VIA E-MAIL

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

The Portfolio Management Association of Canada (**PMAC**) is pleased to have the opportunity to submit the following comments on the Canadian Investment Regulatory Organization (**CIRO**) Position Paper: *Policy options for leveling the advisor compensation playing field* (the **Position Paper)**.

PMAC represents over 320 investment management firms registered to do business in Canada as portfolio managers (**PMs**) with the members of the Canadian Securities Administrators (**CSA**). In addition to this primary registration, the majority of our members are also registered as investment fund managers (**IFMs**) and/or exempt market dealers (**EMDs**). PMAC's members encompass both large and small firms and manage total assets in excess of $3 trillion as fiduciaries for institutional and private client portfolios.

PMAC's mission statement is "advancing standards". We are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection, harmonize regulation and benefit the capital markets as a whole.

We recognize CIRO's objective of harmonizing the rules applicable to Investment Dealers (**IDs**) and Mutual Fund Dealers (**MFDs**) in an effort to level the playing field for advisor compensation. Fundamentally, we believe that regulatory changes should

not be rushed and need to be implemented properly to minimize investor protection risk and regulatory arbitrage. It's also critical to fully analyze each option being proposed in the context of impact and changes needed to relevant tax, corporate and/or securities laws.

KEY RECOMMENDATIONS

1. **Determine whether the use of personal corporations in the investment sector complies with relevant corporate, securities and taxation laws.**

2. **If the use of personal corporations is to be permitted, harmonize their use across all registration categories and between provinces to minimize regulatory arbitrage.**

Discussion

MFD Rule 2.4.1(b) allows compensation earned by Approved Persons of sponsoring mutual fund dealers to be paid to an unregistered corporation, subject to certain conditions, except in Alberta. The ID Rules do not allow this compensation model. Throughout this paper we use the term "personal corporation" to refer to these corporations, to differentiate them from "professional corporations" governed by provincial corporate legislation, as further described below. Allowing its ID members to direct compensation to a personal corporation has been a policy priority for CIRO since its inception. The ability to maintain this compensation model was a key consideration for former MFDA member firms at the time of the merger of the SROs.

The 2021 CSA Position Paper 25-404 - *New Self-Regulatory Organization Framework* (**CSA Paper**) stated that a CSA Directed Commissions Working Group was being formed to consider these issues and make recommendations. We are not aware of any updates having been provided by this Working Group. Any findings and recommendations from the Working Group should be made public.

We believe that before making any changes, it should be determined whether the use of personal corporations in the manner described in the Position Paper complies with relevant corporate, securities and taxation laws. This determination may well indicate which of the proposed options, if any, is preferable from a regulatory point of view. As indicated in the Position Paper, any rule amendments should be subject to publication for public comment and CSA review and approval.[1] It is difficult to understand how stakeholders and the CSA can properly consider any proposed changes without this information.

[1] Position Paper, at page 1

Compliance with tax law

The "primary reason" cited in the Position Paper for the use of personal corporations is "the taxation of compensation earned by Approved Persons for the activities they engage in for their sponsoring Dealer Member". However, the Position Paper does not provide any discussion or analysis of the applicability of relevant tax laws. Currently, under securities legislation, only a registered individual or corporation can perform the registerable activity that generates the commissions.[2] The CSA Paper noted "the tax status of individual registrants who use a directed commission arrangement is unclear. A corporation that does not carry on the business for which commissions are paid, and merely acts as a conduit to receive commissions, may not be able to achieve the desired outcome for tax purposes."[3] The CSA Paper notes that registration of the corporation with relevant securities regulatory authorities may achieve the desired tax outcome.[4] This is because the corporation would become a registered entity, permitting it to receive compensation for performing registerable activity under securities law. We therefore believe that CIRO and the CSA should engage with the Canada Revenue Agency (**CRA**) and Revenue Quebec (**RQ**) to request a technical interpretation or advance tax ruling with respect to any proposed changes to confirm that the desired tax outcomes will be achieved.

Compliance with securities law

The phased approach recommended by CIRO will not achieve the desired tax outcome, and will result in regulatory arbitrage. There seems to be a patchwork of regulation across Canada to allow MFD registrants' use of personal corporations. We believe that if the use of these corporations is expanded, they should be subject to nationally harmonized regulation, including registration and oversight by CIRO and the CSA.

The Position Paper notes that currently, individuals registered under the MFD rules may receive compensation in a corporation that is not registered with securities regulators, provided that the activity being compensated is non-registerable activity.[5] CIRO notes in the Position Paper that it has "concerns about a lack of regulatory oversight over the activities Approved Persons carry out within the corporation to which commissions are directed under this arrangement, and whether the corporation is limiting its activities to non-registerable activities."[6]

We share CIRO's concerns. This consultation presents an opportunity to consider whether these corporations are being used and supervised in an appropriate manner,

[2] See for example, *Securities Act* (Ontario), RSO 1990, c S.5, s. 25
[3] CSA Paper, at page 6710
[4] Ibid
[5] Position Paper, at footnote 6 and page 3
[6] Position Paper, at page 5

whether to subject them heightened regulatory oversight, whether to impose restrictions on their ownership and activities or impose other measures to protect investors, and finally, whether to expand their use to other registrants. We recommend that such a review be conducted jointly by CIRO and the CSA.

If the use of personal corporations is to be expanded to other registrants and registerable activity, a framework should be developed for the proper registration and supervision of these corporations by CIRO and the CSA to ensure that their activities are limited to permissible activities. Their ownership should be restricted to minimize potential conflicts of interest, similar to the treatment of professional corporations in other sectors.[7] In our view, the legislative framework governing professional corporations for other professions would be a sound model for the incorporation of professionals in the investment sector.

Without consistent application of these important protections, we believe that investors could be put at risk. For example, under the current framework, it is not clear whether the corporation and shareholders other than the individual registrant would be subject to CIRO (or CSA) jurisdiction in the event of wrongdoing, would be responsible for investor losses, or whether the regulators would have insight into the corporation's solvency, as they do with respect to individual registrants. There are no minimum capital requirements for these corporations, as opposed to requirements for registered firms. During the consultation phase leading to the Client Focused Reforms, there was discussion of client-facing individuals using titles such as "President" (of an incorporated entity), which is misleading to clients and creates an uneven playing field. The CSA was powerless to address this concern, given its lack of jurisdiction over these corporations.[8] It would also need to be clear that the clients

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[7] For example, in Ontario, professional corporations (PCs) for specified professions are governed by the *Ontario Business Corporations Act* (OBCA). In addition to the OBCA, specific requirements for PCs are established by legislation pertaining to relevant licencing bodies. These requirements include naming conventions, the requirement to obtain an annual Certificate of Authorization, and specifying who is eligible to hold shares in the PC. For example, medical professionals overseen by the College of Physicians and Surgeons of Ontario (CPSO) may form a PC where all shares are owned by CPSO members, and officers and directors must also be shareholders. Non-voting shares may be held by a spouse, child or parent of the member or in trust for minor children. Similar requirements apply to PCs incorporated by legal professionals governed by the Law Society of Ontario (note that family members are not permitted to be shareholders of legal PCs). These PCs do not shield these professionals from liability, and the PCs can only engage in activities related to the professional practice of the licensee. See *Business Corporations Act*, R.S.O. 1990, c. B.16, ss. 3.1-3.4; *Regulated Health Professions Act, 1991*, S.O. 1991, c. 18, O.Reg 39/02: *Certificates of Authorization*; *Law Society Act*, R.S.O. 1990, c. L.8, ss. 61.0.1-61.0.9

[8] See CSA Notice of Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*: Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms) (2019), 42 OSCB (Supp-1), at page 14

are clients of the registered firm, and not the personal corporation. This is important from a supervisory and investor protection perspective.

Regulatory arbitrage

We are also concerned with the potential regulatory arbitrage that may result from the proposed changes. Currently there seems to be some confusion as to whether CSA-registered PM and EMD firms and their registered individuals can use personal corporations, and for what purposes. According to the CSA Paper this is permitted only in Manitoba and Saskatchewan, but CSA Staff have observed such structures in other provinces and in some cases have noted these as compliance deficiencies.[9] We are also aware that some CSA-registered firms are subject to custom terms and conditions to accommodate certain corporate structures. If CIRO-registered individuals are permitted to use personal corporations to conduct registerable activity, this should also be permitted for CSA-registered firms and individuals, to prevent regulatory arbitrage. The use of such corporations for CSA-registered firms and individuals should be harmonized across Canada.

The proposed changes will also have significant impacts on the industry, which may lead to additional burden for certain firms. If rules are not harmonized between CIRO and the CSA, and across all Canadian provinces, this will cause regulatory arbitrage and significantly impact the operations of registrant firms.

Considerations for firms

Future consultations must clarify which individuals will be permitted to use personal corporations within registrant firms, and which will not, and what type of compensation may be directed to the corporation. For example, would it be client-facing individuals only, or other investment professionals within a firm? This determination could result in an uneven playing field between individual registrants, leading to internal equity issues and position arbitrage within registered firms.

Regulatory changes should be neutral with respect to different business models. There are many different business models among registered firms, and different legal relationships with individuals performing registerable activity. For example, some individual registrants are employees of the registrant firm, some are independent contractors or in an agency relationship with the firm, and some are incorporated (such as some MFD Approved Persons). Allowing individuals to receive compensation through a corporation only works for firms using a principal/agent model. In this model, the principal is not liable for the agent's failure to declare income. This is not the case for firms in an employer/employee model.

[9] CSA Paper, at page 6710

If some individual registrants are permitted to incorporate while others are not, there will be an uneven playing field, resulting in pressure on firms to offer tax efficiency and shift to a principal/agency model and away from employer/employee relationships. This would have tremendous repercussions throughout the industry.

Moreover, if CIRO moves forward with an option that allows only compensation related to non-registerable activity to be directed to a personal corporation, the dealer firm will be required to allocate what portion of the compensation is related to registerable activity and what compensation is related to non-registerable activity, which will represent an enormous administrative burden and legal risk to the firm. The firm could be liable if it does not make the correct tax withholdings.

CONCLUSION

We recognize that a significant amount of time, effort and analysis has been spent on this project, by both CIRO and the CSA, and that the multi-jurisdictional nature of the project, beyond securities law, significantly adds to its complexity. However, we do not believe that this project should be rushed for the sake of providing a tax benefit to some registrants. This is especially the case given that the extent of any tax benefit is uncertain and has not been confirmed with the CRA. This important policy and legislative change could have serious repercussions for the industry and for the investing public. Therefore, we recommend that it be given further serious consideration, with more options being reviewed, and if CIRO and the CSA decide to move forward, that any proposed changes be subject to fulsome public consultation.

If you have any questions regarding the comments set out above, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Victoria Paris at (416) 802-4347.

Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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