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Re: CIRO position paper - Policy options for leveling the advisor compensation playing field

We are pleased to provide comments in response to this position paper.¹

FAIR Canada is a national, non-profit organization with a reputation for independent and thoughtful commentary on public policy matters. We dedicate ourselves to advancing the rights of investors and financial consumers in Canada through:

- Informed policy submissions to governments and regulators.
- Relevant research focused on retail investors.
- Public outreach, collaboration, and education.
- Proactive identification of emerging issues.²

FAIR Canada recognizes CIRO's desire to harmonize acceptable compensation approaches for certain Approved Persons. However, this position paper goes much further than mere harmonization. It also introduces other potential risks and inconsistencies.

¹ CIRO Bulletin 24-0029 – Policy options for leveling the advisor compensation playing field.

² Visit www.faircanada.ca for more information.

FAIR Canada urges CIRO to concentrate on tackling the investor protection issues tied to the directed commissions approach used by mutual fund dealing representatives and possibly others. There is no need to go further and capture registerable activity. Doing so will demand more regulatory resources while increasing the regulatory burden and costs on Dealer Members. There is also no guarantee it would achieve its main goal – to help Approved Persons reduce their income taxes. Even if it did, we fail to see how this goal is within CIRO’s public interest mandate.

We have four serious concerns with the position paper. More specifically:

1. It does not focus on, nor stop at, fixing the regulatory gaps arising from directed commission arrangements (DC Arrangements or DC Approach) currently used by mutual fund dealers.³
2. It does not present sufficient information to evaluate other potential options, such as repealing Mutual Fund Dealer Rule 2.4.1(b) to “level the playing field.”
3. It proposes two new ambitious, costly, and burdensome options⁴ to permit Approved Persons to direct commissions and fees in respect of registerable activity without any certainty the Canada Revenue Agency (CRA) will accept either option as a legitimate tax avoidance vehicle.
4. It risks entrenching an unlevel playing field between:
 - Registrants who are CIRO Approved Persons and those who are not, and
 - CSA jurisdictions that may each ultimately adopt a different option.

CIRO’s immediate focus should be to close the gaps arising from existing DC Arrangements. If CIRO cannot address these gaps, it should be open to the idea that the best way to level the playing field might be to repeal the rules that allow DC Arrangements for mutual fund dealers.

We also have serious concerns that by focusing on its preferred approach, CIRO risks introducing new risks and significant new regulatory costs and burden for very little added investor protection benefits.

Simply put, this position paper puts the cart before the horse.

1. Focus on Addressing Existing Risks of Investor Harm

FAIR Canada recognizes that eliminating rule inconsistency between mutual fund dealers and investment dealers is important. We support CIRO applying equivalent standards across all its members, regardless of type. However, CIRO has not demonstrated why harmonizing compensation vehicles for Approved Persons should be among its top

³ This excludes mutual fund dealers in Alberta, but includes licensed Registered Representatives sponsored by firms registered as both investment dealer and mutual fund dealers (Dual-Registered Firms) outside of Alberta.

⁴ The “Incorporated Approved Person approach” and the “registered corporation approach.”

priorities. We think CIRO ought to prioritize the harmonization of other inconsistent approaches to regulating Approved Persons, such as the proficiency requirements between investment dealer representatives and mutual fund dealer representatives. Addressing these types of inconsistencies would have a more significant impact on investors, particularly retail investors.

As it relates to DC Arrangements, CIRO should not justify expanding a compensation scheme that puts investors at risk in the name of regulatory consistency.

The position paper concedes that CIRO has limited regulatory oversight over the current DC Arrangements used by mutual fund dealers and Dual-Registered Firms. We are concerned these DC Arrangements have remained in place for as long as they have despite these gaps in investor protection safeguards. Specifically, it identifies the following investor risks:

- CIRO lacks a clear view of the beneficial owners of the corporation that Dealer Members direct compensation (“DC Corporation”). If a DC Corporation can obscure the identities of its beneficial owners, this can impair CIRO’s ability to hold individuals liable for misconduct.
- CIRO lacks a transparent view of the activities the Approved Person directs the Dealer Member to pay to the DC Corporation. Given the investor protection concerns raised by interposing a limited liability company between the Approved Person and their client and Dealer Member, these activities are understandably limited to “non-registerable” activities.
- CIRO may lack the necessary authority over the DC Corporation to act if an Approved Person improperly directs commissions relating to registerable activities to the DC Corporation, or a Dealer Member pays such commissions to the DC Corporation.

The immediate focus should be on fixing these regulatory gaps.

FAIR Canada would be supportive of amending CIRO rules, as the position paper suggests, by:

- Limiting ownership of the DC Corporation.
- Limiting the securities and other activities that Approved Persons may conduct within the DC Corporation.
- Requiring the sponsoring Dealer Member to verify compliance with the above limitations before directing any commission to the DC Corporation.

CIRO could address any concerns about directed commissions being used for registerable activity through alternative mechanisms such as imposing:

- Clear rules on what Dealer Members must do to check, approve, and oversee DC Arrangements.

- Rules requiring Dealer Members confirm no commissions are paid to the DC Corporation unless they are satisfied it is for activities that do not need to be registered.
- A yearly certificate from the Approved Person that they did not ask that commissions for registerable activity be directed to the DC Corporation.

CIRO's rules should also provide authority to CIRO to suspend, revoke approval or impose additional terms and conditions on any Dealer Member or Approved Person found in breach of these rules.

We believe that rule amendments like these would go a long way in addressing the investor protection concerns with DC Arrangements. There should be no need, as CIRO suggests, to move beyond the enhanced directed commission approach to expand the use of the exemption to registerable activity.

We believe an enhanced DC Approach could achieve CIRO's goal of harmonizing requirements while delivering the desired benefits in the most cost-effective way. As such, we recommend that CIRO fully assess the merits of implementing the proposed enhanced regulatory controls outlined in section 3.2.1 of the position paper before considering expanding it beyond "non-registerable" activities or other Approved Persons. We see no need to consider at this time either the Incorporated Approved Person or registered corporation approaches.

2. The Position Paper Should be Open to All Options

Should these enhanced regulatory controls prove inadequate to manage investor risks, then CIRO should also consider repealing Mutual Fund Dealer Rule 2.4.1(b) entirely. CIRO could achieve regulatory consistency by prohibiting DC Arrangements for all Dealer Members. We are concerned that the position paper did not present this as a possible option.

We also note the position paper does not provide any:

- analysis or data on the extent to which DC Arrangements are used,
- information regarding the pros and cons of revoking Rule 2.4.1.(b),
- explanation for why Alberta rejected the DC Approach or why other CSA jurisdictions permit it.

This information would be helpful in developing a view on whether to maintain and expand DC Arrangements to include other Approved Persons.

3. Proposed Options Expand Scope of Permitted Activity

We are disappointed that CIRO is considering using its limited regulatory resources, as well as the resources of CSA members and provincial governments, beyond what is necessary to address the current inconsistency.

There are more pertinent and urgent regulatory matters facing Canadian investors. As a newly consolidated self-regulatory organization, its regulatory resources would be better spent, for example, on addressing investor confusion over registration categories, titles, and proficiency requirements. It should also prioritize policy projects that improve investor outcomes in a meaningful way, such as those focused on strengthening the complaint process.

We also question how this position paper fits within CIRO's public interest mandate or why CIRO considers it necessary to go beyond addressing the immediate inconsistency.

Either of the proposed new options - the Incorporated Approved Person or registered corporation approaches - could:

- take years to implement
- result in an inconsistent adoption across the country
- fail to produce the desired favourable tax treatment sought by some CIRO members.

Despite these costs and risks, neither option offers significantly more benefits than the enhanced directed commission approach.

As CIRO notes, the position paper "does not engage in a discussion or analysis of compliance with applicable tax laws." Accordingly, CIRO and others could spend considerable regulatory resources to develop and implement a proposed approach the CRA rejects. Simply put, CIRO has not put forward sufficient evidence that the benefits will outweigh the costs of its expanded options.

Furthermore, the position paper does not address the CSA's views of any of the proposed options. Currently, Alberta prohibits mutual fund dealers from adopting DC Arrangements.

The position paper does not explore:

- the basis of Alberta's objection
- whether Alberta would support an enhanced directed commission approach
- how other CSA jurisdictions view the proposed options.

Without any clarity on the application of relevant tax laws or the CSA's willingness to approve any of the proposed options, it is premature to seek comment on them.

4. An unlevel playing field may persist

This position paper proposes three options seeking to level the Approved Person compensation playing field. However, CIRO concedes that an unlevel playing field may persist even if they implement one of the proposed options.

As noted above, there is an existing unlevel playing field among mutual fund dealers since Alberta prohibits DC Arrangements. The three options do not propose a solution to this inconsistency among mutual fund dealers. Even assuming the most limited option (the enhanced directed commission approach that excludes investment dealers), it is unclear if mutual fund dealing representatives operating in Alberta would finally be permitted to adopt DC Arrangements.

Instead, all three options propose expanding DC Arrangements to both mutual fund dealers and investment dealers. The position paper does not describe how CSA jurisdictions view the proposed options, even the options limited to compensation from non-registerable activities and amendment to the CIRO rules only. Without this information, we cannot assess the risk of further incongruity if some CSA jurisdictions approve the expansion of DC Arrangements to all dealer categories and others do not (even if limited to non-registerable activities). An unfortunate but plausible outcome would be DC Arrangements permissible for mutual fund dealers and investment dealers in some CSA jurisdictions, while prohibited in others.

Furthermore, for Approved Persons to conduct registerable activities (whether through the Incorporated Approved Person approach or the registered corporation approach), provincial and territorial governments need to amend local securities legislation. Should these governments decline to amend legislation or make inconsistent amendments, it could entrench a further patchwork framework governing Approved Person compensation.

Finally, even uniform adoption of the Incorporated Approved Person approach or the registered corporation approach across the country would still result in an unlevel playing field between CIRO registrants and registrants in all other dealer categories, who are generally prohibited from using DC Arrangements.

If the primary policy goal of this consultation is to level the playing field respecting advisor compensation, we fear the proposed options only increase the opportunities for regulatory inconsistency.

We urge CIRO to reconsider the prioritization of this policy issue and focus instead on closing regulatory gaps that raise investor risks. We intend to post this submission on our website and understand that CIRO may post it on its website. Should you have any questions or wish to discuss any aspect of our submission, please contact Jean-Paul

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Sincerely,



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FAIR Canada | Canadian Foundation for Advancement of Investor Rights