

CLIENT FOCUSED REFORMS – UPCOMING DEADLINE FOR REGISTRANTS TO COMPLY WITH THE CONFLICT OF INTEREST AMENDMENTS

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The June 30, 2021 deadline for registered firms and their representatives to comply with the new Client Focused Reforms (“**CFRs**”) relating to conflicts of interest is fast approaching.

The new requirements included in the Notice of Amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“**NI 31-103**”) and its companion policy (the “**Amendments**”) will likely require registrants to implement changes to their conflicts of interest policies and procedures and may require certain other changes to businesses of registrants. Registrants who have not yet started assessing the impact of the Amendments should start planning their transition now.

For those with questions on how the Amendments may impact them, McMillan will be hosting an informational webinar on May 6, 2021 (see below for details).

What Are the Client Focused Reforms (CFRs)?

The **CFRs** were adopted by the Canadian Securities Administrators (the “**CSA**”) with the objective of improving the relationship between clients and registrants and to seek to ensure registered firms/individuals continuously put the best interests of their clients first. The Amendments came into force on December 31, 2019, with a phased-in transition plan that was further delayed due to COVID-19 to June 30, 2021 with respect to the conflicts of interest sections. The new CFRs conflicts of interest requirements apply to all registered firms and individuals, excluding certain investment fund managers in respect of investment funds that are subject to National Instrument 81-107 – *Independent Review Committee for Investment Funds*.

These Amendments require that registered firms address all material conflicts in the best interest of their clients or, where such conflicts cannot be resolved in favour of their clients, to avoid the conflicts.

What Changes Are Required?

Changes will likely be required to a registrant’s policies, procedures, internal controls, record-keeping protocols,

client-facing documentation and compliance training, depending on the outcome of a review of the firm's existing practices. Changes may also be required to certain business practices or relationships, depending on the nature of the registrant and how it currently addresses conflicts of interest. Importantly, the Amendments introduce specific requirements that will apply to registered individuals, in addition to the conflicts of interest requirements applicable to registered firms.

Our [previous bulletin](#) provides a summary of certain key Amendments, while this bulletin focuses on the Amendments relating to conflicts of interest that will become effective on June 30, 2021.

Conflicts of Interest Amendments

The expanded definition of a "conflict of interest" in the Amendments includes any circumstance in which:

- i. the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent;
- ii. a registrant may be influenced to put their interests ahead of their client's interests; or
- iii. monetary or non-monetary benefits available to a registrant, or potential detriments to which a registrant may be subject, may compromise the trust that a reasonable client has in their registrant.

Examples of Material Conflicts of Interest

Examples of conflicts of interest that the CSA has flagged as almost always material are:

- **Trading in, recommending or distributing proprietary products.** Registered firms that trade in, or recommend, solely proprietary products or a mix of proprietary and non-proprietary products will be required to address this inherent conflict in their clients' best interests. Examples of controls registrants can consider to address this conflict include prohibiting practices that could bias recommendations towards proprietary products over non-proprietary products and enhancing their due diligence on comparable products available in the market.
- **Third party-compensation.** The receipt of third-party compensation, including the receipt of greater third-party compensation for the sale or recommendation of certain securities over others, is viewed by the CSA as an inherent conflict of interest. Controls to address this conflict may include implementing enhanced processes and procedures designed to ensure that recommendations are based on the quality of the security and uninfluenced by any associated third-party compensation.
- **Paid referral arrangements.** Paid referral arrangements are inherent conflicts of interest. Registrants should consider the benefits of the referral to the client and available alternatives and should ensure the client is not paying more for the same or substantially similar products and services because of the referral.

- **Internal compensation and incentive practices.** Compensation or incentive practices to recommend certain products or services over others are also inherent conflicts. Addressing this conflict may require changes to a firm's internal compensation and incentive practices, including changing how variable compensation is calculated and implementing consequences for conflicts violations that are proportionate to the potential benefits used as incentives.

Enhanced Conflicts of Interest Requirements

The following table outlines the general elements of the enhanced conflicts of interest requirements under the Amendments for registered firms and their sponsored individuals.

Identify	<ul style="list-style-type: none"> • Review to ensure robust policies and procedures exist to identify any material conflicts of interest in a timely fashion. • Take proactive measures to anticipate reasonably foreseeable conflicts, implement training and procedures to identify existing conflicts and assess the materiality of any identified conflicts. • Maintain a greater level of detail in internal records that will assist in identifying material conflicts of interest.
Address	<ul style="list-style-type: none"> • Determine how identified material conflicts of interest between a client and the registrant will be resolved in the best interest of the client. • Consider whether effective disclosure of material conflicts of interest is being provided to clients. • Determine what additional controls are needed to sufficiently address the conflict.
Avoid	<ul style="list-style-type: none"> • Avoid any material conflicts of interest between a client and the registrant if the conflict cannot otherwise be sufficiently addressed in the best interest of the client, or • Avoid any identified material conflict until such time as the registrant has fully implemented sufficient controls to address the conflict in favour of the client.

- Provide written disclosure of all identified material conflicts to clients whose interests are affected by such conflicts, if a reasonable person would expect to be informed of such conflicts.
- To increase the prominence of conflicts disclosure, the CSA suggests that registrants consider using stand-alone and succinct conflict disclosure documents rather than incorporating the disclosure in a registrant's relationship disclosure information document.
- **Disclosure alone will not satisfy a registrant's obligations to identify and address material conflicts of interest and should be used in conjunction with other controls.**
- A registered individual must not engage in any trading or advising activities in connection with an identified material conflict of interest unless the conflict has first been addressed in the best interest of the client and the registered individual's sponsoring firm has authorized proceeding.

Disclose

Abstain

Registered firms must be able to demonstrate how they have complied with the conflict of interest obligations summarized above.

Disclosure Requirements – Deadlines

On or prior to June 30, 2021, all clients must receive the enhanced conflicts of interest disclosure. New clients must receive such disclosure at the time of account opening. For existing clients, registered firms have the option of delivering new conflicts of interest disclosure that replaces any disclosure provided to the client in the past or supplementing their existing conflicts of interest disclosure with updates that include the enhanced conflicts of interest information.

There is no prescribed approach that must be followed with respect to the delivery of the enhanced conflicts of interest disclosure. Registrants interested in avoiding a separate mailing to clients to deliver the enhanced conflicts of interest information may wish to consider a combination of delivery options, including utilizing a registrant's regular Q1 and Q2 mailings, online disclosure and e-mail delivery, and should obtain specific advice in this regard.

Amendments Coming into Force on December 31, 2021

The remaining amendments will come into force on December 31, 2021, which, among other things, will require: (i) enhanced internal controls and systems; (ii) expanded "know your client" (KYC) requirements; (iii) codified "know your product" (KYP) requirements; (iv) enhanced client suitability determination obligations; (v) a consolidated waivers section in NI 31-103 that addresses exemptions from the KYC and suitability

requirements; (vi) expanding the relationship disclosure information obligations of registrants; and (vii) the addition of a “misleading communications” section to address deceptive and misleading practices of registrants.

Informational Webinar

We are pleased to be hosting an informational webinar on the Amendments on May 6, 2021, from 2 p.m. to 3 p.m. EST. If you are interested in attending, please contact events@mcmillan.ca.

If you have any questions regarding the Amendments, we encourage you to contact any one of the following members of McMillan’s Investment Funds and Asset Management Group who would be pleased to speak with you at your convenience.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.