Regulatory resolutions – CIRO continues rule consolidation project in phase 2

January 31, 2024

On January 11, 2024, the Canadian Investment Regulatory Organization (CIRO) published for comment Phase 2 of the Rule Consolidation Project (the Project). The aim of the Project is to consolidate the Investment Dealer and Partially Consolidated Rules (IDPC Rules) and Mutual Fund Dealer Rules (MFD Rules) into a single set of rules, known as the CIRO Dealer and Consolidated Rules (DC Rules). The objective of Phase 2 is to identify and adopt rules that currently apply to investment dealers and mutual fund dealers that are unique to each dealer type, which can be adopted in the DC Rules without a material impact on stakeholders, including investors and the public.

The focus of the proposals is the harmonization of rules related to margin, debt markets and Inter-Dealer Bond Brokers (IDBBs), as well as trading. More details on the specific proposed changes are set out below.

Margin requirements

CIRO proposes to largely adopt in the DC Rules the margin requirements currently in the 5000 Series of the IDPC Rules, with minor modifications and clarifications. CIRO will also adopt MFD Rule 3.2.1 that prohibits mutual fund dealers from allowing clients to purchase securities on margin, however, mutual fund dealers will be permitted to advance funds to clients in connection with redemption proceeds under defined conditions.

While we agree the changes appear to be minor and non-material, we urge dealers to review the modifications in detail to ensure there are no significant operational issues.

Debt markets and IDBBs

CIRO proposes to adopt the current Series 7000 IDPC Rules in the DC Rules with modifications to clarify the application of the rules to mutual fund dealers.

The provisions of current IDPC Rule 7100 will apply to mutual fund dealers who deal in the debt securities market. The intent is to prevent regulatory arbitrage between dealer types. Mutual fund dealers who deal specifically in debt securities will be impacted and will have to develop policies and procedures concerning trading and settlement practices to comply with the proposed rule.

The provisions for current IDPC Rule 7200 regarding debt securities transaction reporting will be adopted in the DC Rules and will continue to apply only to investment dealers. Likewise, the provisions of current IDPC Rule 7300 regarding the requirements for IDBBs used by investment dealers will continue to apply only to investment dealers.

Again, we urge dealers to review these proposed minor modifications in detail to ensure there are no significant operational issues presented.

Trading

CIRO proposes to adopt in the DC Rules the trading related provisions in Series 3000 IDPC Rules regarding best execution (BE), client identifiers (CI) and client priority (CP).

To minimize opportunities for regulatory arbitrage, CIRO proposes to extend these requirements to mutual fund dealers dealing in Exchange Traded Funds (ETFs).

The impact on mutual fund dealers dealing in ETFs would be new requirements to:

- establish, maintain and apply policies and procedure to address BE for client ETF transactions;
- comply with CI requirements for ETF transactions; and
- ensure CP of client ETF orders or transactions over all other orders.

Mutual fund dealers who deal in ETFs will need to seriously consider the impact of these proposals from a compliance and operational point of view.

Rules pending implementation

CIRO also includes in Phase 2 certain “business as usual” amendments, specifically:

- amendments to facilitate T+1 settlement;
- inclusion of proposed amendments to introduce margin requirements for structured products; and
- inclusion of the proposed amendments regarding derivatives, and in particular revised BE requirements for over-the-counter derivative transactions.

Comments requested on specific questions

In addition to general consultation, CIRO has asked for specific input on:

- the impact of the proposed BE, CI and CP obligations on mutual fund dealers dealing in ETFs;
- the impact of the proposed debt market trading and settlement practice obligations on mutual fund dealer debt market activity; and
- whether transaction reporting should be extended to mutual fund dealer debt market transactions.

Conclusion

Stakeholders should review the proposals in detail and consider providing comments to CIRO. Since most of the Phase 2 proposed DC Rules are taken directly from the current IDPC Rules, the impact on investment dealers will be largely neutral, but investment dealer legal and compliance teams should carefully review the details of the proposals to fully assess the impact. There will be an impact on mutual fund dealers who deal in ETFs or the debt market. Impacted mutual fund dealers should review the compliance and operational implications of the proposals and consider providing comments. Comments are due by **March 11, 2024** . If you have any questions, please feel free to contact us.

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