice to needs of specific clients. If you provide research about a particular company to a client but do not advise on whether that client should trade a security of that company or invest in that company, you do not need to register (Rules, section 78). You are, however, still subject to the prohibition against making misrepresentations. (See Part V of this Guide.)

Pre-existing relationships with residents of British Columbia A registered adviser from another Canadian jurisdiction or from a foreign jurisdiction does not have to be registered in British Columbia to deal with a client who is already a client of the adviser and later becomes a resident of British Columbia (either temporarily or permanently) (Rules, section 83(a); BC Instrument 71-502, section 3(a)).

Unsolicited advice to residents of British Columbia A registered adviser from another jurisdiction in Canada or from a foreign jurisdiction does not have to be registered in British Columbia to deal with clients as long as it does not advertise or engage in promotional activity directed at residents of British Columbia during the six months before advice is given (see the discussion above of the corresponding exemption for dealers) (Rules, section 83(b); BC Instrument 71-502, section 3(c)). Like dealers and their representatives, an adviser and its representative from a foreign jurisdiction must also provide the client with the prescribed disclosure in Form 71-502F1.

Advice to registered dealers and advisers A registered adviser from another jurisdiction in Canada or from a foreign jurisdiction does not have to be registered to advise clients who are registered dealers or advisers (Rules, section 83(c); BC Instrument 71-502, section 3(b)).

Advisers and pooled funds If you offer pooled funds to your clients, manage the investment portfolio, and invest the client's assets in the fund so that you can provide discretionary money management services, then you are exempt from the **prospectus requirement** in section 18(1) of the Act (BC Instrument 81-509, section 4(1)). To use the exemption, you must file an annual report (BC Instrument 81-509, section 4(2)). Advisers and their representatives should remember that when they offer securities to their clients under registration or prospectus exemptions they are still bound by the obligations to "know your client" (Code, section 12) and provide suitability advice (Code, section 13). The use of an exemption does not allow you to avoid your obligations as a registrant.

3. Exemption for Personal Corporations

If a representative operates through the business vehicle of a personal corporation, that personal corporation is exempt from the registration requirement (Rules, section 48(2)). To use this exemption, the personal corporation must not trade outside the scope of the representative's own trading or advising authority. The corporation and the registered firm must also agree in writing that the registered firm is liable for the acts and omissions of the corporation that relate to the corporation's securities business.

Representatives who use personal corporations must file new Form 31-902F with the Commission, in addition to filing the application to register through the NRD system (Rules, section 25).

As the firm is ultimately responsible for ensuring that no individual representative and no personal corporation of a representative escapes liability or responsibility, the firm should:

- take steps to ensure its contractual arrangements achieve that outcome
- provide itself with adequate ability to oversee the representative and the representative's personal corporation

C REGISTRANT CONDUCT

1. Code of Conduct

Registrants must comply with the Code of Conduct (Rules, section 31), which replaces most of the detailed and prescriptive requirements that were in the former legislation. The Code and guidance about how to apply it are in Part IV, Section A of this Guide.

2. Other Ongoing Requirements

In addition to the Code of Conduct, there are some specific requirements that apply to dealers and advisers dealing with the following matters:

- records and reporting
- capital and bonding
- personal information filings for partners, directors, officers, and significant securityholders
- segregation of assets and subordination agreements
- annual audited financial statements

These additional ongoing requirements are discussed in Part IV, Section B of this Guide.

III. Getting Registered

A APPLICATION FORMS AND FEES

The IDA administers the registration of investment dealers and their representatives. To apply for registration as an investment dealer, you apply to the IDA and pay the prescribed fees to them.

To apply for registration under any other category, you apply to the Commission and pay the prescribed fee to it.

- BC Form 31-901F is the application for registration for dealers and advisers
- Form 33-109F4 is the application for registration for representatives – the form is filed through the NRD system
- BC Form 31-902F is the supplemental form for representatives who use a personal corporation
- BC Form 31-903F is the short form application for dealers and advisers already registered in another province

For information on getting enrolled in and filing registrations through NRD, and to view the forms, please visit the Commission's website.

We review dealer and adviser applications for registration from firms based in British Columbia and foreign firms not yet registered in another Canadian jurisdiction to the same standard we use to conduct compliance examinations of registered dealers and advisers. The application process is like a mini-compliance examination. We expect that new registrants will come away from the application process with a thorough understanding of their ongoing responsibilities.

Under this legislation, we focus carefully on information about your firm's hiring and information-sharing systems because you are the gatekeeper to the industry for individual representatives. (See later discussion under Code, section 22.) We also focus carefully on those individuals who run your firm (partners, directors, officers, and significant securityholders) as the integrity and competence of those people is critical to your firm's successful compliance. You must file personal information about these individuals (Multilateral Instrument 33-109 *Registration Information*, section 2.1(c); Form 33-109F4). Like applications for representatives, this personal information (which is collected on the same form used for representative applications for registration) is filed through the NRD system.

If the Commission requests additional information about your application, you are obliged to provide it (Act, section 46).

B FINANCIAL STATEMENTS

An applicant for registration as a dealer or adviser must file financial statements in accordance with the required form (Rules, section 25 and Form 31-901F). Audited annual or interim financial statements for the annual or interim period ended within 90 days of the application must be filed.

C CAPITAL AND BONDING CALCULATIONS

Capital

An applicant for registration as a dealer or adviser must file a report disclosing:

- what amount of capital a reasonable person would consider sufficient to meet its reasonably expected business obligations
- a calculation that shows the capital it has (Rules, section 25; Form 31-901F)

If the capital adequacy calculation uses any different accounting methodology than that used in the financial statements (which is not at all unusual – see below), you need to justify the difference and reconcile the two methods. So that readers can understand it, the capital calculation should show how you determined your capital needs.

The capital adequacy rule is not designed to ensure that you are able to pay every conceivable claim any client or third party might have against your firm and its representatives. It ensures that in the event of a winding up you would be able to conduct that winding up in an orderly manner.

What is reasonably sufficient for an adviser or dealer that does not handle or have access to client funds and assets will be different from what is adequate for an adviser or dealer that handles client funds and assets. If you use powers of attorney in serving your clients, or automatically deduct fees from client accounts, your capital adequacy calculation should take into account that you have access to client funds although you may not generally handle client funds and assets. Whether you serve institutional clients, retail clients, or both, also affects your calculation of what is reasonably sufficient.

In deciding your firm's appropriate level of capital, you will want to consider the historical effect of market downturns, potential near-term operating expenses, and other foreseeable risks on your firm and its ability to continue as a going concern. If your firm uses its own capital to underwrite distributions of securities, you will need to ensure that your firm's capital is sufficient to meet your underwriting obligations, even in adverse market conditions, without risking your firm's ability to carry on business.

In reviewing capital adequacy, Commission staff looks at current assets against current liabilities. In considering current assets, for example, it may be unacceptable to include related party receivables in current assets if they do not arise from the normal course of business (e.g. advisory fees). In considering current liabilities, it may be unacceptable to include unsubordinated related party liabilities.

You should consider risks associated with your current assets when calculating what is adequate capital. If a current asset could be lost at a moment's notice because of its availability for operations or investment needs, it should not be included. Some exchange contracts dealers, for example, put their own capital up in some transactions. That capital is not reliably available for other normal course business obligations.

Bonding

An applicant for registration must also file a report disclosing:

- the terms and amount of coverage that is reasonably required to protect the firm from:
  - its representatives, employees, and contractors acting dishonestly
  - fraud, forgery, robbery, or theft
  - client property being lost
- evidence of the bonding coverage it has (Rules, section 25; Form 31-901F)

Again, what is reasonably required will differ, depending on your exposure, your access to client funds and assets, and the strength of your supervision system.

When considering what level of coverage is adequate, bear in mind that very often an employee's dishonesty goes undiscovered for long periods of time and the losses caused by that dishonesty are compounded as a result.

D IDA AND MFDA MEMBERS

A firm applying for registration as an investment dealer must meet the IDA's requirements for financial statements, capital adequacy calculations, and bonding. Similarly, a firm applying for registration as a mutual fund dealer must meet the MFDA's requirements in these areas.

E REFUSAL OF REGISTRATION, AND CONDITIONS AND RESTRICTIONS

The Commission may refuse to accept your application for registration, or attach conditions or restrictions to the registration. Before the Commission does so, you have a right to be heard (Act, sections 15 and 16). (See Part IV, Section C of this Guide.)

IV. Registrant Conduct and Requirements

A CODE OF CONDUCT

A registered dealer or registered adviser and its registered representatives must comply with the following Code. Some aspects of the Code relating to compliance and other systems apply only to firms and not to their representatives (Code, section 28). The only other exemption is for registered investment dealers that are discount brokers and follow the requirements for discount brokers set by the IDA (Code, section 27).

In this Section, the provisions of the Code that are found in the Rules are in bold face type. The relevant guidelines appear underneath in ordinary type.

INTEGRITY AND FAIRNESS

1. Act fairly, honestly, in good faith and in the best interests of your client.

You should regularly consider and evaluate the appropriateness of your activity or your firm's activity in the securities market, whether on your own behalf or on behalf of clients, against this duty.

2. Exercise the degree of care, diligence, and skill that a reasonably prudent person would exercise in the circumstances.

The Commission will measure the degree of care, diligence, and skill in the context of the registrant's responsibility as a part of the system of securities regulation – including the expectation that firms and their representatives will be familiar with all of this Code and act in ways that reflect the outcomes required by this Code.

One aspect of exercising the required level of care, skill, and diligence is to act promptly on client instructions, including an instruction to move a client's account to another firm.

3. Comply with all relevant laws and regulations that govern you.

You will need to keep informed of the laws that govern your business. Apart from securities laws (including the rules of, for example, the IDA, MFDA, Market Regulation Services Inc. (RS), and the exchanges), these laws could include federal proceeds of crime and anti-terrorist legislation.

4. Do not engage in or facilitate conduct that could:
(a) bring the reputation of the securities market into disrepute, or
(b) threaten the integrity of the securities market

You are a gatekeeper of the integrity of the securities market. While it is your duty to act in the best interests of your client, you must also act in the best interests of your firm and the securities industry as a whole.

In this context, the best interests of your firm are not limited to your firm's profitability or growth. The Commission will measure your compliance with this section against a long-term view of "best interests". For example, if your activities or your firm's activities in the securities market are profitable, but would lead a reasonable person to think that your firm lacks integrity or that markets are tilted unfairly in favour of those "on the inside track", then your activity would harm both your firm's reputation and the reputation of the securities market.

If you are suspicious that your client's activities may damage the reputation of the securities market or threaten the integrity of the securities market, you cannot ignore the observations or relevant information that make you suspicious. To ensure you are not vulnerable to facilitating damaging activity, you should identify the "red flags" that indicate you might be facilitating a client who is engaging in damaging activity.

If you conclude that your client's actions threaten the integrity of the securities market, you should seek advice from the person at your firm responsible for compliance about the best approach to take. In some circumstances, personal safety or the safety of others may shape the approach you and your firm take to the client, or may even dictate that you continue to deal with the client until the safety issues have diminished. Your gatekeeper responsibilities may require that you cease acting for the client. In all cases, the best interests of the market and other investors must be weighed against any safety or other considerations carefully. Your actions should demonstrate an understanding of your obligation to do what you can to stop activity harmful to the market and prevent any further such activity from occurring.

5. If a client refuses to comply with all relevant laws and regulations, cease to act on behalf of that client.

You should use all reasonable efforts to ensure that your client understands the relevant regulatory requirements and their implications at all stages of a transaction. If you become aware or suspect that your client is not complying with regulatory requirements, you should inform the person at your firm responsible for your compliance program. At the same time, you should explain the legal requirement to your client and ask your client to comply with it. If your client refuses or fails to comply, you must no longer act for that client and you should consider whether to bring the client's activities to the attention of regulators. (See also discussion under section 4, above.)

6. Do not contract out of any duty you or your firm may have under this Code.

For example, you cannot use client agreements that say this Code or other regulations, in whole or in part, do not apply. It is not a breach of this requirement to enter into a release with a client, as part of a settlement agreement, that releases you and your firm from any further claims based on the Code. Ensure that the drafting does not create an appearance of contracting out.

DEALINGS WITH CLIENTS

7. Keep each client informed of all information that a reasonable person would consider important to the business relationship.

Relationships with clients are based on trust. Each client needs to know any information, both good and bad, about your firm, you, and your business, that a reasonable client would want to know before entering into or continuing that relationship. You should, for example, keep each client informed about any conditions or restrictions on your registration, or on your firm's or your own trading or advising activities (whether imposed by the Commission or by your firm). You should also keep each client informed about relevant employment, regulatory, or criminal history. For example, a reasonable person would likely consider important:

- any limitations on the scope of investment products you can sell
- any criminal or quasi-criminal convictions, or civil court findings, relevant to your integrity and trustworthiness
- any findings by a *regulator* or a *marketplace*, *self regulatory organization*, or *regulatory organization* that you contravened regulatory requirements, and any sanctions imposed as a result, whether through a formal process or a settlement
- any potential financial risks the client assumes by dealing with you or your firm, including any risks associated with the coverage of your bond or investor protection fund

A good way to eliminate any confusion about the nature of the relationship with the client is to set it out in a contract.

In designing your client contract and your client communications procedures, you should also consider what information would help the client understand the nature of your business relationship. Both your expectations of the client and the client's expectations of you are important considerations for discussion and documentation.You should also consider carefully whether your communications convey accurately who the client is dealing with. If you are a representative who uses a personal corporation, you must ensure that all your communications, written and verbal, make clear that the client is dealing with you, as an individual, and the dealer or adviser. Your marketing material should be reviewed to ensure it meets these communication standards.

8. Ensure that each client is provided on a timely basis with the records that a reasonable client would consider important respecting all transactions that you conduct on the client's behalf, and on the status of the client's account.

For dealers, complying with this section of the Code is usually going to mean sending promptly to the client all relevant information relating to a trade, having regard to the type of security being traded. This would normally include the particulars of the trade, any consideration the client pays in connection with the trade, and any information about conflicts of interest that apply to the trade (see sections 15 to 18 of this Code). If a client receives information about the purchase and sale of mutual funds from a fund company or a trust company, you do not need to send the client the same information.

The purpose of sending clients statements is to keep them informed about the status of their accounts and about the activity in those accounts since the last statement. The objective is to ensure that the client has information on a current basis that is reasonable in the circumstances. This would normally mean monthly, but less frequent reporting may be reasonable in some circumstances (for example, if the volume and frequency of trading in the account is low, or if the client requests less frequent reporting).

Advisers should send the client all relevant information relating to advising, based on the mandate with the client. This would likely take the form of regular statements that keep clients informed about the status of their portfolio and about the activity in the portfolio since the last statement. This would normally include details of changes to the portfolio, all consideration the client pays in connection with those changes, and any information about conflicts (see sections 15 to 18 of this Code). The objective is to ensure the client has information on a current basis that is reasonable in the circumstances. This would normally mean at least quarterly, although you and your client may agree to more or less frequent reporting.

All firms should provide to the client anything the client will need to know to prepare and file income tax returns relating to the client's accounts with the firm and the client's capital gains or losses, and dividend or interest income received.

9. Ensure that all disclosure that you prepare and provide to clients is in plain language.

Plain language helps clients understand your disclosure. It will ensure that they understand the securities they hold, the processes to deal with those securities, and their relationship with your firm.

There are many resources available on the subject of plain language, but here are some basic principles for you to consider when preparing these documents:

- use short sentences
- use definite, unambiguous, everyday language

- use the active voice
- avoid superfluous words
- organize the document in clear, concise sections, paragraphs, and sentences
- avoid legal jargon
- avoid boilerplate wording
- avoid multiple negatives
- avoid technical terms where possible (if you use them, include definitions or explain them)
- use charts and tables where it makes information easier to understand

CONFIDENTIALITY

10. Hold in confidence all confidential information acquired in the course of your relationship with the client, unless the client consents to the disclosure, the disclosure is legally required or the client appears to be engaging in activity that could threaten the integrity of the securities market.

In the course of your relationship with a client, you will receive confidential information about your client's financial and personal circumstances. Quite apart from provincial and federal laws relating to personal information protection, receiving this information places you in a position of trust and responsibility and it is unethical to betray this trust. If confidential information is disclosed, the client is damaged, whether or not the disclosure was intentional.

You may disclose your client's confidential information in three situations; you should explain these situations to the client at the beginning of your relationship.

First, you may disclose information if you get the client's consent, preferably in writing. Having the client sign a "blanket" consent statement allowing the general release of confidential information over an indefinite period may be acceptable. However, consent must be meaningful, whether blanket or tailored. A consent that does not alert a reasonable client to the use or disclosure you intend to make of the client's personal information is not meaningful. You should not require the client to consent to the sharing of confidential information as a prerequisite for providing service to clients or prospective clients, as this both compromises the integrity of the consent and creates a conflict between you and your client (see discussion under sections 15 to 18 of this Code).

Second, you must disclose if you are required to do so by law. Legal requirements include legally enforceable requests for information from the Commission, self-regulatory and regulatory organizations (SROs and ROs), and other *regulators* as well as provisions of applicable money laundering and anti-terrorist legislation. For example, the Act facilitates information disclosure by

you about your clients to relevant regulators, law enforcement agencies, and government bodies (Act, sections 166 and 167). In addition, the Rules require you to disclose information to other registrants concerning the hiring of one of your former representatives (Rules, section 28).

Third, you must disclose your client's confidential information to the extent necessary to help regulators deal with situations where the client is engaging in activity that could threaten the integrity of the securities market. If your client is tipping or engaging in insider trading, for example, you can tell the relevant regulator(s).

If you become aware that the intention or effect of a client's trading would be a breach of securities regulations, or would impugn the integrity of the securities market, then, in your role as gatekeeper, you should consider:

- the importance of drawing the matter to the attention of the person in charge of compliance at your firm
- if you are the person in charge of compliance, the importance of drawing the matter to the attention of your firm's management
- potentially drawing the matter to the attention of regulators

These exceptions to the duty of confidentiality are designed to be consistent with personal information protection laws, but you should also consult the relevant law.

PROFICIENCY

11. Maintain the proficiency and exercise the skill and diligence necessary to properly trade for, advise or serve clients.

The Commission or your SRO sets the minimum proficiency standards for *representatives* entering the securities industry (see our website). However, in rapidly changing markets, maintaining proficiency means that you need to keep abreast of changes in products, regulations, and other factors that will affect your ability to provide high standards of client service. Education, especially continuing education, is a necessary component of business skill and the responsibility for continuing competency falls on both firms and those individuals who work for firms.

Firms should consider whether the representative has been adequately trained before that representative is permitted to sell new or different lines of products. For example, mutual fund dealers or advisers that allow their representatives to sell exempt market products must ensure that those representatives, their supervisors, and those who approve these products for sale by representatives of the firm have qualifications that enable them to assess the products being sold.

Investment dealers that allow their representatives to manage client investments on a discretionary basis are expected to ensure that the proficiency of these representatives matches the increased skill demands of a discretionary relationship.

If your firm engages in underwriting activity, you should make sure that any representatives engaged in that activity have the necessary skills and training for that activity.

While the Commission sets out its expectation of the minimum proficiency necessary for portfolio managers of advising firms, these firms should determine their own proficiency standards for persons hired to assist in the investment management process.

Firms should also establish adequate re-qualification requirements for representatives who have been out of the securities industry long enough to affect their proficiency. Firms may want to consider the following when making proficiency decisions:

- the length of time a representative has been out of the securities industry
- the representative's relevant experience during his or her time outside the securities industry
- the representative's educational background
- any industry continuing education courses that the representative completed while not working in the securities industry
- whether an industry exam or course should be taken or repeated

Firms should also consider developing policies to deal with representatives employed in other occupations both inside and outside of the securities industry.

You may also want to consider incorporating your expectations about proficiency directly into the conditions of employment or retainer you have with your representatives or other key personnel so that your expectations, and the consequences of non-compliance, are clear from the outset.

(See later discussion on proficiency standards in Part IV, B, 3 of this Guide.)

KNOW YOUR CLIENT AND SUITABILITY

12. Take reasonable steps to learn, and to keep current your knowledge of the essential facts about the identity, reputation, and financial circumstances of each client.

Sections 12 and 13 set out what have traditionally been referred to as the "know your client" and "suitability" rules. They apply to all trades made for and advice given to clients, whether or not the securities are sold under registration exemptions.

Section 12, the "know your client" rule, requires that you understand on an ongoing basis the client's identity, background, industry affiliations, financial position, and character so you can fulfill your role as a gatekeeper to the securities market. If your client is not an individual, knowing your client means knowing the individuals that control the client, its business, and its financial circumstances.

The "know your client" rule is related to section 1 of this Code. For example, it is in the best interests of your client, your firm, and the securities industry that you really know who the beneficial owner of an account at your firm is. Your client benefits because you can best serve the interests of your client with full knowledge of that client's identity and circumstances. Your firm and the securities market benefit because the risk posed by an unknown beneficial owner is avoided.

If someone other than your client wants to trade in that client's account, you must determine whether that person has a valid power of attorney or trading authority. In these circumstances, you will need to consider the scope of the person's authority and whether the person is a representative of a firm that is registered, or ought to be registered, as an adviser. You should also monitor these accounts to help identify whether the accounts are being used inappropriately as nominee accounts or to disguise abusive trading.

13. Take reasonable steps to learn, and to keep current your knowledge of, the general investment needs and objectives and the risk tolerance of each client. Determine the suitability of a proposed purchase or sale for the client or the client's portfolio based on that knowledge. If a purchase or sale that a client requests is not suitable, advise the client that it is unsuitable before executing the proposed transaction.

This section refers to "suitability" and requires that you determine what is suitable when recommending products or services. This means you will have to be familiar on an ongoing basis with the client's current investment needs and objectives, the client's risk tolerance, and other relevant facts about the client. You should have a reasonable basis for the recommendations you make to your client. When considering the suitability of a trade or recommendation, consider the trade in the context of the client's total portfolio.

It is incumbent on each representative to have the fullest knowledge possible of the personal circumstances, risk tolerance, and investment objectives of all clients and to update that knowledge regularly. It is also important that you help the client understand his or her part in updating you when significant life events occur that could reasonably be expected to affect the client's risk tolerance and investment objectives. You should also consider what record keeping will put both you and the client in the best possible position should you later need that information to resolve a dispute or otherwise.

If a client requests the purchase of a security that is unsuitable, you should consider documenting to the client that fact and your advice not to make the purchase, in case the client later alleges that the investment was made on your recommendation.

The IDA currently has rules that exempt firms from conducting a suitability review of each trade for its clients under certain conditions. Therefore, the suitability requirement found under this section does not apply to those firms and their representatives (Code, section 27). Those firms and their representatives must still comply with the "know your client" obligations in section 12.

Where, with the agreement of the client, an adviser has pooled the client's funds with those of others with a view to making common discretionary management decisions for all the clients involved, the adviser must take reasonable steps to ensure that a discretionary transaction is suitable for the portfolio as a whole, based on the stated investment objectives of the portfolio. You have the same obligation to investors who don't have a portfolio management agreement with your firm but wish to participate in a pooled fund. These investors **are** your clients. However, if the units of your pooled fund are sold through a registered dealer, you can rely on the dealer and its representative to have provided suitability advice to the client.

Individual suitability requirements for clients also apply to purchases of securities sold under registration exemptions or in a "pooled fund" discretionary trading environment. You should ensure that there is consistency between the client's objectives and the investment objectives of the pooled fund.

14. Provide clients with the information necessary to make informed investment decisions.

You should make every effort to give your clients objective and impartial information about their financial needs and advise them of their various options.

You should identify and explain to the client all negative aspects of proposed investments or portfolios, including the risks and costs of your recommendations. Of particular importance are any charges that reduce the net return on the portfolio of the client such as mutual fund management expense ratios or the spread on bonds between the price the client is paying and the price the firm paid to acquire those securities.

It is important for clients to know the full impact of the costs of investing in a particular security over the life of that investment. For example, you should communicate to the client the financial impact of referral arrangements.

In addition to clearly describing the product or service for the client and the ways that the transaction will fulfill the client's needs, you should disclose important assumptions underlying any illustrations or examples provided to the client, and the fact that actual results may differ

significantly from those shown. You should avoid using examples or illustrations that you know, or ought reasonably to know, are based on unusual results or on a time period that generated much better than normally anticipated performance.

To give a client additional information about a security, you should refer the client to the relevant issuer's continuous disclosure record.

As discussed under section 7 of this Code, if there are limitations on the scope of investment products you can sell, you should inform your client that there may be other investment products that the client should consider.

To satisfy the requirements in this section, you may need to advise your client on factors other than the features of the investment itself. For example, if your client intends to invest using borrowed money, you should discuss the risks of leveraged investing. If your client is purchasing securities from you in a branch of a related financial institution, you need to ensure your client understands that:

- your firm is separate from the financial institution
- no government deposit insurer insures any securities purchased
- the financial institution does not guarantee the securities

Mutual fund dealers and investment dealers whose clients are in mutual funds should not presume that adequate disclosure is provided through information that does not originate with the dealer. It is important that the dealer review these disclosures made (for example, by mutual fund companies or trust companies) to consider the extent to which additional or different disclosure is important to the client's ability to make an informed investment decision. Advisers whose clients receive communications from a custodian should also not assume that adequate disclosure is made through those communications.

CONFLICT OF INTEREST

15. Resolve all significant conflicts of interest in favour of the client. Use fair, objective, and transparent criteria. If there are conflicts of interest between or among clients, use fair, objective, and transparent criteria to manage those conflicts. Apply the criteria consistently in all cases.

This section makes it clear that the client's interests always come first. It should be interpreted in the context of reasonable commercial practice — for example, you are entitled to charge a client a fee for your services. The best way to ensure that the client's interests are put first is to have appropriate procedures in place to ensure that all conflicts of interest between the firm or its representatives and the client are resolved in favour of the client and to have a system that effectively monitors and

enforces compliance with those procedures. These procedures should cover conflicts of interest arising in the context of trading, advising, and making recommendations.

You will be able to anticipate many foreseeable conflicts and your firm's procedures on those can be developed and communicated to clients in advance. Some of these are discussed under the next two sections.

The onus of showing that the firm or representative has acted in the best interests of the client is on the firm and representative.

A significant conflict is one in which the interests of the representative or the firm (or another client) compete with those of the client, and the client's financial interests are affected. For example, a significant conflict includes recommending a product to a client because the product manufacturer provides the best remuneration to you for making that recommendation when there are clearly more suitable products available.

It could be difficult to show that you have acted in a client's best interest if the client is required or expected to deal with a particular financial institution in connection with the services you provide, or to purchase securities or pay for advice to obtain other financial products or services ("tied selling"). For example, if a related financial institution refused to make a loan to a client unless the client purchased securities from you, that would breach this section of the Code if the client met the normal criteria for obtaining a loan. Similarly, if you refused to deal with a client unless the client moved a mortgage to a related financial institution, that would also breach this section.

Sometimes the conflict of interest is not between the firm or representative and client, but between clients. For example, a firm sometimes has to decide how to allocate limited investment opportunities, such as initial public offerings of securities, among clients. Again, these situations are best resolved if the firm has appropriate procedures in place to deal with them, and a system to monitor and enforce compliance with those procedures. For example, this does not mean that you must offer all clients part of a particular distribution of securities. It does mean that you must have guidelines for determining to whom to offer the securities. The guidelines for making the determinations must be transparent to all clients and should be applied consistently.

Lending money to or borrowing money from clients With the exception of margin account facilities, it is difficult to imagine how you could ever appropriately resolve the conflict that exists when you either lend money to your client or borrow money from your client. This conflict is so direct and significant that it must be resolved in favour of the client, but your own interest either in profiting from being a lender or in having access to capital makes it nearly impossible for that to happen.

Inside information Sometimes a firm or its representatives will receive material, non-public information (*inside information* or *material order information*). If this happens, the firm must ensure that it is handled properly.

Securities legislation prohibits anyone from acting on inside information (Act, section 30). Firms and their representatives must not buy or sell, or participate in a decision to buy or sell, a security for any account or portfolio while possessing inside information about the security or the issuer of the security.

This is a complete prohibition. It applies to any account or portfolio for which the firm or its representatives play any role in making investment decisions or exercise any investment discretion, or over which the firm or its representatives have direct or indirect control, regardless of whether the firm or its representatives have a personal, economic, or ownership interest (see Part V of this Guide).

Firms may disclose material, non-public information only if it is in the necessary course of business. Otherwise, it would breach the tipping prohibition (Act, section 30(3)). Similarly a firm must not recommend or encourage a person to trade while the firm has material undisclosed information (Act, section 30(4)). Firms should have specific procedures for dealing with inside information.

Securities legislation also prohibits anyone from front running (Act, section 31). Firms and their representatives that know of material order information must not:

- trade a security that is the subject of that information
- enter a derivative transaction based on a security that is the subject of that information
- inform another person of the material order information
- recommend that another person trade in the security or enter into a derivative transaction based on the security that is the subject of the material order information

Again, this is a complete prohibition.

Mutual fund dealers, investment dealers, and their representatives who sell mutual fund units fit within the functional definition of *director* and, so, are considered insiders for the purpose of interpreting the insider trading and front running prohibitions.

You should create information barriers (fire walls) within your firm to "wall off" those who are routinely exposed to inside information from those who are not. This provides you with a defence to both insider trading and front running allegations (Act, section 35). If you restrict the knowledge to those who learn of it, and those who need to know it, others are free to act with respect to the securities involved. Without information barriers, the knowledge of one part of the organization

could be imputed to the entire organization (see also later discussion under section 16 of this Code about developing procedures).

Corporate boards If a representative serves on a board of directors or trustees, several conflicts could arise, including conflicting fiduciary duties owed to the company and owed to a registered firm or client, possible receipt of inside information, and conflicting demands on the representative's time. You should consider requiring your representatives to seek permission from your firm to serve on the board of directors of a *public issuer* or *restricted issuer*. Your firm should consider having policies for board participation that identify the circumstances in which the activity would be in the best interests of the firm and its clients (see also later discussion under section 16 of this Code about developing procedures).

16. Develop procedures for resolving conflicts of interest and disclose them to the client.

Conflicts of interest arise frequently in the securities industry and can be unique to each firm. Some conflicts can be avoided through adopting proper procedures while other conflicts are unavoidable in the context of normal business practice and should be managed as they occur.

This section requires firms to develop conflict of interest procedures that work for their specific business. Your procedures should consider both how you will generally think about and handle conflicts, and should anticipate specific conflicts related to your business. This section also requires you to communicate your conflict procedures to each client. You should consider doing this at the beginning of your business relationship in a way that the client can easily understand.

You should consider whether you want to use fire walls to avoid some conflicts or prohibit certain practices if it prevents you from acting in the client's best interests. For example, it is hard to imagine how you can serve the client's best interests in tied selling situations (the practice of refusing to sell one product or service to a client unless the client purchases a second product or service).

Clients will also be very interested in understanding how you manage the potential for conflict when recommending proprietary products over third party products. These issues should be covered in your policies and communications to clients.

You should also refer to earlier discussions under section 15 of this Code about developing procedures to handle conflicts relating to insiders and corporate boards.

Analysts are exposed to pressures from internal and external sources as well as conflicts of interest. You should develop conflict of interest policies that ensure these elements do not affect the objectivity of analyst reports.

17. Disclose promptly to the client any information that a reasonable client would consider important for assessing your ability to provide objective service or advice.

Conflicts that you cannot avoid should be managed appropriately. You must fully disclose to your clients all conflicts of interest and all potential conflicts of interest that you know of, or about which you reasonably ought to know. Certain conflicts are inherent in the relationship between you and your clients, such as any remuneration you receive for selling securities to a client and any remuneration tied to recommendations you make when selling proprietary products or services of your firm or an affiliated company.

You have an obligation to ensure that your clients are aware of and understand these conflicts. Even when you believe that your actions are not affected by the conflict, you must adequately address even an appearance of conflict.

One of the most important areas for full disclosure is anything to do with compensation you receive that relates to the work you do for the client or to your relationship with the client.

"Blanket" disclosure about routine compensation arrangements in general is appropriate so long as you disclose changes to those arrangements promptly.

You should disclose fees received or paid for client referrals, sharing compensation (commission splitting), contingency fees, and any compensation incentives you receive in connection with the client or the client's business (for example, trailer fees, switching fees, sales incentives, and so on). You must disclose this information before the client has to decide about the transaction in question.

For example, sometimes several products would be suitable for a client but one product will entitle you to a significantly higher commission or a benefit such as a trip. You should disclose this to your client when you discuss the merits of the product.

"Soft dollar" arrangements between advisers and dealers must be disclosed to the adviser's clients. They put you into a conflict position because the fund or client ends up paying charges that you would otherwise have to pay out of your pocket. These arrangements include payment by a fund manager or adviser to a dealer of commissions in circumstances where a percentage of the commissions are used by the dealer to fund or pay for goods and services. These goods and services are usually provided by the dealer or by third parties to the manager, the adviser, the sponsor, or the fund beneficiaries. Soft commissions sometimes take the form of reciprocal commissions.

You should be particularly alert to the danger of partial disclosure being misleading. For example, in your blanket communication to clients about fees and compensation, you may give only very general information about the nature of referral arrangements that you might enter into. If you

recommend a trade or an investment strategy that involves a referral arrangement without providing the client with additional relevant information about the arrangement and the impact that it has on the client, the partial disclosure may be misleading in the circumstances.

18. When acting as an underwriter, act in the best interests of investors and the securities market. Disclose to investors any direct or indirect relationships between you and the issuer or seller that would lead a reasonable investor to question whether you and the issuer or seller are in fact independent from each other.

The role of the underwriter includes performing due diligence and negotiating the price and terms of the offering. In performing these functions, the underwriter is acting on behalf of public investors. Even when the underwriter is unrelated to the issuer or seller of the securities being underwritten, there are conflicts of interest involved, such as the underwriter's desire to earn the commission and underwriting fee and to be considered by the issuer for future underwriting and advising work.

To comply with this section, it is not enough to act in the best interests of your own clients. For example, to ensure that the best interests of the securities market are taken into account, you may want to take reasonable steps to ensure that appropriate restrictions are imposed on existing securityholders so that sales of stock by this group do not disrupt the formation of an orderly market after the issuer goes public.

When the underwriter and the issuer are not independent, the potential for conflicts of interest increases. This section requires that underwriters act not only in the best interests of investors but also in the best interests of the firm, and the securities market as a whole. You are one of the gatekeepers of the securities industry and, therefore, it is incumbent on you to uphold the integrity of the securities market through your actions.

Underwriters will have to be particularly vigilant in situations where there is less than complete independence. The obvious situation is cross-ownership of the underwriter and the issuer, either directly or through a parent entity. However, there can be other relationships between an underwriter and the issuer, or parties affiliated with them, which would lead a reasonable investor to question whether the underwriter and issuer were in fact independent of each other.

The best way to ensure that these conflicts are resolved in favour of the investor is to have appropriate procedures to ensure that outcome and to have a system that effectively monitors and enforces compliance with those procedures.

This section requires you to disclose to the investor the circumstances of any relationship that could reasonably be perceived as less than completely independent. The disclosure should be sufficient so that the investor fully understands the nature of the conflict and its relevance to the underwriting transaction.

In some cases, the conflict may be so direct that you may conclude that following your ordinary procedures and making disclosure to investors would not be sufficient to remove the potential for real conflict, or at least the apprehension of conflict in the mind of the reasonable investor. An example would be your underwriting an issue of your own securities. In those cases, you may conclude that an independent underwriter should be involved in the transaction in a meaningful role to alleviate any concerns over the potential for real conflict. It may be that it would not be appropriate for you to act as an underwriter at all in those circumstances.

This section applies to underwriting exempt market securities, too. If you are underwriting exempt offerings, you must think about whether you have or there is an appearance of a conflict. Some exempt market offerings (under the offering memorandum exemption, for example) may involve actual or apparent conflicts, and call for action to ameliorate those conflicts.

In each case, you need to analyze your interests against those of the securities market and investors, and act accordingly.

COMPLIANCE SYSTEMS

19. Maintain an effective system to ensure compliance with this Code, all applicable regulatory and other legal requirements, and your own internal policies and procedures.

You must develop, implement, and monitor a written compliance system that satisfies the requirements of the Code. The system you develop should be effective for your particular firm and its business procedures. Advisers should consider CFA Institute guidelines as a guide to good practice when constructing their compliance systems.

You should consider the risks of non-compliance and establish measures designed to address them. Good practices in this area include:

- listing key processes, systems, and structures that you will use to ensure that your firm complies with this Code and other requirements
- ensuring your records include evidence of all compliance monitoring
- ensuring your computer and other systems are secure, can meet operational requirements, and can manage the risks of your business (those risks will differ depending on the products you sell, the clients you serve, the size of your business, and your compliance track record)

20. Maintain an effective system to manage the risks associated with your business.

You must think about the risks associated with your business that are additional to regulatory risks and design your compliance system to account for those additional risks. For example, if your firm uses its own capital to underwrite distributions of securities, you will need to ensure that your

firm's risk management systems account for the enhanced risk that this activity poses. Similarly, if your firm sells exempt market products, your firm will need to ensure its risk management systems account for the enhanced risk this activity poses. Your insurance needs should be analyzed and accounted for.

If you run your business from multiple locations, you should consider whether to designate one individual who will have compliance responsibility in some or all of those locations. Perhaps the best way to achieve effective compliance is to have the compliance function in your firm independent from other functions and have the compliance reporting relationship reflect this. In small firms with few employees, the compliance function is unlikely to work effectively unless senior operating management assumes this responsibility.

Surprise audits of a firm's satellite offices can be an effective tool in evaluating compliance with rules and procedures.

21. Ensure that your compliance personnel have the technical competence, resources, independence, and experience necessary for the performance of their functions.

An effective system will provide for monitoring compliance with the system. This usually requires:

- a designated individual who is responsible for, and competent to perform, the compliance function
- staff, sufficient in number, independence, competence, and authority to effectively operate and enforce the system
- the use of regular and surprise audits, both desk and on-site, of the system's effectiveness

You should provide sufficient training so that new and existing staff members are familiar with your compliance system. You should consider authorizing your compliance personnel to report matters directly to your board of directors, when appropriate. If your firm does not have a board of directors, your compliance system should provide a reporting up-the-ladder process that ensures the individual responsible for compliance at your firm always has resources to deal with compliance issues, even when the issue is with personnel at the highest levels in the firm.

22. Take reasonable steps to ensure that every representative working for your firm is suitable for work in the securities industry and is appropriately supervised.

When hiring a representative, you should determine whether that individual is suitable for employment in the securities industry. A candidate is under a positive obligation to disclose all information that you request relevant to whether the candidate is a suitable representative.

(Rules, section 27). You cannot discharge your responsibility by relying on the mere fact that your representative has been registered.

Reference checks with the candidate's previous employer are universally recognized as an important part of the recruitment process. If the candidate was previously employed as a representative in the securities industry by a firm registered in British Columbia, that firm must tell you all information it has about the candidate's suitability to work in the industry (Rules, section 28). There is no need to obtain the candidate's consent.

It would be difficult for you to demonstrate that you complied with this section of the Code if you failed to avail yourself of the information-sharing regime that section 28 of the Rules provides.

You should also consider doing a credit and regulatory history check on the candidate. In these cases, the candidate's consent is required. Credit checks are not conducted by the Commission and provide you with third party validation of the candidate's financial history. If you get the candidate's consent, the Commission will share with you the results of criminal records checks conducted when individuals apply for registration.

If your background checks indicate the individual is in or has recently experienced financial difficulty (for example, a bankruptcy or receivership proceeding), you should consider whether:

- that individual poses too great a risk to clients
- that individual's employment or retainer should be conditional on strict supervision of each trade that the individual conducts
- restrictions should be placed on that individual's ability to access or handle client funds or assets

A firm that dismisses a representative for cause must notify the Commission of that fact. However, this in no way diminishes your obligation to ensure that the candidate is suitable and it does not mean you can rely on Commission filings to replace your own suitability review. Your obligation to do so is independent of any interest the Commission may have in this information.

You are also responsible for all trading and advising activities that your representatives do. You must not only hire people with the appropriate proficiency and other qualifications, but you must also supervise them. Those acting in supervisory positions should have sufficient experience to do so and should also be fully familiar with the firm's compliance system. For example, the person responsible for overseeing a representative selling exempt market products should make sure the representative understands the product being sold, its attached risks, and the firm's policies on selling this type of product (see later discussion on proficiency standards in Part IV, B, 3 of this Guide).

You will want to consider means of ensuring that your representatives and other key personnel tell you about significant changes to information that was important when the contract began (for example, criminal or bankruptcy proceedings). You can restrict or condition your representative's trading and advising activity if that is appropriate for a particular representative.

23. Separate the firm's underwriting functions from its trading and advising functions.

You will need to ensure there is an effective system of fire walls to prevent the flow of information that may be confidential or may affect price between the corporate finance group and the trading and advising groups. Lapses in this area may lead to allegations of tipping or trading on inside information.

If you disseminate research reports that your analysts prepare as well as carry out underwriting functions, you need to ensure these functions are kept separate to ensure your analysts' independence.

24. Notify the Commission immediately of any significant change in the information relating to your organization or business.

The information you provided when you registered is important to the Commission's assessment of your fitness as a registrant and to the Commission's ability to maintain contact with you. Therefore, any change in this information is significant and you must disclose it to the Commission. For example:

- if you begin selling a category of investment product that you did not previously offer and that changes the risks you must manage in your business
- if the people controlling your organization changes (this would also trigger the requirement in Multilateral Instrument 33-109 *Registration Information*, section 5.2, to provide information in the required form for all partners, directors, officers, and significant securityholders that work for or have ownership of your firm)

In considering whether a change in your business, personnel, or systems is significant, you should not confine your thinking to information requested in the application form. Any change that might affect our understanding of your firm and how it meets its compliance obligations should be reported in a timely way.

For example, if you terminate a representative's contract for cause, this is significant information that is not addressed on the application form. The Commission needs to know this information, however, to consider compliance issues and make an assessment of risk presented by that individual to clients, firms, and the securities market. Registered firms can use the NRD system's Uniform Termination Notice to disclose this information.

Another example relates to your firm's capital adequacy. If you release subordinated debt, that information is significant because it affects your capital adequacy. You should report the release to the Commission and consider whether your capital adequacy calculation needs to be revisited.

25. Safeguard any client property you hold and ensure that it is used for its intended purpose.

This includes adequately segregating client funds from your firm's operating funds and ensuring there are adequate custodial or safe-keeping arrangements in place for client securities. You may need to open one or more trust or custodial accounts for this purpose.

CLIENT COMPLAINTS

26. Create and use effective procedures for handling client complaints.

An effective complaint system deals with all formal and informal complaints or disputes internally or refers them to the appropriate external person or process, in a timely and forthright manner. You should be fully aware of all applicable processes – internal or through your SRO – for dealing with complaints and should disclose to all clients the channels available for pursuing different types of complaints (for example, regarding conduct, service, or product performance).

Some registrants are also registered or licensed to do business in other sectors, such as insurance. In this case, you must inform clients of the differing complaint resolution mechanisms for each sector in which you do business and how the clients can use those mechanisms. If you are also insurance licensed, you will be subject to applicable insurance regulations in this area.

It is good business practice to document all complaints made, or legal actions or other dispute resolution proceedings commenced, against your firm and its representatives for potential review by regulators and to respond in writing to any client who complains about you or your firm.

B OTHER ONGOING REQUIREMENTS FOR DEALERS AND ADVISERS

1. Records and Reporting

You are responsible for keeping records sufficient to record your firm's business activities and clients' transactions. Records should be kept in an intelligible form, capable of being printed, and provided within a reasonable time to any person lawfully entitled to examine the information. If you are a firm that carries on business in more than one jurisdiction, you could, for example, centralize your records electronically and organize your affairs so that, although records are not physically held in British Columbia, they are readily available for inspection in the province.

You are required to keep records that enable you to carry out, and demonstrate your ability to carry out, the following critical business functions:

- timely creation and audit of financial statements
- determination of working capital at any given time
- identification of clients' property and things (as distinguished from yours), and what property and things belong to each client
- identification of transactions conducted for clients and those conducted for yourself, including information that provides an audit trail for each instruction and order received and each trade executed (Rules, section 33)

If you are a dealer and subject to regulation by an SRO or by RS, and you meet the record keeping requirements of those organizations, you are exempt from these recordkeeping requirements (Rules, section 43).

You must keep the records discussed above for at least six years (Rules, section 34(1)). You must keep records of communications between you and your clients for at least three years (Rules, section 34(2)).

Code compliance Your recordkeeping practices should ensure that you can demonstrate compliance with each section in the Code of Conduct. Generally, if you fail to keep adequate records, you will be in the impossible position of trying to demonstrate compliance to the Commission, or your SRO, without any supporting evidence.

Exempt market transactions Your recordkeeping should ensure that transactions for both public and exempt market offerings and trades are recorded. You will want to be in a position to demonstrate that an exemption from the registration requirement (or prospectus requirement) was available and that you met your Code obligations in carrying out that transaction.

Compliance examinations The Commission conducts regular and spot compliance examinations of advisers and restricted dealers. In preparation for these examinations, you should consider regular testing to determine whether the outcomes in the Code and other ongoing requirements are being met. The Commission will expect that your records can demonstrate those outcomes and your compliance examinations will reflect that expectation.

During compliance examinations, you are required to provide the Commission's examiner with unrestricted access to your books and records.

2. Capital and Bonding

The legislation requires a firm to have enough capital to meet its business obligations on an ongoing basis. See the earlier discussion in Part III, Section A of this Guide for information on calculating and reporting adequate capital (Rules, section 36).

If your firm borrows to meet its capital adequacy requirements, you must enter into a subordination agreement with the lender so that claims of clients and other creditors come first. Your compliance system should monitor the progress of these credit arrangements and ensure that updated subordination arrangements are made as necessary (Rules, section 37).

In addition to the general obligation to maintain sufficient capital, you must file annual audited financial statements and an annual statement disclosing the amount of capital that a reasonable person would consider sufficient to meet your firm's reasonably expected business obligations and the amount of capital your firm has as of the date of the financial statements (Rules, sections 39 and 40). If your capital falls below the amount reported as sufficient on your latest report, you must immediately notify the Commission (Rules, section 42(1)).

Your firm must also file a statement annually confirming that you maintain bonding that is reasonably required to protect the firm from specified events (Rules, section 41). If there is any act or allegation that might result in forfeiture of bonding coverage, a claim on your bond, or the terms of your bond change, you must report that to the Commission immediately (Rules, section 42(2)).

See earlier discussion under Part III, Section A of this Guide for information on how to calculate and report on adequate bonding coverage.

3. Requirements for Representatives and Other Key Personnel

All dealers and advisers The Commission relies on the SROs to set proficiency for their members. As a result, the minimum proficiency for representatives and other personnel of investment dealers and mutual fund dealers is that established by the SROs.

The Commission specifies the expected minimum proficiency standards for all other representatives to assist firms in meeting their proficiency obligations under the Code. They are on our website.

Because partners, directors, officers, and significant securityholders of a firm shape a firm's overall compliance culture, you must provide personal information about them in the required form. The form is Form 33-109F4 and is available for viewing on the Commission's website. The form is filed through the NRD system.

In deciding who must file this form, remember that the definitions of director and officer are functional definitions. Whenever someone becomes a significant securityholder or a new partner, director, or officer of a firm, the personal information for that person must be filed through the NRD system within five days (MI 33-109, section 3.3; Form 33-109F4).

Restricted dealers and advisers The Commission sets out the courses and the experience Commission staff expect representatives of advisers and restricted dealers to have from time to time (or in the case of unique restricted dealers, specified in their conditions of registration). However, it is up to the representative's firm to determine that the representative has alternative training and experience that are equivalent to the specified proficiency requirements. You should expect that Commission staff will question you about any representatives that do not have the expected minimum proficiency.

The most current proficiency and experience requirements are posted in the Capital Markets Regulation section of the website.

The Commission may also expect and examine for additional proficiencies, depending on the business activity of your representatives. For example, if an adviser intends to use derivatives as part of its investing strategy, the Commission would expect to see appropriate additional proficiencies.

Typical minimum-level experience requirements would be, for those with independent discretion over investment portfolios, at least five continuous years of relevant experience in the securities industry performing research involving the financial analysis of investments in securities.

While the Commission will set the expected minimum proficiency standards for representatives of advisers, the proficiency required of persons hired by the firm to assist in investment research and analysis will be left to the discretion of the firm. As an example, if you hire a junior representative you should make sure that person has the necessary education or experience to complete their work and you should put in place the controls necessary to protect your clients from the mistakes that can come from inexperience.

4. Electronic Delivery of Documents

Delivery You can deliver documents to your clients electronically (other legislation may be relevant).

If you choose electronic delivery, you need to ensure that it is as effective and timely as delivery by more traditional means. If it is not, you will not have met your delivery obligations under the legislation.

Consent If you wish to use electronic delivery, getting consent is a good way to ensure that your client has been given notice that you will be delivering electronically. The client's written consent can set out how and when electronic delivery will occur – and be evidence that you and your client have agreed on the process.

The types of things to consider including in a consent include:

- the documents that may be delivered
- how documents will be delivered
- what software and other systems requirements the client will need
- how a client can revoke the consent

Delivery system An effective delivery system will likely have the following elements:

- ease of access by your clients, which includes making the document available for a reasonable period of time, and allowing the client to download a printable version of the document
- proof that the document has been delivered or otherwise made available to the person
- protections against the alteration or corruption of documents

Hyperlinks You should use caution when using hyperlinks in a document, unless the hyperlink is to another point in that same document. If you are hyper-linking to information outside the document, you risk incorporating the hyperlinked information into the document and becoming legally responsible for its accuracy. Also, hyperlinks to a separate document raise the question of which documents are being delivered.

C COMPLIANCE

1. Examinations and Compliance Reviews

All registrants are subject to regular examinations to determine if they are in compliance with the legislation (Act, section 42). For IDA and MFDA members and their representatives, these reviews are normally conducted by those organizations.

The Commission conducts examinations of advisers, restricted dealers, and their representatives. In addition to a predictable review cycle, the Commission also conducts random reviews determined on a risk-assessment basis.

2. Power to Impose Conditions or Restrictions

Commission staff can impose conditions or restrictions on a registrant. Before doing so, Commission staff must give the registrant an opportunity to be heard (Act, section 16).

The Commission can also impose conditions or restrictions on a registrant after a hearing (Act, section 59).

3. Opportunity to be Heard

You have an opportunity to be heard if Commission staff:

- refuse to grant your registration
- impose conditions or restrictions on your registration (Act, sections 15(2) and 16(2))

For details about the process relating to the opportunity to be heard, go to the Capital Markets Regulation section of our website.

V. Market Participant Conduct

Because the Commission's responsibilities include protecting the integrity of the capital market and the confidence of investors, the legislation imposes duties on market participants and prohibits certain conduct. It is important that registrants are aware of these provisions because if one is contravened the person may be subject to regulatory or criminal sanctions. Contraventions of the insider trading or front running prohibitions can also give rise to an action for civil liability.

Manipulation and fraud Any conduct relating to trading in a security that results in manipulation or fraud is prohibited (Act, section 27).

Misrepresentations Misrepresentations are prohibited (Act, section 28). This means that you cannot provide untrue information, or omit to provide information so that a statement is untrue, if a reasonable investor would consider the untrue information or the omission important in making a decision to:

- buy or sell a security
- enter or maintain a business relationship with a firm or representative

Unfair practices A person must not engage in an unfair practice (Act, section 29). This means that high-pressure sales tactics, taking advantage of an investor's physical or mental infirmity, ignorance, illiteracy or lack of sophistication, and imposing unduly harsh terms or conditions on a sale, is not permitted.

Insider trading, tipping, or recommending A *connected person* (anyone connected with a *public issuer*, *public mutual fund*, or any other issuer whose securities are publicly traded) is prohibited from trading on *inside information (material information* or *significant information* about the issuer that has not been generally disclosed). A connected person is also prohibited from informing another person of inside information unless it is necessary in the course of the issuer's or person's business. A connected person includes anyone doing business with a public issuer and anyone who learns of inside information from someone they know, or should know, is a connected person. If you learn inside information while engaged in professional activities with the issuer, its management, or anyone doing a deal with the issuer, you are caught by this prohibition (Act, section 30).

Front running A person who has access to information concerning an investment program of a mutual fund, an investment portfolio of a client, or an unexecuted order or intention of any person to trade a security, must not trade securities if disclosure could reasonably be expected to affect the market price of the security. You are also prohibited from informing another person of the information or recommending or encouraging another person to trade when you have knowledge of that information (Act, section 31).

False or misleading statements to Commission You must not make or give false or misleading statements and information to the Commission or Commission staff, or fail to include information in a way that makes your statement or record false or misleading. This includes any verbal or written statements or information provided in the course of dealings with Commission staff on a filing or application (Act, section 40).

Obstruction of justice A person must not destroy, conceal, or refuse to give any information or produce a document needed for a hearing, review, or investigation (Act, section 41).

Contraventions attributable to others If a firm contravenes the legislation or a Commission decision, any employee, officer, director, agent, or significant securityholder of the firm who authorized, permitted, or acquiesced in the contravention is also considered to have committed the same contravention. These individuals could be subject to Commission enforcement proceedings or criminal sanctions (Act, section 173).

VI. Leaving the System

A registrant may surrender registration by applying to the Commission. Upon receipt of the application for surrender, the Commission can suspend the registrant's registration or impose conditions or restrictions without providing an opportunity to be heard (Act, section 17).

Representatives will more often take advantage of the automatic suspension and, then, termination (after 90 days) of registration when their contractual relationship with a registered firm comes to an end and is not superceded by a new contractual relationship (Rules, sections 22(2) and (3)).

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