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ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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October 8, 2010

Dear Sirs/Mesdames:

Re: Clarification re: Scope of Referral Arrangements Provisions in NI 31-103 (the Referral Provisions or Provisions)

We write on behalf of our members to seek clarification and provide input in respect of the intended scope of Division 3, Referral Arrangements, of NI 31-103 *Registration Requirements and Exemptions.*

In response to the number of concerns and questions raised by the Provisions, the IIAC formed a working group to isolate the key issues for clarification and provide regulators with information and member firm perspectives on the practical application of this section of the regulation.

The definitions of “referral arrangement” and “referral fee” in the Instrument are very broad, and can be interpreted to encompass a number of situations that are unrelated to investor protection, and ultimately would result in meaningless disclosure being provided to clients, while creating a significant compliance and administrative burden on firms.

Members support the intent of the Referral Provisions, to the extent that they ensure clients are informed when their advisor, or potential advisor obtains or pays material compensation for the referral. Given the potential for conflicts, clients are entitled to understand the nature of the relationship between the referrer, and the party receiving the referral, so that they can make an informed choice as to whether they wish to retain

the services of the party to which they were referred. This transparency enhances investor confidence in the industry and trust in their specific advisors.

The potentially broad application of the Provisions, however, has created significant regulatory uncertainty, as firms attempt to ascertain the intended scope and comply with the requirements. The result is inconsistency in respect of industry practice, and the disclosure provided to clients. As such, it is important that clear guidance be issued relating to the application and non-application of the Provisions in various situations.

The IIAC working group has several questions relating to the intended scope and application of the Referral Provisions. We submit these questions and feedback from the working group for your consideration. Our objective is to help establish the appropriate scope of the Provisions, and provide guidance to the industry about the situations in which they apply.

The questions and industry feedback relate to three broad areas: the services to which the Referral Provisions apply, internal vs. external referrals, and the clarification of what constitutes compensation.

1. Services / Industries to which the Referral Provisions apply

Q: Assuming there is some form of compensation involved, do the Provisions apply when an IIROC registrant refers a client to a non-IIROC registrant employed by a different firm, for services that do not relate to IIROC registerable activities? (eg: providing services related to the sale of insurance products) Does the application differ if the referral relates to services wholly outside the financial industry for which there is no implied knowledge or expertise on behalf of the referrer, for example, for physiotherapy?

The Companion Policy states that the application of the Provisions are "not limited to referrals for providing investment products, financial services or services requiring registration. It also includes receiving a referral fee for providing a client name and contact information to an individual or firm." We agree that particularly in respect of referrals relating to any investment or financial product and service, it is appropriate for clients to be informed about compensation arrangements relating to referrals. The rationale is that a client would likely have an expectation that any financial advisor (whether registered or not) has special expertise and knowledge that lends credibility to their referrals within the broad category of financial services. As such, disclosure is important to provide a balance to uninformed reliance on the advisor's expertise and credibility in matters involving financial services.

The Provisions, however, are so broadly worded that they also appear to apply to referrals that are clearly outside the industry and perceived expertise of the registrant or person governed by securities industry regulation. For instance, if a registrant refers a client to their massage therapist or dentist, and receives compensation of any form, this would technically attract the requirement for written agreements and disclosure. We do not believe it was the intent of the regulation to extend to these types of activities. Concerns regarding unauthorized solicitation or the provision of contact information are appropriately

dealt with under other legislation dealing with privacy, including PIPEDA, Do Not Call legislation and the proposed Do Not Email legislation. As such, we believe it would be helpful to explicitly limit the scope of the Referral Provisions to services that are reasonably connected to the provision of financial services. This does not preclude the application of the Provisions to non-registrable activities, and could include legal and accounting services related to financial matters.

It would be helpful to clearly and specifically articulate these types of examples in an FAQ document.

2. Internal vs. External Referrals

Q: Are referrals within a firm, as opposed to referrals to third party individuals or firms subject to the Provisions?

Members are extremely concerned about the potential application of the Referral Provisions to client transfers within a firm, whether through the departure, retirement or death of an IA, or in relation to an IA referring a client to an appropriately licensed colleague that engages in business that the advisor is not licensed to undertake. There are a number of reasons why such internal referrals should not be subject to the Provisions.

First, clients understand that firms will seek to retain their business for any services that it can provide, rather than refer them out to a competitor. As such, the client is not put into a position where they would reasonably believe that the referral is made on a completely objective and independent basis, as may be the case with referrals to third parties.

Second, any compensation that may be provided in these situations is more appropriately characterized as an internal allocation of resources, as the entities distributing and receiving the fee are one and the same.

Practically, for large firms with several divisions, the application of the Referral Provisions would result in potentially thousands of internal contracts and disclosure documents relating to internal referrals for mortgages and other loans, credit card services, mutual funds, and insurance etc., being generated on a weekly basis. This exercise would not result in increased investor protection, and would inundate clients with irrelevant and unwanted documentation.

Q: Should the purchase of lists be considered a referral arrangement?

The mere purchase of a list of potential clients without a direct referral from, or reference to, the seller of the list, should not be considered a referral. Without the direct and specific action of making a reference to the client, the client would not be relying on their advisor's opinion or professionalism as a result of being on a list received from the seller. As such, concerns about conflict of interest would not be relevant. In purchasing a list from a list providing service, advisors are also bound to comply with privacy and Do Not Call legislation which severely

restricts their ability to contact subscribed clients in the absence of express consent.

Q: Should a finders' fee be considered a referral arrangement?

When an advisor provides a client name to an issuer in respect to a financing, IIROC MR 0481 indicates that any resulting transaction must be conducted "on book" and as such, payment should be treated the same as a commission, where a trade confirmation is issued. These transactions have not, and should not be considered to be a referral.

3. Compensation

Q: What are the defining elements of "compensation"? Are the following factors considered?

- **Uncertain or unquantifiable compensation**
- **One-off referrals**
- **"Gifts of appreciation" where there was no expectation of reward or compensation**
- **Materiality**

In order to fall within the Referral Provisions, there must be an element of compensation. In many cases, particularly where there is a commission splitting arrangement or where compensation is based on the types of revenue generated by a referred client, it is unknown how much if any compensation will eventually be paid to the referrer.

Other times, compensation may not be anticipated, but the recipient of the referral may wish to provide a gesture of appreciation to the referring party as gratitude for the new business. This would often happen in respect to one-time referrals, where there is no pattern or expectation of business flowing as between parties. Much of the time, this would not take the form of a cash payment, but rather a dinner or a bottle of wine or some such similar gift.

In order to address the regulatory intent of the Referral Provisions, and not create unnecessary compliance burdens for firms and irrelevant unwanted documentation for clients, it would be helpful to distinguish between situations where there is a reasonable expectation that the referrer will receive material compensation for referrals, and situations where there is no such expectation, or when the compensation that may be provided is not material.

The reasonable expectation test will assist in capturing situations where the compensation is likely to result, but the amount is unknown or undeterminable at the time of the referral, and may not take place immediately.

We note that FINRA has developed a materiality standard of $100 per year, in Rule 3220, (Influencing or Rewarding Employees of Others). In addition section

5.6 of National Instrument 81-105 *Mutual Fund Sales Practices* establishes a standard for dealers receiving non-monetary benefits from mutual fund companies. Section 5.6 permits a representative of a participating dealer to receive a non-monetary benefit if,

> *"the provision of the benefits and activities is neither so extensive nor so frequent as to cause a reasonable person to question whether the provision of the benefits or activities improperly influences the investment advice given by the representative to his or her clients."*

We believe these examples of materiality standards provide a basis for the development of an appropriate threshold relating to the referral provisions. If however, a fixed monetary standard is used, we recommend that a more reasonable yearly limit be established, as the FINRA limit has not been amended in recent history.

4. Conclusion

The IIAC acknowledges and supports the importance of establishing transparency in situations where conflicts of interest exist or could reasonably be perceived to exist. Maintaining such transparency contributes to market integrity and investor confidence. As such, we support the intent and application of the Referral Provisions in situations where there are real and potential conflicts relevant to clients. However, it is important that the regulation be properly targeted to achieve its objective and not create unnecessary costs and inefficiencies to the industry. It is also important not to create irrelevant disclosure documents for clients already overburdened and confused about what material they should review.

Thank you for considering our submission. We would be pleased to discuss these matters with you if you require further information.

Yours sincerely,

Susan Copland