

April 22, 2016

BY EMAIL

Marsha Gerhart
Vice-President, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
121 King Street West, Suite 2000
Toronto, ON M5H 3T9
mgerhart@iroc.ca

Dear Sirs/Mesdames:

Re: IIROC White Paper – The Public Policy Implications of Changes to Rules Regarding Proficiency Upgrade Requirements and Directed Commissions on the IIROC Platform (the “White Paper”)

The Canadian Advocacy Council¹ for Canadian CFA Institute² Societies (the CAC) appreciates the opportunity to comment on the White Paper, and we would like to provide the following general comments.

The White Paper indicates that IIROC is considering the introduction of new registration categories with reduced proficiency standards for those individuals and firms dealing exclusively in mutual funds and exchange traded funds. The CAC directionally supports higher proficiency standards and does not believe lowering the standards for persons selling specific products would be in the public interest. Where proficiency standards across platforms differ, regulators should ideally default to the standard that best serves investor interests. Lower proficiency standards may detract from the quality of advice given. We are particularly concerned that the proposed “restricted” IIROC registrant category might not require completion of The Conduct and Practices Handbook Course (or equivalent) that covers ethics and conduct matters. We are of the view that the investing public benefits greatly from the requirement that IIROC registrants must take courses that specifically address and build registrant knowledge in ethical practices, registrant conduct and compliance standards.

Establishing proficiency standards that are understandable and straightforward for both registrants and more importantly, the investing public, is our preferred approach. The multitude of registration categories and the variations on each are already a source of confusion for investors seeking to understand the categories of registration under the securities registration regime set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

¹The CAC represents more than 15,000 Canadian members of the CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at <http://www.cfainstitute.org/cac>. Our Code of Ethics and Standards of Professional Conduct can be found at <http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx>.

² CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 135,000 members in 151 countries and territories, including 128,000 CFA charterholders, and 145 member societies. For more information, visit www.cfainstitute.org.

This problem is potentially worsened by additional categories for IIROC registrants and the applicable proficiency standards. Consequently, we agree with comments expressed in the IIROC member survey that the elimination of the proficiency upgrade requirement could cause confusion among investors as to which products and services could be offered by the proposed restricted dealing representatives.

As CFA charterholders, we have agreed to uphold The Code of Ethics and Standards of Professional Conduct (“Code and Standards”), which requires us to put the best interest of our clients ahead of our own. We wish to stress the importance of implementing a statutory best interest standard on all persons providing investment advice, including investment dealer representatives. Such a standard would help ensure that investment or allocation of financial resources is in fact in a client’s best interests, and would help mitigate concerns relating to potential conflicts of interest. The end users of these services, the investment industry, and society as a whole, would benefit if all professionals offering investment advice were held to this high standard. The best interest standard is at least as important as determining proficiency requirements for true investor protection, especially for less sophisticated investors.

The second aspect of the White Paper proposed to permit directed commissions. We do not believe that allowing directed commissions serves the public interest, and agree with the position previously taken by IIROC when considering this issue. Our primary concern is that allowing IIROC registrants to direct commissions to a broader, unregulated set of entities may incent registrant decisions that are not in clients’ best interests, and where the advice provided to clients could be more explicitly driven by registrant compensation considerations. For example, many more registrants may be drawn toward a commission model and away from a fee based model as a result of the additional flexibility being considered for directed commissions. We question the rationale for reversing a reasonable policy that provides sufficient flexibility for various business models to operate simultaneously.

An obvious benefit to IIROC registrants for directed commissions may be the ability to direct fees for financial planning and other non-registrable activities directly to a holding company; we understand that currently many IIROC dealer members and their representatives working directly with financial planners may have to enter into other indirect payment arrangements. An area of particular concern to the CAC is the nature of activities generating the directed commissions, and the potential for certain persons (regulated and otherwise) to avoid regulatory oversight on what should be registrable activities. We are also concerned about the potential to minimize liability to possible client claims through the use of holding corporations. We do not believe that, absent a change in the commonly used structure for directed commissions by registrants as permitted by other SROs, that there is a compelling reason to permit them until such time as IIROC receives confirmation from both the tax authorities and all of the Canadian securities regulators that such usage is acceptable and does not result in a non-registrant performing and receiving compensation for registrable activities.

As noted in Appendix B of the White Paper, of those securities regulators that permit MFDA members to direct commissions to a holding corporation, a number have published specific orders/rulings with respect to such activity, which suggests some specific concerns about the use of such commissions. For example, BC Instrument 32-503 provides an exemption only for the corporation to which commissions are directed from the dealer registration requirement provided the dealer remains liable for the acts and omissions of the corporation that relate to securities business. The fact that an order was required in BC and guidance was required in other jurisdictions

suggests past regulatory concerns that these holding corporations were engaged in some form of registrable activities.

We understand that the costs for maintaining a separate corporation could potentially outweigh the tax benefits for registrants that could choose to utilize the structure as proposed, and that a large volume of mutual fund sales and commensurate commissions would be required in order for the structure to make sense economically. It is possible that a registrant in this scenario selling solely mutual funds under the IIROC platform could be motivated to do so as a result of the tax benefits of their directed-commission holding company structure and not the best interests of the client. Our fear is that mutual funds sales generating sufficient commissions to justify a separate incorporated and unregulated entity, serving one or a small group of registrants, are potentially being sold at a scale or volume whereby the registrant(s) may either not be sufficiently advising an excessively numerous client base, or selling financial products with trailer fee burdens that are not appropriately sized to the scale of their clients' portfolios.

The White Paper notes that if directed commissions were permitted under the IIROC platform, the IIROC rules would need to be amended to ensure, among other things, that such a structure is in the interests of the public, including ensuring that an IIROC dealer remains liable to its clients for the actions of its dealing representatives. We note that similar changes would likely be required under securities legislation which would obviously utilize resources and time. We also question how commission rebates to investment dealers could be accommodated in a directed commission structure.

The potential benefits to IIROC-regulated investment dealers and their representatives of the directed benefit structure that have been espoused, including potentially creating a more tax-efficient structure and facilitating succession planning, are not in our view sufficient to outweigh the potential negative implications, such as the impact on the legal liability to clients and the potential for increased conflicts of interest.

It would be helpful to understand how other comparable jurisdictions, such as the U.S., the U.K. or Australia have considered or implemented a directed commission structure and, if so, the conclusions of any such research.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have or to meet with you to discuss these and related issues in greater detail. We appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) *Michael Thom*

Michael Thom, CFA
Chair, Canadian Advocacy Council