



Monday, March 25, 2024

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Re: 24-0029 CIRO Policy options for leveling the advisor compensation playing field, issued on January 25, 2024

The **Canadian Independent Finance and Innovation Counsel** appreciates the opportunity to provide comments to CIRO regarding advisor compensation.

The Canadian Independent Finance and Innovation Counsel represents national Investment Dealers and their industry's position on securities regulation, public policy, and industry issues. We represent notable CIRO-regulated Investment Dealers in the Canadian securities industry.

CIRO intention

As stated in the Executive Summary, CIRO analyses three policy options for leveling the Approved Person compensation playing field:

Currently, Approved Persons governed by the Mutual Fund Dealer (MFD) Rules of the Canadian Investment Regulatory Organization (CIRO) are permitted to utilize an approach where the compensation they have earned through a sponsoring Dealer Member is paid to a party other than themselves. Approved Persons governed by the CIRO Investment Dealer and Partially Consolidated (IDPC) Rules, are not permitted to use such an approach.

We support CIRO in wanting to level the playing field. However, this proposal could have significant impacts on Investment Dealers. Below we set forth some potential implications and concerns in detail:

Future implementation for Investment Dealers – Flexibility needed

Investment Dealers support the initiative to level the playing field, but many firms are still assessing whether or not they would implement the new initiative (option 1, 2, or 3, as will be decided by CIRO).

It is important for firms to have the flexibility to maintain an employee-employer relationship with their advisors if they wish to do so. For example, assigning responsibility for bad debts or trading errors is more easily handled through an employment contract, as is the provision of hiring incentives.

Significant impacts of the new model

Implementing a new relationship model with advisors (option 1, 2, or 3) would have a significant impact on Investment Dealers in the following ways:

- Investment Dealers would need to adapt their **organizational structures** to accommodate the new model. This could involve restructuring departments, revising job roles, and redefining reporting lines to effectively integrate advisors operating through corporations.

- Investment Dealers would need to re-evaluate **revenue and cost arrangements and compensation structures** and potentially negotiate new agreements that align with the revised business model.
- Investment Dealers would face **additional regulatory compliance obligations** related to advisors operating through corporations. Dealers would need to ensure proper supervision of advisors and their corporations and client communications, while also managing conflicts of interest. This would require amendments to current compliance processes, systems, and training programs.
- Investment Dealers would see an impact on their **risk management practices**. With advisors operating through corporations, there would be changes in risk profiles, including legal, operational, and reputational risks. Investment Dealers would need to implement measures to mitigate these risks effectively, such as strengthening due diligence procedures and implementing robust monitoring mechanisms.
- Investment Dealers would need to seamlessly **integrate advisors operating through corporations into their operational workflows**. This could involve aligning technology platforms, data management systems, and communication channels to facilitate collaboration and information sharing between advisors and other stakeholders within the investment firm.
- Investment Dealers would need to **assess the implications of the new model on their business strategy, growth initiatives, and market positioning**, and make strategic decisions accordingly to capitalize on opportunities and mitigate risks.

Aside from these significant known impacts with respect to the implementation of this new model, there are also unknown ones: for example, moving away from an employee-employer relationship to a new type of relationship could lead to monitoring and supervision issues for Investment Dealers and impact the current cost model, where the investment firm is responsible for certain types of expenses.

As previously mentioned, the industry is still assessing the impacts of the CIRO proposal.

Preferred option: Incorporated Approved Person approach

If firms were to implement a new approach (despite impact assessments not having been completed at this point), many would choose, as their preferred option, the Incorporated Approved Person approach (option 2). Many Investment Dealers believe that this approach has a simpler implementation than the other two options proposed by CIRO.

We are supportive of the fact that this option would hold Approved Persons equally accountable to their clients; sponsoring Dealer Member; and to CIRO for the activities they conduct in their corporation, in the same manner as for activities they might conduct as an employee or agent of the Dealer Member.

Unfortunately, this preferred option still creates concerns for the Investment Dealers we represent.

Concerns with the Incorporated Approved Person approach

As CIRO states, this approach *“will introduce additional requirements on the relevant individual Approved Persons, the sponsoring Dealer Member and CIRO registration staff.”*

One of the concerns cited by Investment Dealers is with respect to taxation. Dealers want to ensure the new model is compliant from the perspective of the Canada Revenue Agency and the provincial revenue agencies in Canada.

Another area of concern is the supervision that may be required to ensure a Dealer Member accurately supervises an Incorporated Approved Person and its Approved Person employees and agents, as the Dealer Member remains *“liable to clients and other third parties for acts and omissions of the Incorporated Approved Person.”* Transparency is therefore required between the Incorporated Approved Person and the Investment Dealer. Guidance may be needed from the regulator to ensure proper supervision.

Investment Dealers are also concerned that the new model may be confusing to the public. Over recent years, regulators have applied considerable pressure on their Dealer Members in order to protect clients from any conflicts of interest or possible misunderstandings. For example, Vice-President titles were removed from hundreds of advisors across Canada. The rationale of the regulators was that a client dealing with a “Vice-President” who did not have a meaningful management role might believe their advisor had more authority at his/her firm than was the case. With respect to CIRO’s permitting incorporation, presumably the person who controls the corporation would be its Chief Executive Officer, President, Director, Chairman or possibly all of the above. How will the presentation of titles be handled so the public is not misled?

Another area of concern is that the new corporation may employ persons who are not employed by the Dealer Member. As previously mentioned, this would have a significant impact on the business model and its supervisory processes. It raises the following questions:

- How will their communication with clients be managed?
- Will the dealer become responsible for ensuring approved channels of communication (such as email domains and related email services) are supervised and archived?
- Will the dealer become responsible for overseeing business relationships or financial dealings between the new corporation and others with respect to non-registerable activities?

Registrable versus non-registrable activities – Securities legislation amendments

As per the CISO proposal:

Securities legislation amendments would not be necessary to permit the use of the Incorporated Approved Person approach where the activities of the corporation are limited to non-registrable activities.

Securities legislation amendments would be necessary to permit the use of the Incorporated Approved Person approach where the activities of the corporation are to include registrable activities. This is because provincial and territorial securities acts do not permit non-registered individuals and corporations to engage in registrable activities.

If option 2, the Incorporated Approved Person approach, is to be implemented, we believe that the securities legislation should indeed be changed to permit registrable activities within the corporation.

Transitioning to a new model

Many of the Investment Dealers we represent prefer, if a transition is needed, a direct transition to option 2, the Incorporated Approved Person approach. However, one firm would prefer the interim use of an enhanced directed commission approach while pursuing, over the medium-term, the adoption of an Incorporated Approved Person approach.

Clarity needed – Corporations and Share ownership

One firm operating under the independent dually licensed model mentioned that many advisors currently have financial services corporations which are not professional corporations. The Investment Dealer does not believe that professional corporations are required to enforce CISO regulatory objectives, and this runs the risk of additional provincial level legislative differences.

In addition, the Investment Dealer wishes to confirm that share ownership can be held by:

- **one or more Approved Persons and their families;** and/or
- **trusts and/or personal holding corporations** for operating and business reasons, where these indirect entities are also controlled by the Approved Persons,

and that as long as a majority percentage of voting shares are held directly or indirectly by the registered dealing or advising representative of both the professional and holding corporation,

the legislation should not inhibit this business model since this “look-through” ownership approach is already applied when it comes to share ownership of the Dealer Member.

Questions provided in the Request for Comments and Industry responses

The questions have been answered throughout this comment letter. However, here is a summary of our responses.

Question #1: Which of the following rulemaking options do you prefer that CIRO pursue and why?

- pure adoption of an Incorporated Approved Person approach,
- pure adoption of a registered corporation approach, or
- interim allowed use of an enhanced directed commission approach while pursuing over the medium-term the adoption of either:
 - o an Incorporated Approved Person approach, or
 - o a registered corporation approach.

Answer to Question #1: As mentioned above, the pure adoption of an Incorporated Approved Person approach is preferred by many Investment Dealers at this time despite the incomplete assessment of impacts. As previously mentioned, the implementation of this option may be simpler than the other two. Furthermore, the advisor’s responsibilities towards clients, their Investment Dealer, and CIRO would be maintained through the change in model.

Question #2: Are there other requirements not discussed in this paper that CIRO should include within any rule amendments it proposes relating to acceptable compensation approaches?

Answer to Question #2: CIRO must permit Investment Dealers to maintain, if they wish to do so, an employee-employer relationship with their advisors: flexibility is needed.

Question #3: Are there other matters not discussed in this paper that CIRO should consider when assessing which policy option to pursue?

Answer to Question #3: CIRO must consider the potential impact on Investment Dealers wishing to implement the new relationship model with their advisors (option 1, 2, or 3), such as:

- Changes to their organizational structures.
- Re-evaluation of their revenue and cost arrangements and compensation structures.
- Additional regulatory compliance obligations (supervision of advisors, their corporation, and client communications; and management of conflicts of interest).
- Changes to their current compliance processes, systems, and training programs.
- Changes to their risk management practices (legal, operational, and reputational risks).
- Integration of advisors operating through corporations into their operational workflows.

- Implications of the new model on their business strategy, growth initiatives, and market positioning.

In summary, the CIRO proposal allowing investment advisors to operate through corporations can have wide-ranging impacts on Investment Dealers. Successfully navigating these impacts requires careful planning, effective execution, and ongoing monitoring and adaptation to ensure a smooth and successful transition.

We are available to discuss the content further, address any concerns you may have, or provide additional information as needed. Your feedback is invaluable to us, and we are committed to ensuring that we all achieve our objectives effectively and efficiently.

Please feel free to schedule a call at your earliest convenience to discuss any aspects of the letter or to explore potential next steps. We look forward to our continued collaboration on this matter.

As always, please do not hesitate to contact me at annie@cific.co should you have questions or comments.

Sincerely,

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