

# IIROC NOTICE

## **Rules Notice Response to Comments**

Dealer Member Rules

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**16-0230**

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## **IIROC White Paper**

### **The Public Policy Implications of Changes to Rules Regarding Proficiency Upgrade Requirements and Directed Commissions on the IIROC Platform**

#### **Response to comments**

#### **Executive summary**

IIROC is committed to making the delivery of securities regulation in Canada more efficient by reducing regulatory gaps and overlaps and harmonizing our requirements and standards with those on other regulatory platforms, while maintaining or enhancing investor protection. With this goal in mind, we sought comment (the White Paper)<sup>1</sup> on an illustrative proposal that would allow firms and individuals to conduct, under IIROC's regulatory oversight, a business that is limited to mutual funds and exchange-traded funds. The proposal would achieve a consistent approach to the regulation of MFDA<sup>2</sup> and IIROC registrants on two key fronts: proficiency and directed commissions.

In response to the comments on the White Paper, we will:

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<sup>1</sup> See IIROC Notice 15-0260 published November 25, 2015.

<sup>2</sup> Mutual Fund Dealers Association of Canada.

1. Actively participate in the Canadian Securities Administrators' (**CSA**) consultation on enhancing registrant obligations towards clients<sup>3</sup> (which includes targeted reforms to enhance proficiency requirements on some platforms).
2. Seek clarification from federal authorities on the tax rules applicable to directed commissions.
3. On a case-by-case basis, work with interested firms to help their advisors upgrade to meet IIROC's proficiency requirements as efficiently as possible.
4. Engage our partner regulators, government authorities, investors and other stakeholders in initiatives to reduce fragmentation, burden, and arbitrage across regulatory platforms while maintaining or increasing investor protection.

Our response reflects the wide range of opinions put forward in response to the White Paper and the legitimate concerns raised therein, each of which will need to be addressed individually.

It also reflects a number of developments in the policy landscape since we published the White Paper, including proposals put forward by both our CSA partners and some of their governments that may render elements of the White Paper moot.

This notice summarizes the comments we received on the illustrative proposal and outlines our response.

## **Background**

The illustrative proposal focused on two things:

1. Eliminating IIROC's current requirement for an individual to be qualified, within nine months of approval as a dealing representative on the IIROC platform, to offer a full range of investment products (the **proficiency upgrade requirement**) and instead allowing firms and individuals to offer only mutual funds and exchange-traded funds<sup>4</sup>.
2. Allowing all firms and individuals under IIROC's regulatory oversight to take advantage of "directed commissions"<sup>5</sup>, something not permitted under current IIROC rules but permitted on the MFDA platform for many years.

The proposal would open up the opportunity for mutual fund dealing representatives to move to the IIROC platform to carry on their mutual fund sales activities, and for IIROC to consider the desirability of a new category of approval for mutual-fund-only firms and individuals.

The White Paper identified a number of policy considerations for stakeholders to take into account in answering the following:

1. Would you support the illustrative proposal as being in the public interest?

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<sup>3</sup> CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients* published April 28, 2016.

<sup>4</sup> (with appropriate adjustments for the relative risk of such firms and individuals to IIROC's proficiency, supervisory and oversight requirements)

<sup>5</sup> *Directed commission* is distinct from the idea of an *incorporated salesperson*, which is the ability of an individual to carry on registrable activities (e.g. trading or advising activities) through a corporation that is itself registered under securities legislation.

2. What impact would the adoption of this proposal have on each of the following, and how should these impacts be addressed:
  - a. investors
  - b. registered firms
  - c. registered individuals
  - d. Canadian regulatory and financial industry structure?

The White Paper also raised many complex and inter-related issues that have broad policy implications. We signaled that the illustrative proposal was a possible first step in what, if pursued, would be an extensive consultative process.

### **Summary of comments**

We thank all commenters for taking the time to consider the issues in the White Paper and provide thoughtful comments. We received 36 public comment letters<sup>6</sup> representing a broad spectrum of investment industry participants. The commenters included:

1. Individuals (both investors and individual registrants)
2. IIROC dealer members including:
  - a. multi-platform dealers (e.g. IIROC, MFDA and/or provincial/territorial securities commissions (**CSA jurisdictions**)) representing both employer/employee and agent/principal models
  - b. single platform dealers representing both employer/employee and principal/agent models
  - c. dealers with dually registered individuals (e.g. securities and insurance)
  - d. mutual fund dealers including multi-platform dealers (e.g. mutual funds and insurance)
3. Portfolio managers registered with one or more CSA jurisdictions
4. Industry associations
5. Advocacy organizations
6. Insurance companies

### *Common themes*

A number of common themes permeated the comments on the issues specifically discussed in the White Paper and addressed broader regulatory issues. Key themes are:

1. The importance of regulatory harmonization and efficiency, the need to reduce regulatory overlap, regulatory arbitrage, inconsistencies across registrant platforms (e.g. IIROC and MFDA), and the challenges and costs created by multiple registrant platforms.

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<sup>6</sup> All public comment letters are available on the IIROC website at <http://www.iroc.ca/SitePages/Comments-Received.aspx?linkid=1133>

2. The need for Canadian regulators (i.e. both self-regulatory organizations and CSA jurisdictions) to work together to increase the effectiveness of the current regulatory regime but without compromising investor protection.
3. Concern that the illustrative proposal would destabilize or reduce the economic viability of the MFDA – something that could have a disproportionate and negative impact on dealers and their clients in smaller communities across Canada.
4. The need to reduce regulatory barriers that do not affect investor protection but that interfere with a firm's flexibility in structuring its wealth management business to respond to rapidly evolving investor needs.
5. Concern that the investment industry is facing economic challenges and is overwhelmed with current regulatory initiatives that need attention (e.g. Point of Sale, CRM2), making this not the right time for the changes discussed in the White Paper.

#### *Comments on eliminating the proficiency upgrade requirement*

These comments ranged from full support to qualified support to full opposition. Those in full support commented that:

1. Regulators should remove unnecessary barriers for individual registrants to provide them more choice and employment opportunities.
2. The proposal is better for investors in the longer term as they would not need to change firms as their investing requirements become more sophisticated.
3. The proposal is beneficial for firms that could consolidate systems, platforms, operational functions, and oversight.

Those taking a qualified position commented that:

1. A simplified registration regime, with reasonable proficiency requirements commensurate with the nature and complexity of the products sold, is desirable.
2. Further discussion among regulators is required before taking a position, as well as consideration of the impact on the MFDA and on small and medium-size dealers who rely on the expertise of the MFDA.
3. Further details on the illustrative proposal are required to understand fully its implications.

Some commenters think the illustrative proposal is not in the best interest of the public generally. Others think it is not in the public interest at this time and that more work/research is required. They commented that:

1. A higher proficiency standard for all registrants is more appropriate and better for investors.
2. The illustrative proposal is disruptive to the MFDA; it could cause disorderly and costly disruption to the SRO structure.
3. The proposal is not a priority with respect to investor protection and would be harmful.

### *Comments on allowing directed commissions on the IIROC platform*

These comments also ranged from full support to qualified support to full opposition. Those in full support commented that:

1. The illustrative proposal will level the playing field – especially for independent and small firms.
2. Investor protection would not be compromised as long as there were appropriate requirements in place that cover supervision, conflicts, access to books and records, and legal responsibility to clients. Commenters pointed to the lengthy experience on the MFDA platform as evidence of this position.
3. Regulators and firms are capable of putting an appropriate regime in place to accommodate directed commissions on the IIROC platform.

Those taking a qualified position commented that:

1. They support directed commissions until (if) “incorporated salesperson” legislation is implemented.
2. They support directed commissions on the IIROC platform provided it is permitted on the same basis – both from an investor protection and regulatory requirements perspective – as is permitted on the MFDA platform.
3. There are issues that need clarification before considering the proposal further, including supervision, liability, employment, and tax treatment.
4. The two proposals – proficiency upgrade and directed commissions – are two distinct issues and should be considered separately.

Comments from those opposed included:

1. Pursuing legislative change (i.e. incorporated salesperson) may be a better solution for both the MFDA and IIROC platforms than the expansion of directed commissions.
2. The proposal is not a priority with respect to investor protection and would be harmful.

### **Our response to the comments**

The broad policy issues raised by the White paper and crystallized by the comments we received affect investors, dealers, and individual registrants and go well beyond the narrow questions posed in the document.

As a public interest regulator, IIROC is committed to improving oversight of our Dealer Members and their individual representatives in order to protect investors and support healthy capital markets. Our response to the comments on the White Paper, therefore, reflects our view of how we can further the execution of our public interest mandate.

We also considered the impact on the illustrative proposal of the range of financial industry and investor protection issues that other regulators and governments in Canada are currently considering. These

include CSA policy initiatives, work on the regulation of financial planning activities<sup>7</sup> and the financial services and pension sectors in Ontario<sup>8</sup>, and possible amendments to the legislation governing financial services distribution in Québec.

The CSA's recently published Consultation Paper 33-404 discusses targeted reforms to enhance the obligations of advisers, dealers, and representatives toward their clients and, in certain CSA jurisdictions, the introduction of an overarching regulatory best interest standard. The CSA proposals touch on a number of foundational elements of the securities regulatory regime, including proficiency requirements (which raise many of the same issues as IIROC's illustrative proposal to eliminate the proficiency upgrade requirement did). The CSA has also published its next steps in the examination of mutual fund fees, the outcome of which may affect how mutual funds are distributed.

And finally, as part of our recently-published three-year Strategic Plan<sup>9</sup>, we intend to enhance our delivery of value within the Canadian regulatory framework in ways that will benefit the system by reducing regulatory fragmentation, burden and arbitrage across platforms.

In light of this dynamic regulatory environment, we will pursue the following, some of which are already in progress:

1. Participate actively in the CSA's consultation on the issues set out in its Consultation Paper 33-404. The targeted reforms on proficiency put forward by the CSA would result in a more harmonized proficiency standard across regulatory platforms. If implemented, these reforms could make the elimination of IIROC's proficiency upgrade requirement unnecessary or less impactful on industry participants.
2. Seek clarification from federal authorities on the tax rules applicable to directed commissions when used by individual registrants particularly given that, despite comments in opposition to directed commissions on the IIROC platform, there was no suggestion that the current practice on other platforms should cease.
3. On a case-by-case basis, work with interested firms to help their advisors upgrade to meet IIROC's proficiency requirements as efficiently as possible.
4. Engage our partner regulators, government authorities, investors and other stakeholders in initiatives to reduce fragmentation, burden, and arbitrage across regulatory platforms while maintaining or increasing investor protection.

We look forward to engaging with our fellow regulators and other industry stakeholders on these important issues.

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<sup>7</sup> For more details, see the Preliminary Policy Recommendations of the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives published April 5, 2016.

<sup>8</sup> For more details, see the Final Report regarding the mandate reviews of the Financial Services Commissions of Ontario, Financial Services Tribunal, and the Deposit Insurance Corporation of Ontario published on March 31, 2016.

<sup>9</sup> <http://www.iiroc.ca/news/Pages/Annual-Reports.aspx>