



IIROC Response to:

**Consultation on Possible Options for the  
Incorporation of Individual Representatives  
of Registered Dealers and Advisers in  
Canada**

**February 25, 2011**

**Via E-mail**

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Dear Sirs/Mesdames:

RE: Consultation on Possible Options for the Incorporation of Individual  
Representatives of Registered Dealers and Advisers in Canada

On behalf of the Investment Industry Regulatory Organization of Canada ("IIROC"), I am pleased to respond to the Consultation on Possible Options for the Incorporation of Individual Representatives of Registered Dealers and Advisers in Canada (the "Consultation Paper").

As a national self-regulatory organization ("SRO") recognized by provincial securities regulators across Canada to oversee investment dealers and their registered employees, our mandate is to serve the public interest, to protect investors and to enhance market integrity.<sup>1</sup> IIROC currently regulates 208 investment dealers operating in 6,000 branches across Canada, employing over 28,000 individual registrants.

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<sup>1</sup> IIROC carries out its regulatory responsibilities through setting and enforcing rules regarding the proficiency, business and financial conduct of investment dealers and their registered employees and through setting and enforcing market integrity rules regarding trading activity on Canadian equity marketplaces.

Whether employees of investment dealers (“individual registrants”) should be allowed to re-direct remuneration to and declare any part of such remuneration in a personal corporation is not a regulatory issue and IIROC is not expressing any views as to what the outcome of the consultation process should be on this specific question posed in the Consultation Paper. IIROC has no objection per se to the proposal set out in the Consultation Paper to provide individual registrants with a more tax efficient business structure so long as investor protection is not compromised and the use of such structures complies with all applicable laws.

IIROC supports the principles identified in the 1999 CSA Distribution Structures Committee Position Paper (“CSA Paper”) in assessing alternative distribution structures and we propose the following additional principles: (a) the individual registrant should be personally responsible for complying with individual registration requirements and regulatory obligations and should be personally responsible to the regulator for failures to comply; and (b) the individual registrant should only be allowed to achieve the tax efficiencies of incorporation in full compliance with all applicable laws. Any incorporation model should be consistent with these principles, address the regulatory and accountability issues identified in the CSA Paper and ensure the protection of the investing public.

IIROC believes that a legislative option is clearly preferable over a change in IIROC Rules to permit commissions to be re-directed to unregistered corporations (“IIROC re-direction model”) for the reasons set forth below. There is, however, insufficient detail in the two legislative options set out in the Consultation Paper to comment on whether the legislative framework is consistent with the principles in the CSA Paper and those additional principles identified above, or whether investor protection concerns are adequately addressed.

IIROC acknowledges the uneven playing field resulting from the Canadian Securities Administrators’ (“CSA”) approval of MFDA Rule 2.4.1. If the objective of any future policy initiative is to level the playing field, IIROC believes that a legislative solution would most efficiently and effectively level the playing field amongst individual registrants of mutual fund dealers (MFDA), investment dealers (IIROC), registered advisors (CSA) and other dealer firms directly regulated by the CSA. IIROC also believes that a legislative solution would provide more certainty that investor protection will not be undermined versus relying on the rules and jurisdiction of the SROs which are largely based on contract. With an IIROC re-direction model, the framework of legal and regulatory protections is established by contract between the investment dealer, the individual registrant and the personal corporation. As with any relationship or arrangement based on contract, there is the potential for the validity and/or enforceability of its provisions to be subject to challenge from time to time.

The extent to which the personal corporations of MFDA salespersons are declaring commissions as income is not a matter of public record. However, it is on the public record and of regulatory concern that in some cases where salespersons have been challenged by CRA, it appears to have been held out to CRA that the registerable activity that generated the commissions was undertaken by the personal corporation. We would note, however, that this is currently prohibited by provincial securities legislation.

Any individual engaging in the business of trading in securities with an investment dealer must be approved by IIROC and registered with the applicable provincial securities commissions. IIROC performs the registration function of individuals pursuant to IIROC Rules and on behalf of most provincial securities commissions pursuant to Delegation Orders. An unregistered personal corporation would be in contravention of securities legislation if it engaged in trading activities for which the commission income was paid. The individual registrant would also be in contravention of securities legislation if the individual purported to engage in these trading activities on behalf of the unregistered corporation, because the individual's registration would only authorize this activity being carried out on behalf of the investment dealer.

The MFDA re-direction model does not reconcile the requirement in provincial securities legislation (i.e. that all registerable activities be conducted by individual registrants) with the requirement in tax legislation (i.e. that a corporation can only declare income that it earns from activities that the corporation undertakes). An IIROC rule permitting re-direction of commissions would have the same risks and limitations as the MFDA re-direction model.

In addition to the issue of the potential tax liability of individual registrants and their personal corporations in a re-direction model, IIROC is concerned with the potential tax liability of investment dealers paying commissions to unregistered corporations. There appears to be uncertainty from a tax compliance standpoint what the dealer is reporting; what withholding tax and source deduction obligations apply; and whether there is any potential tax liability arising from the general anti-avoidance provisions of the *Income Tax Act*. IIROC is concerned with the potential impact of any tax liability on the risk adjusted capital of the investment dealer, the measure of financial solvency of a firm.

The Consultation Paper states that legislative options 1 and 2 would involve potential tax revenue losses. This implies that an IIROC re-direction model would not. It should not be assumed that an IIROC re-direction model would result in no loss of tax revenue to the tax authorities. It is foreseeable that SRO rules that permit individual registrants to re-direct their commission income to their personal corporations will result in a number of cases where all or a significant portion of

the commission income generated by registerable activity will be declared in the personal corporation for tax purposes.

The Consultation Paper states that it is not clear that there would be tax benefits associated with a re-direction model. It is also not clear to IIROC what the purpose of a re-direction model would be if full tax efficiencies of incorporation cannot be achieved without contravening either securities law or tax law. We note that certain tax efficiencies can already be achieved through a principal/agent relationship between the investment dealer and the individual registrant, which is a business structure already permitted by IIROC Rules.

The proposal in 2006 by the Investment Dealers Association of Canada (IIROC's predecessor) sets out a framework where tax efficiencies would be achieved in full compliance with securities and tax legislation. The proposal required certain changes in provincial securities law to permit securities-related activities to be carried on by an individual registrant's personal corporation. The proposal contemplated contractual arrangements between the investment dealer and the individual registrant and between the investment dealer and IIROC, respectively, designed to ensure that the supervision and regulation of the activities of registered individuals who conduct their business through a corporation did not compromise investor protection. IIROC continues to believe that without a legislative change, requirements in securities and tax law cannot be reconciled in any incorporation model.

In response to the question posed in the Consultation Paper on whether there should be restrictions on the personal corporation, IIROC believes that there should be strict restrictions on directors, officers and shareholders and on the activities that may be carried out by the corporation. As IIROC's jurisdiction is over "securities-related activities" undertaken by the investment dealers and their individual registrants, it is essential to investor protection that these corporations be single-purpose vehicles.

We also note that the Consultation Paper refers throughout to the incorporation model being applicable to "salespersons". "Salesperson" was the individual registration category that existed under provincial and territorial securities law for individuals acting on behalf of investment dealers prior to the implementation of National Instrument 31-103 *Registration Requirements and Exemptions*. These registered individuals have been renamed "dealing representative" for purposes of provincial and territorial securities law. Currently, any "dealing representative" purporting to be engaged in securities-related activities on behalf of an unregistered corporation to which commissions are re-directed would be in contravention of both IIROC Rules and provincial securities laws. Therefore, any incorporation model should be applicable to not only "salespersons" but to any

employee of a dealer/adviser trading or advising in securities. These would include traders at investment dealers and any other employees acting in a registerable capacity.

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In summary, IIROC has no objection per se to an incorporation model being adopted by the investment industry so long as investor protection is not compromised and the use of such structures complies with all applicable laws. IIROC believes that a legislative solution would most efficiently and effectively level the playing field amongst individual registrants of mutual fund dealers (MFDA), investment dealers (IIROC), registered advisors (CSA) and other dealer firms directly regulated by the CSA. IIROC's focus on any legislative proposal that would permit incorporation of individual registrants engaging in the trading or advising in securities is on the protection of the investing public. We would be pleased to comment on specific draft language of a legislative proposal in order to provide more concrete comments in this regard. To the extent that IIROC Rules may be required to supplement the legislation, we are committed to doing our part within the securities regulatory framework to ensure that investor protection is not compromised.

In the meantime, please do not hesitate to contact me should you have any questions or comments on our submission. We consent to the provision of this submission to the other government organizations and to its publication on the government's website.

Yours truly,



Rosemary Chan  
Senior Vice President and General Counsel

cc. Susan Wolburgh Jenah, President & CEO, IIROC  
Paul Riccardi, Senior Vice President, Enforcement, Policy & Registration, IIROC