March 25, 2024

VIA EMAIL: memberpolicymailbox@ciro.ca

Member Regulation Policy
Canadian Regulatory Industry Organization
Bay Adelaide North
40 Temperance Street, Suite 2600
Toronto, Ontario,
M5H 0B4

Dear Sir/Madam:

Re: **Position Paper – Policy Options for Levelling Advisor Compensation Playing Field**

I am writing on behalf of Integral Wealth Securities Limited ("**Integral**") in response to the request for comments on the above-noted position paper on policy options for levelling the advisor compensation playing field (the "**Paper**") published by the Canadian Regulatory Industry Organization ("**CIRO**") on January 25, 2024. Thank you for the opportunity to provide comments on this very important topic.

Integral is a registered Investment Dealer, CIRO Dealer Member and Type 2 Introducing Broker. The firm is registered in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario. Quebec, New Brunswick, Nova Scotia, PEI and Yukon. Integral operates in three distinct business lines – investment banking, market making and wealth management. Our wealth management division, most germane to the issues set out in the Paper, consists of 25 individual registrants, conducting business from eight business locations in B.C., Ontario and Quebec. Almost all of the individual registrants are independent contractors to Integral, operating under the principal-agent business model. Collectively, Integral administers approximately $1.2 billion in client assets and utilizes the services of Fidelity Clearing Canada, ULC, as its carrying broker.

Integral is pleased to provide comments not only on the three policy options set out in the Paper for levelling the advisor compensation playing field, but also to respond to the specific questions raised in the Paper.

General Comments

Overall, Integral supports the underlying premise of the Paper, being to harmonize CIRO's Mutual Fund Dealer ("**MFD**") Rules and the Investment Dealer and Partially Consolidated ("**IDPC**") Rules, with respect to allowing Approved Persons to direct compensation earned through a sponsoring Dealer Member to a party other than the Approved Person themselves. Specifically, the lack of this choice for Approved Persons who are subject to the IDPC Rules, specifically those who operate under a principal-agent model, at a significant disadvantage to their MFD colleagues, in terms of costs and flexibility in operating a successful business.

Comments on the Policy Options

The Paper sets out three different approaches to advisor compensation – the enhanced direct commission approach, the incorporated Approved Person approach and the registered corporation approach. The Paper also sets out the benefits and concerns with each approach, leading to CIRO staff identifying the incorporated Approved Person approach as the preferred approach. However Integral believes that certain benefits and concerns with the various approaches are not being given sufficient consideration which, if more carefully considered, would lead to a different conclusion for a preferred approach. Our analysis supporting this claim is set out below:

A. Enhanced Directed Commission Approach

Integral agrees with the primary benefit cited for this approach, being that it could be achieved through modification of CIRO rules alone, unlike the other approaches which would require amendments to securities legislation in each province and territory. In our view, **this is the most compelling benefit** of not only the enhanced directed commission approach, but the other approaches discussed. Integral believes that the need to obtain agreement and commitment from at least a significant majority of Canadian provinces and territories to amend securities legislation in a coordinated and expeditious manner, in order to implement either of the other two approaches, renders the likelihood of either of those approaches ever being enacted as minimal, at best.

As a result, given the primary objective of the Paper is to "level the advisor compensation playing field" by eliminating this significant policy inconsistency, in Integral's view, the enhanced directed commission approach is clearly the preferred alternative.

While Integral also agrees with the general concerns noted for this approach, being the lack of transparency over the beneficial owners and activities of corporations that Approved Persons direct commissions to, we do not agree with the recommendations proposed to address these concerns. We also do not agree with the premise that CIRO lacks the necessary jurisdiction over the activities of these corporations. Our explanations of our concerns and suggested alternatives are set out below.

Lack of Transparency Over Beneficial Owners & Activities of Corporations

i. Beneficial Owners

Integral acknowledges that without imposing a requirement for transparency over the beneficial owners of these corporations, the potential exists that undesirable persons, including those with dubious backgrounds and/or those who have been banned or removed from the Canadian capital markets, could become shareholders of such corporations. This would allow these undesirable persons to benefit from the compensation earned by Approved Persons directly, through dividends or shareholder advances, or indirectly, through appreciation of share values, all of which may be an undesired outcome for both regulators and the investing public. Therefore, placing limitations on such corporate ownership, as proposed in the Paper, makes sense to us.

However, placing arbitrary restrictions on such corporate ownership, such as limiting ownership to Approved Persons and their immediate family members and/or a family trust does not, in our view, correctly or sufficiently address this concern. Given that Approved Persons are subject to a 'fit and

proper' test to determine suitability for securities registration and the ability to earn and enjoy the benefits of compensation from securities related activities, we believe this standard should be extended to all beneficial owners for corporations that advisor compensation is directed to.

We believe (and we believe that many securities regulatory authorities, including CIRO, share this view) that one of the key underlying premises to the overall issue of directed advisor compensation is the inexorable link between the securities related activities that generate compensation and who or, in this case, which entities, should receive the benefits of that compensation. Given that belief, and the concern regarding a general lack of transparency over beneficial ownership of these corporations, a broader, more relevant standard should be implemented in vetting the corporation's beneficial owners. A similar 'fit and proper' test should be applied to shareholders of these corporations, which would include the completion of satisfactory background checks and a determination whether the individual was subject to any significant regulatory enforcement actions. This 'fit and proper' test would apply to any proposed corporate shareholder, including an Approved Person's immediate family members and/or the beneficiaries of any family trust.

To provide a further element of control over the ownership of such corporations, Integral also recommends that whatever the shareholding structure of the corporation, that the Approved Person own a majority of the corporation's voting shares.

ii. Corporate Activities

Integral also acknowledges the need for restrictions over the activities conducted through such corporations, to protect investors and support the high standards of conduct expected from registrants and capital market participants. However, placing arbitrary restrictions on such activities, such as limiting other corporate activities to financial services activities does not, in our view, correctly or sufficiently address this concern. Once again, in our view, applying a broader, more relevant standard to determining allowable activities within such corporations, will result in better investor protection.

For those corporations that advisors wish to direct compensation to, especially if the Approved Person is the controlling shareholder, as we recommend above, we recommend that any activity that the corporation would engage be treated as an "outside activity", as contemplated under National Instrument 31-103 and IIROC Guidance Note GN-2500-22-001. As such, the Approved Person's sponsoring Dealer would be required to review the proposed activity and determine if it could be approved, after considering potential conflicts of interest and a general assessment of whether activity is consistent with the high standards of conduct in the securities industry. This process wouldn't place any arbitrary limits or restrictions on the types of allowable activities. Rather it would require the sponsoring Dealer to properly assess the proposed activity against established regulatory standards and guidance as part of the approval process.

CIRO Jurisdiction Over Corporations

The Paper notes that one of the concerns with the enhanced directed commission approach is that this approach does not give CIRO staff the necessary jurisdiction to determine whether an Approved Person who is using this approach is limiting the activities of the corporation to non-registerable activities.

From our understanding, this issue has not arisen in a material way since the rules authorizing the current version of the directed commission approach was approved by the Mutual Fund Dealers Association ("**MFDA**") in 2010. Further, in our view, CIRO staff have full jurisdiction over Approved Persons and their conduct, including conduct in connection with securities related activities. If CIRO staff become aware of or concerned with any activity within an Approved Person's corporation, which suggests or may suggest that an Approved Person is contravening CIRO rules, other securities regulatory requirements, or otherwise acting in a manner that would render the Approved Person no longer suitable for registration, CIRO staff have the right to request information from the Approved Person and compel the Approved Person to cooperate with any related investigation. In Integral's view, all of this is possible and occurs on an ongoing basis, without CIRO having any jurisdiction over any related corporation or other entity. **CIRO staff have and can continue to provide protection to investors without having jurisdiction over an Approved Person's corporation.** Therefore, we do not agree that a lack of jurisdiction over an Approved Person's corporation is a concern with the enhanced directed commission approach.

B. Incorporated Approved Person Approach

The Paper cites the benefits of this approach, being that it could, at least in part, be achieved through modification of CIRO rules alone and that as a result, CIRO would have regulatory jurisdiction over the related corporation. Integral, however, disagrees with these items as benefits, for the following reasons:

i. As noted in our comments under the enhanced directed commission approach, CIRO staff does not require direct jurisdiction over the Approved Person's corporation to regulate the Approved Person's activities and ensure effective investor protection.

ii. Integral agrees that securities legislation amendments would be required to allow Approved Persons to conduct registerable activities in their corporation, an outcome of which the likelihood of achievement is minimal at best, as noted previously. However, we believe there is neither a need nor a desire to establish a regulatory framework that allows registerable activities to be conducted through a corporation.

This was never the impetus for the directed commission approach approved by the MFDA. Instead, the impetus was to allow Approved Persons the flexibility to receive compensation in a corporation, which provides significant tax advantages, in terms of deductibility of expenses and distributing income through dividends and other means to shareholders, as well as providing a legal entity vehicle for the Approved Person, operating under a principal-agent, independent contractor business model, to enter into contracts, hire employees, negotiate with vendors, all in the spirit of the effective and efficient running of the Approved Person's business.

In addition, beyond disagreeing with the proposed benefits of the incorporated Approved Person approach, Integral believes there are further concerns with this approach not identified in the Paper – **reduced accountability** and **additional regulatory resources required**. These concerns are set out below.

Reduced Accountability Through the Corporate Veil

Even with the most carefully crafted securities legislative amendments that would ensure the Approved Person is accountable for activities conducted through their corporation, and even with a well-crafted Incorporated Approved Person Agreement, referred to in the Paper, that details the rights and responsibilities of all the relevant parties, the fact remains that conducting registerable activities through a corporation affords the Approved Person (and their officers, directors and shareholders) with an additional layer of protection through the veil of the corporation. Whether it is CIRO staff pursuing an investigation or a client seeking redress on a complaint through the Approved Person's sponsoring Dealer, the existence of a corporation, as a 'blocker' between the regulator or the client and the Approved Person makes the task of effective investor protection more, not less difficult.

Integral acknowledges the examples noted in the Paper to mitigate the risks of introducing a corporation into the relationship between the Approved Person and the regulator, including requiring the corporation to be incorporated under Canadian federal or provincial/territorial law and limiting the nature of activities conducted within the corporation. However, considering the concept of limited liability for the shareholders of the corporation and the ability of the corporation to establish subsidiaries and affiliates, whose locations and records may or may not be within Canada, let alone within CIRO's jurisdiction, the ability to ensure effective investor protection using the incorporated Approved Person approach is, in our view, further eroded.

Additional Regulatory Resources Required

The introduction of the incorporated Approved Person approach, whether the corporation is allowed to engage in registerable activities or not, will require CIRO to apply additional resources in overseeing the corporation and officers, directors, and shareholders, as compared to overseeing an individual Approved Person. Reviewing and understanding corporate records and agreements, conducting background checks on multiple individuals and tracking the corporation, any subsidiaries and affiliates, and all related individuals, both initially and on an ongoing basis, will require a significant effort, far, far greater than is required to follow and oversee the activities of a single Approved Person.

The securities industry cannot afford to bear the costs of these additional resources, nor the diversion from potentially more important investor protection issues, like investigations or enforcement activities, that this additional element of regulatory oversight will bring under the incorporated Approved Person approach.

For the reasons set out above, Integral strongly recommends that CIRO not pursue this approach.

C. <u>Registered Corporation Approach</u>

The registered corporation approach is similar to the incorporated Approved Person approach. Accordingly, the concerns Integral has identified with the incorporated Approved Person approach are comparable and applicable to the registered corporation approach. The registered corporation approach goes one step further than the incorporated Approved Person approach in that the registered corporation approach contemplates not only the Approved Person's corporation being approved by CIRO to conduct non-registerable and potentially registerable activities, but contemplates the corporation becoming registered under securities legislation, in addition to the Approved Person.

As a result, the registered corporation approach will require even more regulatory resources to both register and oversee the activities of the registered corporation, beyond what is contemplated for the incorporated Approved Person approach.

We would add to this the concerns of reduced accountability through the corporate veil and establishing a regulatory framework that allows registerable activities to be conducted through a corporation, that was never the impetus for the directed commission approach approved by the MFDA.

For the reasons set out above, Integral strongly recommends that CIRO not pursue this approach.

Specific Questions for Response

The Paper set out three specific questions that CIRO staff are seeking responses to. Integral's responses to these questions are as follows:

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

Integral does not prefer any of the three rulemaking options set out in this question, as none of the options are consistent with Integral's preferred approach, being the enhanced directed commission approach, with our recommendations to address the concerns regarding lack of transparency over the beneficial owners of and the activities of the corporation.

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

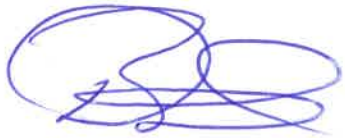
As highlighted in our concerns with the incorporated Approved Person approach and the registered corporation approach, CIRO should include not only the immediate corporation in question, wholly-owned or at the very least controlled by the Approved Person, but limits on the Approved Person's ability to establish subsidiary or affiliate corporations which may increase the density and complexity of the 'corporate veil', making CIRO's job of ensuring effective investor protection even more difficult,

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

While pursuing this policy issue, CIRO should take the opportunity to continue to highlight the differences in sales practice regulation between the securities industry and the insurance industry. There continues to be a lower and lesser standard of both regulation and enforcement in the insurance industry, as compared to the securities industry. This gap creates regulatory arbitrage and facilitates the potential for activities that have a greater likelihood of harming investors.

We thank you again for the opportunity to comment on this important initiative and invite you to contact myself directly if you have any questions on our comments and responses.

Sincerely,
INTEGRAL WEALTH SECURITIES LIMITED



Darrell Bartlett, CFA, CPA, CA, CIA
Chief Compliance Officer

cc:

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