Debate over MFDA salesperson incorporation continues in the wake of new proposals from the CSA

The long-standing debate on whether registered salespersons should be permitted to incorporate has recently recharged. In October 2007, the Manitoba Securities Commission exempted salespersons in the investment industry from the Manitoba Securities Dealer Registration Requirements Act solely to allow them to register as corporations. While directors, officers and shareholders of the corporation and the dealer must have a written contract under which the dealer will be liable for the acts or omissions of the corporation that relate to the securities business, the corporation also must make its books and records available for inspection by the Manitoba Securities Commission.

The issue of “incorporated” salespersons in the investment industry has been under review for well over 10 years. The then newly established Mutual Fund Dealers Association of Canada (MFDA) initially passed a rule in 1999 that would have, in effect, prohibited the incorporated salesperson structure, since dealers were not to pay commissions to anyone other than a registered salesperson (an individual) who earned that commission. Once the MFMA became operational in 2001, this rule was suspended, largely in recognition that corporate business structures had been customary for mutual fund salespersons for some time. Notwithstanding this suspension, which continues today, several provincial securities commissions indicated that they did not permit commissions to be paid by dealers to anyone other than a registered salesperson, although the regulators in British Columbia, and now Manitoba, later crafted exemptions to permit these payments.

Many believe that an incorporated business structure provides flexibility for the Canadian investment industry and recognizes the evolving organizational structures in the provision of financial services in Canada. In recent years, the relationship between a dealer firm and an individual advisor has been changing into a relationship that is entered into between the dealer firm and groups of independent advisors. These groups function within existing firms with operations that are increasingly independent — independent in terms of controls over operating expenses and revenues, product lines and branding — while still under the umbrella of the dealer’s regulatory compliance and investor protection systems.

Proponents of the incorporated salesperson model believe that a corporate structure would offer advisor groups the most tax-efficient structure to manage expenses and cash flow. The Canadian Securities Administrators (CSA) has reiterated its concerns with incorporated salespersons, which centre on a perceived lack of a public interest policy for the model and concerns over maintaining an adequate level of investor protection. The CSA believes that in the absence of a requirement for the salesperson’s corporation to be registered, investor protection could be compromised as the salesperson’s corporation would not have the statutory obligations that a registrant has under Canadian securities legislation. Moreover, the CSA has stated that regulators would be more limited in their ability to deal with issues related to improper trading, among other things, since one link in the chain — the salesperson’s corporation — would, in the view of some CSA members, be outside the regulatory regime.

The industry, however, has voiced many arguments in favour of allowing incorporated salespersons. This business structure would level the playing field among investment professionals and other professionals who are allowed to incorporate, including insurance agents, lawyers, doctors, accountants, architects, engineers, etc. It would also support current investment industry harmonization and uniformity initiatives.

The Investment Industry Association of Canada (IIAC) has indicated that allowing advisors to incorporate would remove an obstacle to advisor migration from the MFDA to an Investment Dealers Association of Canada (IDA) platform, which would result in the IDA-regulated advisor being subject to increased proficiency and continuing education standards and having the ability to offer a greater degree of choice to clients.

One has to wonder whether the level of legal and regulatory risk that would exist if incorporated salespersons were permitted would be materially greater than the risks that arise from the current permitted model used by dealer firms of engaging individuals either as employees or agents (independent contractors). An adequate legal and regulatory framework would be constructed for a corporate model, which would include contractual liability of the dealer firm and a salesperson’s corporation to customers, protection of customer assets, confidentiality, confidentiality protection, supervision and preservation of regulatory oversight through books and records access. The investment industry recognizes that in order to allow this business structure to be implemented, the integrity of investor protection must be preserved. The solid business case in favour of incorporated salespersons has been acknowledged, in part, by the CSA. In releasing the draft registration reform rule — National Instrument 31-103 – in February 2007, the CSA conceded that the incorporated salesperson issue was not dealt with by the proposals, but indicated that they intend to address this issue. Let’s hope that the second draft of National Instrument 31-103, which is to be issued in the coming weeks, provides a framework for this business structure, which can then be made effective on a parallel time-frame to the implementation of the registration reform proposals.

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