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Ms. Marsha Manolescu
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M. François Bouchard
Directeur, Direction de l'encadrement du secteur financier
Ministère des Finances Québec
8, rue Cook, 4e étage
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Dear Ms. Manolescu and M. Bouchard,

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

Advocis appreciates the opportunity to comment on the Consultation on Possible Options for the Incorporation of Individual Representatives of Registered Dealers and Advisers in Canada.

Advocis, The Financial Advisors Association of Canada, is the largest and oldest voluntary professional membership association of financial advisors and planners in Canada. Our members are provincially licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across Canada. Advocis members are professional financial advisors who provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, long-term care and critical illness insurance to millions of Canadian households and businesses.

Generally, provincial securities legislation does not permit incorporated entities or 'sales companies' to register for the purpose of making trades in securities. Many provincial securities acts define a 'salesperson' as an individual who is employed by a dealer for the purpose of making trades in securities. The term 'individual' does not include an incorporated entity and sales companies do not fall within the definition of 'salesperson'. Further, most provincial securities legislation does not permit incorporated entities, or 'sales companies' to register for the purpose of making trades in securities.

Our proposed permanent solution includes changing the definition of 'salesperson' in the securities act to include the concept of a person 'including a corporation' that trades in securities on behalf of a dealer, and prescribes the conditions for a corporation to be registered as a salesperson.

In addition, our proposal seeks to establish broad parameters for incorporation which would resemble the requirements for an incorporated life insurance agent, as many advisors are dually licensed for insurance and securities.

Advocis believes that any new requirements should not constrict current practices in respect of the type of corporate structures currently in existence. At present, a significant number of mutual fund advisors in Canada use general purpose corporations to operate their business. Under the current provincial regulatory structures permitting incorporation, we are not aware of situations where mutual fund licensees operating through these corporate structures have impeded regulatory scrutiny of their business or shielded themselves from any obligations or liability to clients. Indeed, the research provided by the Mutual Fund Dealers Association of Canada (MFDA) in support of amended Rule 2.4.1 supports this position. Ours proposed solution allows for this flexibility while maintaining a high degree of consumer protection. In this respect, Advocis has done considerable legal research on the issue of incorporation which we have shared with securities regulators across Canada, addressing many of the questions and concerns raised by securities regulators[1].

Should governments allow individual representatives of registered dealers and advisers to incorporate?

It is customary practice for professionals to incorporate. Incorporation allows professionals to take advantage of the beneficial tax treatment extended to incorporated entities and the administrative and succession planning benefits that corporations accommodate. Care has been taken to ensure that professionals who incorporate remain fully accountable to their clients. However, due to restrictions in many securities acts, financial advisors were one of the last professions unable to take advantage of the corporate structure. Stated another way, while MFDA Rules have been amended to accommodate advisor incorporation in most jurisdictions, current securities laws and regulations have not kept pace with modern business resulting in continuing and needless uncertainty with respect to tax implications and the increased possibility for an adverse tax ruling by the Canada Revenue Agency.

With the approval of the various provincial securities commissions, the MFDA Rule, that required that any remuneration in respect of business conducted by an Approved Person on behalf of a Member be paid by the Member (or an affiliate) directly to and in the name of the Approved Person, was temporarily suspended through the issuance of exemption, or blanket orders, allowing an advisor's corporation to receive payments. Ultimately, MFDA Rule 2.4.1 was amended to allow for advisor incorporation.

Of particular relevance is that over the period of time that the MFDA Rule was suspended, the MFDA collected data and it was demonstrated that neither consumers nor the Approved Persons/Members relationships were harmed when the rule was suspended.

The MFDA application to amend MFDA Rule 2.4.1 that was submitted to the Recognizing Jurisdictions on July 16, 2008 stated the following:

[1] Please see Appendix – BLG LLP Memo to Advocis, Incorporation of Professionals in the Securities Industry, November 15, 2007

"Over the course of the suspension period for the Rule, the MFDA has had the opportunity to review the effect of the suspension on the application of other MFDA Rules and its potential effect on other investor protections issues. MFDA staff estimated that of the approximately 75,000 registered Approved Persons, approximately 35,000 are those of bank-owned Members that do not rely on the suspension of the Rule and that a high proportion of the approximately 40,000 Approved Persons that remain are likely to rely on its suspension. **Despite these large numbers and the fact that the suspension has been in place for several years, the MFDA has not experienced any affect on the regulatory liability of Approved Persons arising from the payment of commissions to corporations and is unaware of any changes in the industry that might increase the risk of negative impacts** since the last suspension was granted. In addition, **payment of commissions to non-registered corporations is a long-standing business practice that predates the establishment of the MFDA and concerns have been expressed that it would be disruptive to industry to disallow it. Based on this information, the MFDA is satisfied that the arrangements currently in place *do not raise investor protection concerns* and that *allowing them to continue would not be contrary to the public interest*."** [emphasis added]

In addition to our involvement in working toward the successful amendment to MFDA Rule 2.4.1, Advocis has presented provincial securities commissions across Canada with the required legislative changes needed to securities law that would allow for advisor incorporation, and the suppression of the requirement for the corporation to be a registrant under securities law. Our envisioned structure would allow advisors to take advantage of a corporate structure, and there would be no added compliance burden or cost associated with both the Approved Person and his/her corporation being required to be registrants under the act. The Advocis proposal is a cost efficient solution that preserves consumer protection.

If yes to question 2, which incorporation option would in your view to be the most effective and balanced alternative?

Evidence gathered by the MFDA clearly indicates that they are aware of no instances of consumer harm, or of conflict with existing rules under the current method of dealing with this issue. It follows, that in the absence of a compelling reason to the contrary, the permanent solution should mirror what is taking place in the current business environment.

The Advocis solution would simply require slight modifications to existing definitions in securities law. Additionally, it would require that the requirement under securities law for the corporation to be a registrant be suppressed through an exemption, or blanket order.

We would also note that this is how the matter is currently being dealt with in a number of jurisdictions, and as noted above consumers have not been disadvantaged in any way.

The imposition of additional requirements and red tape is clearly unnecessary. Added compliance burdens and costs, in the face of evidence collected by the regulator that demonstrates that neither consumers nor the industry have been harmed, is unjustifiable.

Needless compliance requirements and costs only serve to make it more difficult for those in the industry to stay in the industry. It also makes it more difficult to attract new people to the profession, as the cost of entry becomes a barrier.

Advocis has long argued that prior to implementing new legislation or regulation, that governments and regulators first identify the problem, and the policy outcome they hope to

achieve. Practicality would then dictate that governments and regulators implement the least costly and intrusive means available to achieve the desired outcome.

In this instance the policy objective is to ensure consumer protection and ensure that the existing rules are not harmed through the incorporation of financial advisors. The evidence gathered by the regulators indicates that the existing interim solution has achieved the desired policy outcome. Accordingly, the technical amendments needed to securities legislation and the continued suppression of the requirement for the corporation to be a registrant makes common sense.

Advocis proposes that the key legislative amendments to the definitions sections of the applicable securities acts should explicitly state that an 'adviser', 'salesperson', or 'person' captures the concept of a corporation. Further, a commitment from the commissions to issue exemption orders, blanket orders, or local instruments exempting corporations from the registration requirements under the applicable securities acts.

Are there other provisions or options that should be considered to ensure that the use of a corporation continues to preserve the registrant-client legal relationship for both firms and individual sales representatives and provides for proper oversight of individual sales representatives by their registered dealer and adviser?

Some CSA members argue that if the sales corporation is not registered, then there exists the consumer protection problem regarding liability of the corporation versus that of the individual registrant. A sales company does not have the statutory obligation a registrant does under securities legislation (i.e., securities law does not necessarily apply to an unregistered corporation). Furthermore, some CSA members assert that liability and obligations between the sales company and the client would be provided only through contractual arrangements, which may not provide the client with sufficient protections, despite legal research that illustrates the contrary.[2]

In order to preserve ongoing consumer protection and appropriate Member oversight, we proposed that the legislation around the definition of salesperson strip away the corporate veil but only against liability for market conduct related to the registered activity in the sale and distribution of securities. Some securities commissions, it was suggested, may wish to impose statutory provisions for greater clarity. Various provinces have adopted legislation that permits some professions to incorporate while preserving the accountability of the individual, such as those found under some Business Corporations Acts. Advocis would consider certain provisions under securities legislation, such as the following:

- The acts of the salesperson corporation are deemed to be the acts of its salesperson shareholders and its employees or agents;
- The liability of an individual salesperson for a claim arising out of his or her obligations as a salesperson is not affected by the fact that the salesperson is engaged in the activities of a salesperson through a salesperson corporation;
- An individual salesperson is jointly and severally liable with the salesperson corporation for all liability claims made against the corporation arising out of the activities of a

[2] Please see Appendix – BLG LLP Memo to Advocis, Incorporation of Professionals in the Securities Industry, November 1, 2007)

salesperson in respect of errors or omissions that were made or occurred while the salesperson was a shareholder of the corporation;
- The liability of an individual salesperson cannot be greater than his or her liability would be in the circumstances if he or she were not practicing through the corporation.

Additional assurances that registrant salespersons will not seek shelter from their obligations behind the corporate veil can be accomplished through a requirement that a salesperson, his or her corporation and the dealer enter into a suitable contract with prescribed terms that address that concern. Those contracts would include undertakings and waivers that preserve the status quo of individual accountability and, in effect, reduce the corporation to a conduit for expenses and compensation, as has been the case for other professions and business groups.

Do you have any concerns or comments about potential income tax consequences or regulatory obstacles regarding each option?

The ability of mutual fund advisors in some provinces to operate through corporations has been achieved, first, through provincial securities commissions suspending MFDA Rule 2.4.1 (Remuneration, Commission and Fees – Payment by Member Only), and most recently through the amended MFDA Rule 2.4.1 that was approved by all Recognizing Jurisdictions.

Despite the changes to MFDA Rule 2.4.1 the corporation might not be viewed as actually carrying on the business of trading in securities, posing a tax exposure risk if the corporation is not properly structured. To provide greater clarity on the tax issue, three provinces (British Columbia, Manitoba, and New Brunswick) have issued blanket orders or local instruments stating that these corporations are not required to be registrants under their securities acts. It is accepted that having the Approved Person as a registrant was sufficient. To require both the Approved Person and his/her corporation to be registrants was unnecessary.

A condition to incorporation contained in the amended MFDA Rule 2.4.1 is that "such arrangements are not prohibited or otherwise limited by relevant securities legislation"[3]. Currently both the definition sections of most securities acts and the registration requirements are legislative barriers to incorporation[4]. The MFDA Rule further states, as a condition of incorporation, that the arrangements not be prohibited by, "securities regulatory authorities"[5]. While the policy objective is to allow for incorporation, the drafting of securities law in most jurisdictions is an obstacle.

Clearly the policy intent is to allow for incorporation. To buttress the argument that the business is conducted by the corporation, it is important that securities legislation be amended in such a way as to support the policy objective. As previously noted, some jurisdictions have amended their securities legislation in line with the policy objective of allowing for incorporation. Additionally, a number of jurisdictions have issued exemptions suppressing the requirement that the corporation be a registrant under securities law. What is now needed is the amendment of securities legislation across all jurisdictions which removes any doubt that advisors can incorporate and that the corporation is in the business of providing securities services.

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[3] Proposed Amendment to Rule 2.4.1 (b)(i).

[4] This is an example of why Advocis feels the MFDA should make the point to the CSA that the Proposed Amendments to Rule 2.4.1 are part one of a two part process.

[5] Proposed Amendment to Rule 2.4.1 (b)(i).

While the Canada Revenue Agency ("CRA") has not been actively pursuing the tax issues, the CRA may argue that the individual is not carrying on the securities related business through the corporation but remains an individual agent or employee of the dealer and thus should be taxed as an individual – i.e., the corporation must be actually carrying on the business of trading in securities. This remains a tax exposure risk for financial advisors taking advantage of this business structure if the corporation is not established properly. The Tax Court of Canada case *Boutelier v. Her Majesty the Queen* (February 10, 2007) provides guidance as to what constitutes an appropriate structure for a corporation to be considered actively earning securities related income.

All reasonable steps should be taken to minimize this risk and the Advocis proposal helps achieve this goal.

Do you have any concerns or comments about the potential impact of the incorporation options on investor protection?

Federal and provincial governments have identified the important role that financial advisors play in educating consumers and helping them achieve their financial goals.

The model for advisor incorporation presented by Advocis is the least intrusive model presented that ensures continuing consumer protection at a low cost to advisors and government.

Investor protection is clearly preserved under the MFDA amended Rule 2.4.1. This rule has essentially captured the conditions established by the provincial securities regulators in their exemption orders that allowed for the preexisting MFDA Rule 2.4.1 to be suppressed. The next logical step is for those elements in securities legislation to be changed so that they are compatible with the SRO rules.

Thank you for the opportunity to present our views. We look forward to working with you in resolving this most important issue.

Sincerely,

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