

# CIRO Position Paper: Policy options for leveling the advisor compensation playing field

03/25/2024

# General Comments

The Canadian Bankers Association (**CBA**)<sup>1</sup> appreciates the opportunity to provide input on CIRO's *Position Paper: Policy options for leveling the advisor compensation playing field* (**Position Paper**).

We understand CIRO's commitment to developing a consistent approach to acceptable Approved Person compensation and its promotion of harmonization as a guiding principle in the development of public policy. We are also supportive of CIRO's engagement with stakeholders via the Position Paper before proposing rule amendments. This should facilitate CIRO's consideration of feedback in advance of any proposed rule changes and inform an effective policy with an appropriate outcome that takes into account the impact on all stakeholders and the public interest in relation to this proposal.

Advisor compensation encompasses complex and significant tax, employment law and operational considerations. The CBA is concerned that the Position Paper does not address the impact of these considerations and how they may affect the viability of any of the proposed approaches for various Dealer Members, including large, national Dealer Members.

In our view, a thorough analysis of these considerations is needed in order to build on the foundation established by the Position Paper, prior to proposing any rule amendments. These considerations are discussed in further detail in our comments below.

## Specific Questions

- 1. This paper discusses compensation approaches that could be made available for use to all CIRO Approved Persons. 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**

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<sup>1</sup> The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals.

- **interim allowed use of an enhanced directed commission approach while pursuing over the medium-term the adoption of either:**
  - **an Incorporated Approved Person approach, or**
  - **a registered corporation approach.**
- 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.**
- 3. Are there other matters not discussed in this paper that CIRO should consider when assessing which policy option to pursue?**

Although the questions are posed at a conceptual level, more information is required in order to determine which, if any, of the approaches to Approved Person compensation set out in Question 1 are optimal and in the public interest. There are a number of matters that would benefit from further consideration to inform any choice to be made. It would be helpful for CIRO to engage directly with the CBA to address these concerns.

Key matters that we believe require further consideration are outlined in detail below.

***i) Tax Implications***

The Position Paper notes that taxation of compensation earned by Approved Persons for the activities they engage in on behalf of their sponsoring Dealer Members is the primary reason CIRO is considering the various compensation approaches outlined in the Paper. While we appreciate that CIRO is not in a position to opine on compliance with tax laws, Dealer Members and Approved Persons will need to understand potential tax implications, including any position the Canada Revenue Agency (**CRA**) and Revenu Quebec (**RQ**) may take regarding tax treatment of compensation directed to or earned by a corporation, for activities engaged in under a sponsoring Dealer Member.

We note that in an August 2021 paper, the Canadian Securities Administrators (**CSA**) indicated that a Directed Commissions Working Group (**DCWG**) would study the issue of leveling the

playing field with respect to directed commission arrangements (**the CSA Paper**).<sup>2</sup> In doing so, the CSA expressed the view that the DCWG should, among other things, “consider the tax status of registered individuals”.<sup>3</sup> In our view, at a minimum, the DCWG analysis of the relevant tax issues should be completed and leveraged to inform the analysis of the various compensation approaches set out in the Position Paper.

Key tax issues that require further consideration and analysis include:

- **Approved Person/Dealer Member relationship.** For Dealer Members that have an employer/employee relationship with the Approved Person, simply transitioning to models that allow for incorporation may not be sufficient to change the fundamental nature of the relationship with the Approved Person for purposes of the *Income Tax Act*. It is our initial understanding that the relationship between the Dealer Member and Approved Person's corporation will likely need to be at arm's length however, this in fact may be difficult to implement under the proposed strict oversight of the Approved Person's corporation by the Dealer Member.

CIRO and the CSA should also make their intention clear in proposed enabling CIRO Rules and/or legislation that any compensation approach adopted will be available to Approved Persons whether in an employer/employee arrangement or a principal/agent arrangement with their Dealer Member.<sup>4</sup>

- **Earned vs. received commission.** It is unclear what difference, if any, there is in tax treatment with the current directed commission model permitted for mutual fund dealers and the new models proposed to earn commissions within a corporation, whether as an Incorporated Approved Person or a Registered Corporation. This impacts the merits of any choice of compensation structure to be made as it is necessary to determine

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<sup>2</sup> [CSA Position Paper 25-404: New Self-Regulatory Organization Framework \(lautorite.qc.ca\)](#) at page 23.

<sup>3</sup> Ibid.

<sup>4</sup> Mutual Fund Dealer Rules (Rule 1.1.1 (c)) and Investment Dealer and Partially Consolidated Rules (Rule 2302(1)) permit employer and principal agent relationships. Mutual Fund Dealer Rule 2.4.1(b) only permits payment of commissions to unregistered corporations where an Approved Person acts as an agent of the Member in compliance with Rule 1.1.5 regarding Agents.

whether either selection will lead to unintended tax consequences. While the CSA Paper indicated that a model whereby the corporation itself is able to engage in registerable activities that would *earn* commissions rather than simply acting as a conduit to *receive* commissions “would not seem problematic from a tax perspective”<sup>5</sup>, there has been no tax treatment evaluation provided for earned compensation compared to directed commissions with which there is already experience in the financial services industry.

- **New mandatory disclosure rules.** The potential impact of the new mandatory disclosure rules introduced into the *Income Tax Act* effective June 22, 2023 should also be considered.<sup>6</sup> Pursuant to these rules, transactions that have a “main purpose” of obtaining a tax benefit may be reportable to the CRA and failure to report may result in financial penalties.

Moreover, without gaining reasonable tax treatment certainty and reporting clarity, we can expect tax reassessments of Dealer Members and Approved Persons with potential fines and penalties that may negatively impact their business, which risks curtailing investor access to advice.

## *ii) Registrable vs. Non-Registerable Activities*

In our view, whether Approved Persons are permitted to direct compensation to, or earn compensation in, a corporation, the compensation should be expressly permitted to be derived from registerable and non-registerable activity<sup>7</sup>. An approach that limits an Approved Person to compensation derived from non-registerable activities, even as an interim solution, is problematic because of the following factors:

- **Confusion and compliance risk.** It creates a strong likelihood of confusion among

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<sup>5</sup> [CSA Position Paper](#) at page 24.

<sup>6</sup> [Mandatory disclosure rules – Overview - Canada.ca](#)

<sup>7</sup> Certain provinces already have exemptions from registration in place for corporations to which commissions and fees from registerable activity may be directed.

Approved Persons and clients, together with compliance risk as Dealer Members may take on detailed monitoring of Approved Persons' corporations. It also creates tax allocation risk to the Dealer Member by putting the Dealer Member in the position of allocating an Approved Person's payment stream between registerable and non-registerable activities – leaving every Dealer Member potentially liable to tax authorities for an incorrect allocation for significant numbers of Approved Persons.

- **Dual payment systems.** It will require the creation of two different payment systems in short order, requiring Dealer Members to first stand up an operational system for non-registerable activities, and subsequently establish a system for registerable activities.

Permitting compensation from both registerable and non-registerable activity, in or to a corporation, removes this confusion and compliance risk. It also provides clarity to the financial services industry on permissible payment flows for activity that can be supervised. Dealer Members will be better able to operationalize a payment mechanism if the compensation structure captures compensation from Approved Person activities consistently. Moreover, the operational challenge of having to decouple registerable and non-registerable activity for client reporting purposes will be alleviated.

### *iii) National Harmonization*

To promote harmonization and provide certainty for Approved Persons serving clients across different jurisdictions, prior to pursuing any of the proposed compensation approaches, it would be preferable if CIRO obtained assurances that the relevant approach would be adopted on a uniform basis across Canada. We note that the current “directed commissions” model is not permitted in Alberta or Quebec.<sup>8</sup>

National harmonization would assist in simplifying the treatment of compensation earned by

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<sup>8</sup> Regarding Quebec, it is our understanding that section 160.1.1 of the Québec Securities Act allows mutual fund dealers to share a commission only with certain registered persons, as noted by the Autorité des marchés financiers (see page 21 of [Summary of Comments and Responses Relating to CSA Staff Notice and Request for Comment 25-304 - Application for Recognition of New Self-Regulatory Organization](#)).

Approved Persons serving clients across certain jurisdictions as it would not need to be determined whether the compensation approach(es) would be based on the location of the Approved Person's business or by the residence of the client. It would also alleviate the potential for Approved Persons to favour clients in regions where their commissions are permitted to be directed to or earned in their corporation, which may raise potential conflicts of interest with their clients.

**iv) *Liability and Supervision***

Although the Position Paper addresses Dealer Member liability and supervision requirements with respect to the activities of the Approved Person under the Incorporated Approved Person approach, these topics are not addressed under the other two proposed compensation approaches as set out in the Position Paper. We believe that these matters are relevant under each compensation approach and should be specifically addressed in the analysis in order to provide necessary clarity to Dealer Members and the appropriate investor protections.

In terms of supervision and consequence management, the framework for the proposed compensation approaches must be feasible to employ and should place the onus on the Approved Person to document and evidence compliance with applicable laws, including tax and securities laws and regulations, and provide flexibility for the Dealer Member to take appropriate action that would otherwise be permitted under an employee/employer relationship, where required.

**v) *Structured Implementation***

We note that the Position Paper does contemplate a transition period for mutual fund dealing representatives to allow them time to comply with the new requirements. In our view, a similar accommodation is required to allow Dealer Members sufficient time to make the necessary operational changes to implement any new compensation approaches. Recognition of the wide divergence among Dealer Members in terms of the efforts required to undertake any non-traditional compensation approach is essential, particularly if it requires a shift in business model to be adopted.

Further, the level of impact on employees and firms with shorter-term employee/employer relationships will look very different than on those with longer-term employee/employer relationships. Dealer Members needing more time and resources than others to make necessary changes would be placed at a competitive disadvantage with potential negative impact to financial services industry stability.

In addition, for the compensation approaches outlined in the Position Paper, it is unclear which entity (the Dealer Member, the Approved Person's corporation or both) would be entering into the required client agreements.

Given the issues noted, it is important that CIRO consider how any implementation framework is structured to minimize disruption to the various segments of the financial services industry and limit any impacts which may curtail investor access to advice, cause client confusion or lessen investor protection.

We recognize that the specific features of CIRO's proposed compensation approaches and details of how firms would operationalize them, as well as any associated rule changes, will not become clear until a future date. In the interim, due to the importance of the tax implications to this proposal, publication of any rule proposal should be deferred until further consultation and analysis is completed and tax implications are understood.

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We thank you for taking the time to consider our views regarding the Position Paper and trust that you will find these comments helpful. We would be pleased to discuss our comments further at your convenience.