What’s new for dealers - CIRO releases Phase 4 of the Rule Consolidation Project

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On October 17, 2024, the Canadian Investment Regulatory Organization (CIRO) published for comment Phase 4 of its Rule Consolidation Project proposal (Proposal) relating to the consolidation of the two sets of rules currently applicable to investment dealers and mutual fund dealers into one set of rules. These Phase 4 changes relate to rules that are mostly unique to the investment dealer and mutual fund dealer rules that have been assessed as having differences deemed to be significant with potential material impacts on stakeholders. Our assessment is that the Proposal will have significant implications for mutual fund dealers.

This phase involves the adoption of rules relating to approval and proficiency for individuals, managing significant areas of risk, and business conduct and client account rules. The Proposal also relates to CIRO review procedures for approvals and membership.

The consultation notes that the following decisions have already been made by CIRO with respect to account types and services offered by mutual fund dealers (subject to any further approvals necessary):

- Mutual fund dealers will **not** be permitted to offer discretionary or managed accounts;
- Mutual fund dealers will be able to offer margin accounts; and
- Mutual fund dealers will be permitted to use free cash credit balances in their operations.

The following is a summary of some of the significant changes in the Proposal.

Approved person regime

Currently, the Ultimate Designated Person (UDP), Chief Compliance Officer (CCO) and dealing representatives of a mutual fund dealer are registered pursuant to the requirements of the Canadian Securities Administrators under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. This will continue to be the case under the Proposal. However, in addition, CIRO proposes to regulate the approval, experience and proficiency requirements for mutual fund dealer directors, executives, Chief Financial Officers (CFOs) and supervisors (formerly known as branch managers), as well as approved investors.

Mutual fund dealer stakeholders should review these specific provisions of the Proposal carefully and consider the impact on their firms, particularly with respect to the requirement to appoint a CFO given the potential scarcity of candidates (which has been expressed as a concern by some industry members). The consultation also asks whether it is appropriate to allow the continuation of existing directors of mutual fund dealers into the approved person regime.

Delegation and automation

The current Investment Dealer and Partially Consolidated Rules (IDPC Rules) concerning the delegation of tasks will be extended to apply to mutual fund dealers. The applicable IDPC Rule is more permissive than the current Mutual Fund Dealer Rule (MFD Rules), in that it permits delegation of tasks, **except** where expressly prohibited. The current MFD Rule approach prohibits delegation, unless expressly permitted.

There is also a proposed rule clarifying the requirements for individual human tasks which are automated. Automated tasks will be subject to specific supervision and controls to ensure the automated tasks are properly performed.

Definition of "investment product"

The current definition of "investment" in the MFD Rules is not being adopted, and instead the term "investment product" will be used in rules relating to key regulatory obligations, including know-your-product (KYP) and suitability. The new definition describes an "investment product" as a product that is a security, derivative, precious metal bullion or a product approved by CIRO as an investment product.

Risk management

The IDPC Rules regarding risk management will be adopted, which will be a new set of obligations for mutual fund dealers. Among other things, there will be a requirement to identify significant areas of risk and to assign an executive (as defined in the IDPC Rules) to be responsible for significant areas of risk.

Conflicts of interest

The current MFD Rules regarding conflicts of interest are general in nature. CIRO proposes the adoption of more precise conflict rules which are currently found in the IDPC Rules. More specifically, the current IDPC Rules regarding conflict policies and procedures and personal financial dealings will be applied to mutual fund dealers, which would among other things, extend the restriction from engaging in any personal financial dealings with clients to employees (and not just approved persons). There will also be a new restriction on approved persons accepting beneficiary status or a bequest from a client's estate, with an exception for immediate family members. This could present a material difference from current mutual fund dealer representative practices, and CIRO is specifically seeking comments on these new restrictions.

The current MFD Rules regarding referral arrangements will be adopted in the proposed new consolidated rules.

KYC, KYP, Suitability

Generally, the requirements concerning know-your-client (KYC) and client accounts that are currently in the IDPC Rules will be adopted in the proposed rules. The MFD Rules and IDPC Rules are similar in this area, and the changes proposed are not considered material.

The product due diligence and KYP requirements have been amended to clarify that the obligation applies to all products which fall within the new definition of “investment product” described above. The MFD Rules and IDPC Rules are similar is this area, and again the changes proposed are not considered material.

The requirements concerning suitability determination that are currently in the IDPC Rules are generally proposed to be adopted in the consolidated rules. The MFD Rules and IDPC Rules are also similar in this area. By adopting the IDPC Rule framework, mutual fund dealers will be able to designate accounts as institutional (instead of only retail). Dealers will also be required to have specific policies and procedures to determine the suitability of leveraged accounts and to detect and prevent unsuitable leveraging.

Supervision

With respect to governance, the Proposal adopts the IDPC Rules, which require a dealer to maintain a governance document and if the document is changed, file an updated copy with CIRO.

The IDPC Rule will be adopted with respect to both account supervision policies and daily/monthly trade supervision requirements. For account supervision, the IDPC Rule is the same as the MFD Rule, except for additional requirements to identify high risk clients and establish controls for accessing and amending records. With respect to daily and monthly trade supervision, CIRO proposes to remove some of the prescriptive requirements regarding thresholds for review found in the MFD Rule, believing that those detailed requirements would be better situated in guidance. The current mutual fund dealer requirements regarding the designation of certain account types for supervision will be adopted.

For supervision of new registrants, the IDPC Rule providing for six months of close supervision is proposed to be adopted, and for mutual fund dealers, this would replace the current program which consists of two consecutive 90-day segments of supervision.

Review procedure for approvals and membership

CIRO has proposed a streamlined review process for all decisions of CIRO staff regarding individual approvals, exemptions from proficiency or continuing education requirements, and terms and conditions on approved persons. These decisions will be subject to an opportunity to be heard by a CIRO senior decision officer and may be subsequently reviewed by a CIRO hearing panel.

Membership applications are to be received and analyzed by CIRO staff and approved by the CIRO board. The CIRO board will provide an opportunity to be heard in advance of its decision, which will be final and not subject to review by a hearing panel.

Comments sought

CIRO has asked stakeholders to comment on seven specific questions in addition to seeking general comments on the Proposal. The questions relate to items such as the definition of "investment product", applying the CFO requirements to mutual fund dealers, and the application and implementation of the proficiency regime to mutual fund dealers.

The Proposal is wide ranging and touches many of the existing rules impacting investment dealers and mutual fund dealers. CIRO dealer members and other stakeholders should carefully review the changes and CIRO's questions and consider commenting, and we would be pleased to assist. The comment period expires on **February 4, 2025** .

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