GUARDIAN CAPITAL
GROUP LIMITED

October 19, 2018

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Notice and Request for Comment: Proposed Amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. Reforms to Enhance the Client-Registrant Relationship

Guardian Capital Group Limited is pleased to have the opportunity to respond to the Canadian Securities Administrators' (**CSA**) notice and request for comment on proposed amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) and to Companion Policy 31-103CP - *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the **Companion Policy** and, together, the **Client Focused Reforms**).

Guardian Capital Group respects the intention behind the Client Focused Reforms, and supports targeted regulatory initiatives designed to protect and inform the investing public. That said, such regulatory initiatives should not be, insofar as possible, anti-market, and should avoid unintended consequences that do more harm than good.

The Client Focused Reforms are broad ranging and would, if implemented, have significant effects across the investment management industry. Our comments herein, however, are focused narrowly on the proposed reforms to "Referral Arrangements" to be contained in section 13.8 and 13.8.1 of NI 31-103. Of all the Client Focused Reforms, these in our view would be the most unnecessarily disruptive and have the least benefit relative to the harm caused.

Guardian Capital Group Limited

Guardian Capital Group Limited (**GCG**) has been an active player in the investment community for more than 50 years. In that half-century, we've earned a reputation for building wealth year by year – client by client, one trusted

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relationship at a time. GCG is a diversified financial services company founded in 1962. Through its operating businesses, GCG provides institutional and private wealth investment management services; financial services to international investors; services to financial advisors in its national mutual fund dealer, securities dealer, and insurance distribution network; and maintains and manages a proprietary investment portfolio. Its Common and Class A shares are listed and traded on the Toronto Stock Exchange.

GCG's core Institutional Investment Management services are provided by Toronto-based Guardian Capital LP (**GCLP**), UK-based GuardCap Asset Management Limited, Salt Lake City, Utah-based Alta Capital Management LLC and Toronto-based Guardian Capital Real Estate Inc., with GCLP being, by far, the largest. GCLP serves pension plan sponsors, broker dealer third-party platforms, closed-end funds, exchange traded funds and mutual funds, endowment funds, and foundations. GCLP's capabilities span a range of asset classes, geographic regions, and specialty mandates. One of the largest independent investment management firms in Canada, GCLP is the successor to our original investment management business, which was founded in 1962. Guardian's institutional assets under management were $24.3 billion at the end of 2017.

GCG's Financial Advisory business, Worldsource Wealth Management Inc. (**Worldsource**), is an integrated financial advisory platform, with independent financial advisors offering mutual funds, securities and life insurance products to Canadians from coast to coast. Worldsource operates two businesses within the Financial Advisory segment. Financial planning and investment advisory services are provided through Worldsource Financial Management Inc., a mutual fund dealer, and Worldsource Securities Inc., a securities dealer (together the **Dealers**). The Dealers occasionally refer clients to a variety of discretionary investment management firms, in exchange for a referral fee, in accordance with written referral arrangements currently permitted by NI 31-103. Worldsource representatives who choose to refer clients to discretionary portfolio managers often do so knowing that they will receive lower compensation than they would receive by simply investing the client account in a mutual fund. Worldsource representatives make these referrals because they are working in the client's best interests, and because they have confidence that the discretionary investment managers to whom they make the referrals will do the same.

Worldsource insurance advisory services are provided through IDC Worldsource Insurance Network Inc. (**IDCWIN**), a leading national insurance Managing General Agency (**MGA**), which is majority owned by Worldsource and provides sales, marketing and administrative support to independent licensed insurance advisors. IDCWIN is one of the largest MGA firms in Canada. Many of the licensed insurance advisors contracted with IDCWIN provide other financial planning services to their clients. In addition to life insurance policies and insurance segregated fund investments, these advisors may themselves engage in referral arrangements with discretionary investment managers.

Guardian Capital Advisors LP

Guardian Capital Advisors LP (**Guardian**) is the Canadian private wealth management arm of GCG. Guardian manages approximately $3 billion of private client assets for high net worth families, foundations and charities, primarily in Canada, from offices in Toronto, Calgary and Vancouver. Our clients come from all parts of Canada and equally split between Eastern and Western Canada. As the trusted advisor to our private clients, we manage discretionary portfolios consistent with their investment goals and objectives.

Guardian's goal has always been to deliver a total investment solution to the client that was of high value to the client. Our collaborative work with our clients' financial, legal, accounting, insurance and other advisors, ensures a holistic and integrated approach to wealth management. A significant proportion of our assets under management is with clients involving a referral arrangement with a referring advisor or other referring party (each, an **RA**). Some of Guardian's referral agreements with RAs date as far back as 2000, with many other such relationships also dating back many years and operating without problems, to the delight of clients who often continue to benefit from significant ongoing planning and oversight services from the RA, often at no additional cost. The relationships established under these referral arrangements between RAs, clients and Guardian are usually long term in nature, with the RA maintaining a continuing relationship with the client over time.

The Portfolio Manager Referral Model

In the distant past, discretionary investment management services of highly trained professional portfolio managers were previously available only to institutions and very high net worth investors. The services are expensive to provide, and were therefore restricted to clients who could afford to pay a higher fee in absolute dollars, meaning that smaller investors would only be able to access the services if they were willing to pay an inordinately high percentage of assets as an annual fee, thereby reducing returns to an unacceptable level.

The development of mutual funds allowed for smaller investors to obtain the services of these highly trained managers indirectly, through pooling their assets with those of other investors. Although relatively expensive, mutual funds provided the opportunity for enhanced returns over guaranteed investment certificates and bank deposits, with access to a variety of investment strategies.

Some investors were large enough to qualify for the direct services of a professional portfolio manager, but because many portfolio managers focus their efforts on investing money rather than client prospecting and other functions, matching investors with these experts often required the involvement of somebody else. A referral model facilitates this matching and removes a barrier of access to these experts to a larger group of investors.

The referral model used by Guardian is simple. All referral arrangements between Guardian and RAs are established on terms set out in a written referral agreement. Prior to entering into any such agreement, Guardian conducts due diligence into the proposed referral partner with a view to establishing the RAs registration status, if any and to screening out bad actors, corporate entities that do not appear to be validly organized, individuals or entities with significant negative disciplinary histories, and any other entity or individual with which Guardian would not want to be associated for any reason.

Prior to opening an account for any referred client, Guardian provides the client with all of the disclosure information required by NI 31-103, including *inter alia* the name of each party to the referral agreement, the purpose and material terms of the agreement, including the nature of the services to be provided by each party, conflicts of interest, the method of calculating the referral fee, the category of registration of each entity that is a party to the referral agreement with a description of the activities that each party is or is not authorized to engage in, and a statement that all activity requiring registration resulting from the referral arrangement will be provided by Guardian.

Guardian's referral arrangements typically provide for the payment of an ongoing quarterly referral fee that is calculated as a simple percentage of the investment management fees received by Guardian from the client. Typically, the fee is ongoing and continues to be paid so long as the client remains with Guardian. Administration is relatively straightforward, with referral fee compensation calculated and paid out following the end of each calendar quarter.

Based on our understanding, the referral model utilized by Guardian is similar to that used by many of our competitors in the discretionary investment management space.

In many cases the referring party continues to provide the client, over time, with a host of valuable services, often with no additional compensation other than the fee sharing received from the investment manager or other service provider to whom the client was referred. While these services often more than justify the compensation received, it is not necessary, in our submission, that such services be provided in order to justify the payment of an ongoing referral fee. It may be that the prospecting function alone justifies the fee received, from an economic perspective, if the party receiving the referral does not have infrastructure in place to perform this function itself.

Registered RAs, such as mutual fund dealer representatives, direct clients to portfolio managers where they see the client may need the next level of investment sophistication beyond mutual funds. The <u>total</u> fees that clients pay are low vis-à-vis the average mutual fund fee: clients receive service, value, and advice. Other RAs, particularly those that are unregistered, may direct clients to a portfolio manager as part of a holistic suite of financial planning services

offered by that RA. Many RAs are well-connected to a variety of service providers who are able to assist their clients in a variety of ways. Many of these service providers have nothing to do with securities.

Securities laws requiring registration and their associated obligations including proficiency are designed to narrowly cover registrable activities such as dealing and advising in securities. Indeed, it could be argued that the whole point of these rules is to encourage a world where advising/dealing activities are conducted by those best qualified to do so – exactly the state of affairs encouraged by the referral model.

The CSA should encourage activities that facilitate flow of clients to the correct place, the optimal service for their needs. The more money that is managed by professional, experienced, registrant portfolio management firms, the better off every participant is, since individuals who cannot, should not, or do not wish to be making investment decisions are no longer making those investment decisions when they refer clients to the correct channel.

The proposed reforms would not only fail to facilitate this flow, they would have the likely effect of decimating the model as it currently exists and replacing it with far less optimal results. The destruction of the referral model is not a desirable result from a market perspective, an industry perspective, or an investor protection perspective. It is a proven model with a proven track record of minimal client complaints and regulatory mishaps over a period approaching decades.

The Reforms

Guardian has very serious concerns about the unintended consequences that the proposed amendments on referral arrangements may have on stakeholders, especially on investors and on their access to advice.

Clients seek out financial planners to help them plan their financial lives. This planning includes engagement of relevant experts. Financial planners are most effective in their planning function when they are free to refer clients to the relevant experts, unfettered by arbitrary constraints on the structure of the applicable referral arrangement. Investors are best served when regulatory constraints are applied clinically for maximum public benefit for the least possible intrusion. An example of such an appropriately balanced regulatory constraint is the existing requirement that all referral compensation be fully disclosed to the client in advance, so that the client is aware that compensation is being paid in return for the referral, and is positioned to assess whether or not the referral makes sense for them. Many of the new proposals, to the contrary, are imbalanced in that they impose onerous and arbitrary restrictions on commercial arrangements without a corresponding benefit to the parties affected – in particular, the clients who will now be less likely to be referred to the most appropriate investment management provider for their needs.

Portfolio Managers are unlike other registrants and should be regulated in a manner that encourages continued investor access to this highly professional advice and to a diversified universe of securities and investment strategies. Portfolio managers are:

- bound by the highest duty of care to their investors;
- subject to the most stringent regulation, capital and insurance requirements under 31-103; and
- required to obtain the very highest degree of proficiency and of relevant investment management experience of any registrant category.

We believe the combination of these factors means that portfolio managers are the most qualified and experienced channel through which investors can obtain investment management advice. It is our view that preserving and promoting investors' access to this type of advice should be a CSA priority.

The referral model is an innovation – developed over time by market participants – that has resulted in benefits for all due to division of labour. While many financial planners may be capable stock pickers in their own right, some

are not and others, while perfectly capable, enjoy putting their efforts toward other activities like financial planning, relationship management, and prospecting for new clients. Similarly, while some portfolio managers may be capable of sourcing new clients, others may not have that skill set, or may prefer to spend their time picking stocks and explaining the markets to existing clients. The investing public is best served if the best planners plan, and the best stock pickers pick stocks. Regulators should applaud this result and should refrain from intervening except to the minimal extent necessary to prevent harm.

Reforms that effectively force registrants to engage in all of these functions under the same roof benefit large, bank-owned firms at the expense of boutique investment management firms who specialize in selecting securities matched to client objectives and risk tolerance ranges.

Limitation of referral fees to 25% of investment management fees

We start from the principle that in a market economy, regulators should not be the arbiters of fee rates between commercial participants, except in the most extreme cases of bargaining inequality and even then only when one party requires protection. The imposition of a 25% cap on referral fees paid between investment managers and RAs strikes us as arbitrary, not a market-based solution, and an unwarranted intrusion into the functioning of an open market for goods and services, akin to central planning not a market-based economy. Regulators in industries with little or no consumer choice (e.g. hydro) often set price or fee limits however in this case, investors have many options and a 25% limit has the effect of penalizing firms that are efficient and can easily pay more.

Existing referral fee rates, which may exceed 25%, are a function of the equilibrium achieved by negotiation between willing participants. Guardian generally pays standardized referral fees in excess of 25% because a higher level is perceived to strike the optimal balance between maximizing referred assets while minimizing margin compression. In other words, the economics of the amount of a referral fee is the direct concern of the party choosing to willingly pay it. A portfolio manager would always determine what referral fee they can "afford" given their business model – as any other profit-oriented business would do.

Annex E to the proposal package indicates that the CSA has seen, and is implicitly offended by, referral fee rates much higher than 25% and as high as 80%. The CSA is said to believe as a principle that, if an individual is receiving the bulk of the revenues from the registerable activity then that individual should be registered. We submit that this conclusion is based on the false premise that all fees charged by registrants are in respect of registrable activity. In reality, the fees charged by investment managers reflect all of the costs of operating the investment management business, including but not limited to investment management, IT, operations, sales, rent, legal and compliance costs, and all of the other costs normally associated with operating a business. To take an extreme example, imagine a portfolio manager that operates in a community where rents are extremely high such that 80% of its revenues go to office space. If a registered adviser has to pay extremely high rent, should the landlord be required to be registered because he is receiving the bulk of the revenues from the registerable activity? If not, then why should any other service provider that is not, itself, engaged in registerable activity?

Our view is that any investment manager that is able to pay out 80% of its management fee revenue as a referral fee is likely doing so for one of two reasons. Either (a) it has established an unsustainable business model that eventually will need to be changed or the organization will ultimately fail to thrive and will go out of business; or (b) it has harnessed technology such that it can succeed on razor thin margins if it outsources the client prospecting function. Neither one of these phenomena, in our submission, warrants regulatory intervention. However, we are open-minded to the possibility that there may be something else in these business models that the CSA might rightly find inherently offensive. In that case, the CSA should specifically identify the offensive aspects and address them with more targeted regulation that does not have the consequence of disrupting swaths of legitimate business operating under a nominally similar business structure.

Other factors that we submit should be considered include:

- The onus to pay the referral fee is, by contract, that of the portfolio manager, not the client;

- The client is not affected negatively by a fee being paid between the portfolio manager and a RA;
- The client is often affected positively by the relationship between the portfolio manager and the RA;
- The client is indifferent to the amount of referral fee, as it is paid by the portfolio manager;
- The potential unintended consequence of RAs directing business to firms with higher client fees, in order to achieve a similar revenue stream from a 25% referral fee as was previously received based on a higher percentage referral fee;
- The potential unintended consequence of leading portfolio management firms to raise fees in order to achieve sufficient compensation for RAs.

Regulators should not concern themselves with "market power" dynamics between registrants and their referral sources. There is nothing forcing any registrant to accept any referral that is uneconomical.

Referral from non-registered referring party

Referral business should be encouraged for reasons previously noted. Every time a new client is referred to a registered Portfolio Manager, that referred client becomes subject to CSA oversight and protection. This is another reason why the flow of clients through these arrangements should be encouraged, regardless of the registration status of the person or entity making the referral. Full written disclosure to clients of the relationship between the client and all referring parties has been the practice, in accordance with existing regulatory requirements and common sense. Prohibiting Portfolio Managers from accepting referrals from non-registered parties will undoubtedly stop those referrals from occurring, but is that a desirable result?

A client's trusted advisor can come from a registered or non-registered field. An insurance advisor or certified financial planner provides a related but unique offering to a client. Accountants, lawyers, and other professionals may do the same. These professionals, while not necessarily investment professionals themselves, may be in a position to recognize if a client needs a higher level of investment service or may not be receiving acceptable quality of investment service. They can then make an appropriate referral to a firm that can provide that enhanced level of service.

The CSA has expressed a belief that referral fee payments may provide an incentive for some registrants to give up their registration, and suggests that this would be an undesirable result due to the loss of regulatory jurisdiction over the former registrant. We do not know whether this phenomenon is in fact widespread but if we assume that some individuals choose such a path, we question whether this would necessarily be a bad thing. The picture looks something like this: an MFDA-registered salesperson gives up her license to sell mutual funds and instead refers her clients to a discretionary portfolio manager, in exchange for an ongoing referral fee. The client account, formerly eligible only to be invested in retail mutual funds, and protected only by the salesperson's obligation to ensure that trades in those retail mutual funds are "suitable", now is overseen by a highly proficient professional portfolio manager with an inherent fiduciary duty to act in the client's best interests, who will work within the bounds of a customized investment policy statement, and who can invest the client account in whatever securities are most appropriate to the client without being limited to retail mutual funds. What is wrong with this picture?

In our submission, the scenario described above is actually a positive development for all concerned. The former registrant, no longer conducting securities dealing or advising services, can focus on whatever he or she is best at: prospecting, relationship management, financial planning, insurance and estate planning, or other valuable services, while still receiving an income stream connected to the referred clients. Referred clients receive the benefit of lower cost, professional investment management services from the highest level of investment professional with the most stringent ethical obligations. Finally, a specialized discretionary portfolio management industry is itself able to innovate and thrive.

Moreover, we submit that the perceived loss of jurisdiction over the former registrant who has "left the industry" is, itself, illusory. The CSA continues to have full authority to take enforcement action against any individual or entity who deals or advises in securities without registration or an exemption from registration. Individuals who elect to

forego registration are simply no longer eligible to deal or advise in securities, and must accept the regulatory consequences of any violation of Canada's well-established securities laws governing dealing and advising activity.

Finally, lack of registration is not equivalent to lack of general competence in financial matters. Many financial planners, though unregistered to deal or advise in securities, maintain competency across multiple disciplines including cash and debt management, tax planning, retirement planning, wills and estates, insurance and risk, and are eminently capably of selecting appropriate experts to which their clients may be referred.

While retail mutual funds were and are a tremendously positive innovation for small investors, and have served smaller investors very well over many years, the relatively high cost of retail mutual funds often make them a sub-optimal investment solution for investors who qualify for lower cost, higher touch discretionary portfolio management services. The proposed reforms will have the effect of driving some investors back into the world of retail mutual funds, if that is the only solution that their advisors are qualified to offer for compensation.

True wealth management encompasses not only asset management, but also tax planning, estate planning, cash flow planning & insurance planning. It would be rare to have one provider able to provide all of these functions, and the referral model creates incentives to bring in the best providers for the client for each element of their financial lives.

Limitation of referral fees to 3 years

Historically, portfolio management firms and the referring parties have mutually determined the economic duration of the fee sharing. This market-based approach has operated effectively for many years and is well-entrenched without there having been investor protection concerns raised until recently.

In the absence of regulatory action, firms will enter into arrangements that make economic sense. An efficient firm may be able to provide a longer period and would be penalized by the implementation of an arbitrary cap on duration.

There has been some speculation to the effect that the imposition of a 36 month time limit on referral payments will result in a form of "churning", in that referring parties will have the incentive to refer their clients to a different investment manager every three years, regardless of the best interest of the client, in order to restart the clock on a new three year timeframe. While this phenomenon may very well occur in a few cases, we do not believe that this outcome is likely to be widespread. More likely, planners will abandon the referral model altogether and find a different path for their clients that does not involve time limits on compensation, such as, for example, insurance segregated fund sales. Those who do continue referring clients might feel financial pressure to seek out the highest fee services due to the short term nature of the compensation stream required by the new rules.

Another unfortunate unintended consequence of the proposed three year limitation would be the loss of the manager oversight function currently performed by many planners as they assess the performance and capabilities of the service providers to whom they refer their clients. Clients benefit from this second opinion as to whether we (Guardian) are doing a satisfactory job. In the absence of a continuing relationship, there would be no further incentive for a financial planner to continue monitoring the portfolio manager to which a client had been referred. An ongoing financial incentive, received only so long as the client remains with the portfolio manager to which the client was referred, encourages the referrer to perform continued due diligence of portfolio managers and to recommend only those who will provide satisfactory services to clients over the long term, since an unsatisfied client puts the ongoing revenue stream at risk.

Effect on Industry and Economy

Aside from the investor protection considerations, these reforms are a bad idea from the perspective of the industry and economy. While larger firms like Guardian will carry on regardless of the outcome of the reforms, smaller portfolio management firms who rely heavily on referrals as a means of sourcing clients may struggle to survive. On

the other side of the referral coin, many planners who refer clients rely on this source of income as a means to support their offering of holistic "one stop" financial planning services to the public. These smaller firms cannot compete with banks by offering all services in-house. From this perspective, the reforms are another attack on small business that will further consolidate financial services among a few very large players in the marketplace. In a world of ever-increasing complexity and regulatory burden, the ability for smaller independent firms, through these networking arrangements, to compete with the banks and provide alternative investment choices is a very important consideration from the perspective fostering a strong, innovative and thriving investment management industry.

Conclusion

We urge the CSA to approach the regulation of portfolio managers in a different way than currently proposed under the Client Focused Reforms, particularly as relates to referral arrangements, for the reasons set out above. Portfolio managers should be exempted from those aspects of the Client Focused Reforms that are intended to address regulatory concerns not specific to portfolio managers, and rely to the greatest extent feasible on the existing fiduciary duty owed by portfolio managers.

The referral arrangements described in this letter have operated to the benefit of all concerned for years. Regulatory reform that scuttles these mutually beneficial arrangements should not be undertaken lightly. We submit that the proposed reforms to referral arrangements should be reconsidered in a separate project where all relevant voices can be heard.

Having made our submissions on these issues, we acknowledge that there may be myriad differing views on many aspects of this issue. Those views should all be considered and any decision to add further layers of regulation in the area of referral fees should only be made following a complete vetting of all of the opposing viewpoints, giving consideration to the principle that additional regulation should be added only where the benefits clearly outweigh the potentially negative effects.

In further considering these proposals, the CSA may wish to consider whether (or not) it makes a difference whether the referring party continues to provide services to the client (a "shared service model") or, alternatively does not continue to provide services and merely makes the referral. In our view, both arrangements should be deemed acceptable but the two arrangements are demonstrably different in some ways and these differences should be considered as part of any assessment of appropriate regulation.

We thank you once again for the opportunity to participate in the regulatory process, and the invitation to provide these comments. Please do not hesitate to contact the undersigned should you wish to discuss our submission or any other aspect of the Client Focused Reforms.

Sincerely,

GUARDIAN CAPITAL GROUP LIMITED

Per:

Matthew D. Turner
Senior Vice-President and Chief Compliance Officer