



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

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MFDA Bulletin

Compliance

For Distribution to Relevant Parties within your Firm

Conflicts of Interest – Promotional Activities

In 2018, Members were asked to provide details of their policies and procedures relating to their advisors' receipt of promotional items and attendance at promotional events.

Attached to this Bulletin is [a Report](#) which summarizes the findings of MFDA staff, and provides additional guidance in this area.

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Conflicts of Interest: Promotional Activities

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INTRODUCTION

The MFDA continues to examine conflicts of interest and incentive practices that have the potential to influence the behavior of advisors and lead to unsuitable advice. In 2018, MFDA issued a survey asking Members to provide details of their policies and procedures designed to address conflicts of interest when their advisors receive promotional items or attend promotional events (collectively “promotional activities”) paid for by mutual fund companies, other investment product issuers, or entities Members have a referral arrangement with.

This report outlines MFDA staff findings from our review and provides guidance for Members.

Members should also review the following publications for additional guidance:

- National Instrument 81-105 Mutual Fund Sales Practices (“NI81-105”)
- 2017-2018 disciplinary proceedings of the Ontario Securities Commission relating to NI81-105¹
- OSC Staff Notice 33-749: Annual Summary Report for Dealers, Advisers and Investment Fund Managers
- OSC Staff Notice 33-743: Guidance on Sales Practices, Expense Allocation and other Relevant Areas

¹ Settlement Agreements included:

- In The Matter Of The Securities Act, R.S.O. 1990, C. S.5, As Amended - and - In the Matter of Sentry Investments Inc. and Sean Driscoll - and - In the Matter of a Settlement Agreement Between Staff of the Ontario Securities Commission and Sentry Investments Inc. and Sean Driscoll; April 5, 2017
- In the Matter of Mackenzie Financial Corporation - and - In the Matter of a Settlement Agreement Between Staff of the Ontario Securities Commission and Mackenzie Financial Corporation; April 4, 2018
- In the Matter of 1832 Asset Management L.P. - And - In the Matter of a Settlement Agreement Between Staff of the Ontario Securities Commission and 1832 Asset Management L.P.; April 19, 2018

MFDA RULES AND RELEVANT REGULATIONS

MFDA Rule 2.1.4: Conflicts of Interest

MFDA Rule 2.1.4 requires Members and Approved Persons to identify and resolve conflicts “by the exercise of responsible business judgment influenced only by the best interests of the client.” Rule 2.1.4 is a rule of general application meant to address all manner of conflicts that may arise. While MFDA Members predominantly sell mutual funds, Rule 2.1.4 is not limited to activity between Members/Approved Persons and mutual fund companies.

National Instrument 81-105: *Mutual Fund Sales Practices*

NI81-105 Section 5.6 allows mutual fund companies to provide advisors with non-monetary benefits of a promotional nature and of minimal value, and to engage in business promotion activities that result in advisors receiving a non-monetary benefit. However, these non-monetary benefits must not improperly influence the investment advice given by advisors to their clients.

GENERAL OBSERVATIONS

While the majority of MFDA Members stated they had policies and procedures that addressed promotional activity, many policies and procedures submitted were incomplete or needed improvement. For example, some policies and procedures:

- Only related to co-operative marketing practices with mutual fund companies but did not mention promotional activities;
- Included guidelines on promotional items but did not mention anything relating to promotional events;
- Repeated the wording in section 5.6 of NI81-105 without providing further details or guidance to advisors; and
- Limited the policy to promotional activities with mutual fund companies when the Member offered other types of investments or had referral arrangements with other entities where the same types of conflicts of interest may arise.

Members also tailored their policies to conform to their business model. For example, some Members had policies that applied to all entities within their corporate group. MFDA staff do not expect every Member to implement the same policies and procedures. Rather, MFDA staff expect Members to consider the guidance contained in this report and apply it in a reasonable manner based on the Member’s business model.

Promotional Items

Member policies varied in terms of the level of detail and criteria for acceptable activity. While some Members had comprehensive policies, in general, Member policies were not sufficiently detailed to provide adequate guidance to their advisors. Where Members had policies, they contained one or more of the following:

- A description of promotional items that did not require reporting and indicated a maximum dollar limit. For example, these promotional items were not to exceed \$20 each and included pens, calendars, t-shirts, hats, coffee mugs, paper weights and golf balls;
- A requirement to report all promotional items that were above this value to supervisory staff (“reportable items”);
- A dollar limit for each reportable item. The most common dollar limits were \$150 or less;
- An annual aggregate dollar limit per advisor for all promotional activity (i.e. reportable items and promotional events). The most common annual aggregate limit per advisor was \$1,000;
- A description of items that would not be acceptable including cash, gift cards or gifts that were not promotional in nature (e.g. do not have provider’s logo); and
- A prohibition on advisors requesting promotional items.

In a few cases, the Member’s policy discouraged advisors from receiving promotional items. For example, one policy reviewed by staff recommended that advisors decline the offer or, if that was not possible, donate the item to charity (without receiving a tax receipt). In other cases, Members only allowed the receipt of items of nominal value (e.g. \$20 or less).

As noted above, some Members had an annual aggregated dollar limit for all promotional activity for each advisor. We understand that mutual fund companies may also have their own internal annual limits for each advisor. Even where Members have annual limits in place, if all of the promotional activity was from the same source a reasonable person might feel the Approved Person has been improperly influenced. Therefore, in addition to a total aggregate limit, Members should establish sub-limits for each mutual fund company or organization. Further, while some Members had policies that did not require reporting for promotional items under a specified dollar limit (e.g. \$20), an advisor could receive these non-reportable items on such a frequent basis that it could be considered a conflict of interest. In such cases, the Member should consider requiring reporting of these items and including them in assessing compliance with their limits.

Promotional Events

Again, Member policies varied. Several policies only addressed promotional items but did not consider promotional events (e.g. entertainment). Where Members had policies specific to promotional events, they applied the same limits that were in place for promotional items (e.g. \$150 per event with an aggregated annual limit of \$1,000 for all promotional activities).

Some policies also contained:

- An explanation that the limits would also include the cost of an advisor's guest;
- A requirement that events should be reasonable, should not be recurring or offered with the expectation that it will influence the behavior of the advisor; and
- A prohibition on advisors asking issuers to pay for their attendance at an event or pay for entertainment expenses.

Referral Arrangements and Other Issuers

Generally Member policies were focused on compliance with NI81-105 and referred to promotional activity with mutual fund companies. In a few cases, Members policies on promotional activity were part of a much broader and comprehensive "conflicts of interest" policy. In these cases, the policies were not limited to promotional activity with mutual fund companies but rather any organization that does business with the Member. This would include organizations Members have referral arrangements with (e.g. portfolio managers) and issuers of other types of investment products (e.g. exempt security issuers).

Other Issues Identified - Charitable Donations

NI81-105 specifically prohibits mutual fund companies from making a charitable donation where the tax credit or deduction benefits an advisor. However, we understand that advisors do solicit charitable donations from mutual fund companies although they do not receive tax credit or deduction benefits. In the view of MFDA staff, such donations, depending on their size and nature, could create a potential conflict of interest. We note that some Members did provide policies and procedures related to charitable donations, stating that advisors should not accept donations to charities they are associated with unless they are nominal in value.

While we support the philanthropic efforts of advisors, there is a potential conflict of interest if it could be viewed as a "quid pro quo" situation. In other words, the circumstances may make the mutual fund company feel obligated to pledge a donation

in order to retain or gain business and/or advisors may be unduly influenced in the investment advice they give to their clients. Obtaining the charitable donation may also confer non-monetary benefits to the advisor, such as an improved public profile and ability to attract new clients. For example, we have encountered a situation where an advisor received publicity in association with a charitable donation made by a mutual fund company.

As a result, the potential conflicts of interest need to be considered by both advisors Members. Members should be aware of such charitable donations and should have them reported through, and supervised by, the Member in a similar manner as promotional activity. Besides the size of the donation, Members should also consider the charity's size and track record, any ties to the advisor, if it is a direct donation to the charity or a payment or gift to an event being held to raise money for that charity, and the manner in which it is presented to the charity.

Reporting, Record Keeping and Supervision

In order to support its supervision of conflicts, Members must have policies and procedures to maintain records of promotional activity occurring with its advisors. We acknowledge that obtaining this information is challenging for Members as mutual fund companies and other organizations often deal directly with advisors. To address this issue, some Member policies require advisors to report when they receive promotional items over a prescribed dollar limit or attend promotional events. Some policies require advisors to report promotional activity to a specific individual (such as a branch manager or compliance officer) and the recording of the information in a log. Others require reporting on a periodic basis (such as in a questionnaire or attestation). Further, we understand that some Members have also asked mutual fund companies to provide them with information on promotional activity with their advisors. These records can be also used to compare to the information provided by advisors for accuracy and completeness.

Members should be monitoring this information periodically to avoid or identify instances of non-compliance. Where an advisor is at risk of violating the policy, Members should inform the advisor of actions to be taken in order to avoid non-compliance. For example, where an advisor is approaching the annual limit, the Member may limit future promotional activity. Where the policy has been violated, Members should take appropriate action in the circumstances. This may involve restricting the advisor from engaging in future promotional activity or other disciplinary action.

GOOD PRACTICES AND RECOMMENDATIONS

Member's policies and procedures should include:

➤ **Promotional Activities:**

- **A description (including a dollar limit) of promotional items and events of minimal value that would not need to be reported;**
- **A dollar limit for each reportable promotional item and event;**
- **An annual aggregate dollar limit and sub-limits per mutual fund company or organization for each advisor for all promotional activity; and**
- **A description of promotional activities that are not acceptable, due to their value or nature.**

➤ **Reporting, Record Keeping and Supervision:**

- **A requirement that advisors report all reportable promotional items and events;**
- **Clarification of any situation requiring pre-approval;**
- **A description of how activities should be reported (e.g. in writing to a specific supervisor and recorded in a centralized log);**
- **The reporting frequency (e.g. each instance or on a periodic basis); and**
- **The details to be reported including:**
 - **who it is received from and given to;**
 - **the nature of the item or event;**
 - **the value of the item or event;**
 - **additionally for charitable donations:**
 - **the charity's name;**
 - **any relationship between the charity and the advisor;**
 - **if it is a direct donation to the charity or a donation to an event being held to raise money for that charity; and**
 - **if the advisor will receive any public recognition as a result of the donation.**

➤ **Supervision:**

- **Periodic review of information to assess compliance with the Member's policies; and**
- **Appropriate procedures and actions to avoid non-compliance or address violations.**

CONCLUSION

We encourage Members to review the good practices and recommendations contained in this report, update their policies and procedures and provide staff training as required.

The limits outlined in this report were derived from the policies submitted by Members. Members may need to obtain records relating to promotional activity with their advisors in order to establish reasonable limits. Going forward, the MFDA may request further information and/or engage in consultation with Members in order to provide additional guidance on reasonable limits.

Members with additional questions or those seeking guidance in enhancing their policies and procedures should contact their assigned MFDA Compliance Manager for further assistance.