

October 11, 2018

On June 21, 2018, the Canadian Securities Administrators requested comments regarding the proposed amendments to National Instrument 31-103. Below is my submission for comment which focuses on Referral Arrangements. I am making this submission on behalf of myself and the clients I serve.

I graduated from commerce at the university of Saskatchewan in 1998, I wanted career where I could help people and make a meaningful difference in their lives. On the advice of a family friend, I entered the financial planning profession. I am a certified financial planner, Advocis member and author of "Money Assassins", a financial planning book for those in their 20s and 30s. 20 years later, what surprises me most is the role "trust" plays in deciding and selecting financial advice and financial products, including investments.

When choosing an investment or financial professional, trust is consistently listed well above credentials, returns, fees and experience. These factors of course help contribute to building trust but is not a guarantee, nor does trust guarantee that a client's best interest is looked after. The same is true when we discuss sincerity and truth.

When considering the best interest of clients, an advisor can be 100% sincere with a client and at the same time, be 100% wrong. That's why given the subjective nature of trust and sincerity, it is important that the regulatory framework being proposed establishes truth in the pursuit of investor protection.

Part of that understanding lies in Canadians having confidence in a regulatory environment that was built with an understanding of how and why Canadians select their professional advisors.

Client's best interest are served when Canadians:

- Can freely choose a team of designated financial professionals
- Have continuous and ongoing advisor relationships
- Receive relationship disclosure
- Have access to personalized and tailored investment products
- Have transparency and choice in how to compensate their professional advisors.

## Client best interest - Why choose a referral arrangement

I made the decision to enter into a referral arrangement because it was in my clients best interest. I was under a mutual fund platform but with rising interest rates on the horizon and increased stock market volatility, I did not have the necessary tools or platform to protect clients money, especially retirees, so I began to investigate portfolio manager options and referral arrangements.

The referral arrangement I entered provided clients with:

- Lower management fees (often up to 25% less but in some cases 40%)
- More consistent and often stronger returns
- Better reporting and fee transparency
  - What clients say about the reporting “I can actually tell what is happening with my money.”
  - No embedded commissions, such as DSC fees or LSC.
  - Clients signs referral fee disclosure (Relationship Disclosure Information)
    - Referral payment reduces the clients out of pocket planning costs as it covers the cost of a financial plan, tax planning, estate consultation and insurance planning.
  - Enhanced suitability discussions. I have personally found that clients are more aware of their investment suitability since switching to a referral arrangement. I believe this is true because clients are getting a chance to speak directly to their manager. With Mutual funds clients have an assumption that “someone” must be watching the manager and ensuring suitability.
- Direct access to decision makers, portfolio managers, who are influencing their money
  - Client gets their financial planner and portfolio manager at the table
- Ease of administration (especially for older or senior clients)
  - Investor fairness - portfolio managers are able to make an investment decision and all accounts are treated equally. With a mutual fund platform, if the advisor wants to make a change, they have to decide which client to call first to initiate the changes. The timing of this can take weeks if not months. Clients are not treated equally and in some cases unfairly.
- Access to quality advice
  - The portfolio manager I selected also works with clients with less than \$1 million of investable assets. This was an important consideration to ensure fair access for clients.
  - Mutual funds often have different threshold levels to receive reduced pricing. Sometimes not starting until \$500,000.
- Clients get to expand their “team”
  - Many clients are initially hesitant to introduce a portfolio manager into the mix because they “trust” me and want to work with me. Clients want someone to watch their money but also want a “trusted” advisor that they can share their financial complexities with.
    - Selling a business, career changes, blended marriages, disabled or dependent adult children, sickness and death are a few examples of clients wanting team of advisors that play different roles in their financial life.
  - Collective proficiency is essential to ensuring best of interest of client.
    - Investment professionals or portfolio managers are not always aware of a clients personal complexities. KYC and KYP information is not always

sufficient. Clients want an advisory team that can meet a variety of needs as their financial lives evolve.

- Wealth and risk management is more than simply “investing”.
- Engaging in a referral arrangement helps advisors not overstep their role and expertise. It is when advisors do not have access to expertise that they feel they need to provide answers beyond their scope. My clients have specifically said that they appreciate the additional expertise that is available if needed.
- Clients are made aware of the role of the planner and the role of the portfolio manager. The Expectation gap is narrowed and clarified.
- Engaging in a referral arrangement has also allowed me to spend more time, especially in meetings, focussed on a clients overall financial planning needs.
- My experience and my clients experience tells me that a well-coordinated referral program between quality PM's and independent advisors delivers high value that results in the clients best interests being served. One new client in the past year said “I have been looking for something like this for the past 30 years”. This client is a 70 year old lady who did very well self managing her investment portfolio and tried a number of other platforms.
- Continuity of service for the client is also enhance when the team of advisors is expanded. The client is not at risk of a single advisor or perspective.

These are some of the reasons I chose to enter a referral arrangement and I actually get paid LESS compared to what I was paid through mutual funds. In my experience most advisors choosing referral arrangements are doing so to serve their clients best interests.

## 25% cap and 36 month period

The problem with compensation models is that they work!

I would strongly encourage the CSA not to regulate the compensation portfolio managers or referral partners pay, and eliminate the proposed 25% cap and 36 month time period being proposed. Here are some reasons why:

- What starts and stops the clock on the 36 months? Unintended consequence will be unregulated pay arrangements between referral partners.
- Compensation stops after 36 months and the client loses their financial team, often the advisor/team they started with and want to continue with.
  - Client confusion:
    - a new (advisory) fee is suddenly introduced to the client. Nothing has changed in the clients life, but regulation is unexpectedly injected.
    - advisor may be forced to give up the client relationship, though neither the client nor the advisor want to, hence reducing access to advice.

- Client gets the wrong portfolio
  - Some advisors will keep their clients in a higher, longer paying mutual fund portfolio, even though there is a better, lower cost option available.
  - Clients may be exposed to higher portfolio risk and underperformance
  - Reduced portfolio customization.
- Client may pay a higher fee.
  - Some advisors will charge a higher fee than what the referral partner charged. The industry is already seeing this where some advisors are charging a planning fee and then also receiving embedded commissions or trailer fees that were intended to cover the cost of advice.
  - The proposed cap and time frame will force clients to try to differentiate “investment advice” and “financial planning advice” which is difficult for industry professionals to agree on. Exchange traded funds say the investment advice is worth 0.25% or less, a financial blogger says financial advice is free or worth the cost of advertising. To ask a client to figure this differential out is beyond difficult to quantify. Let the market place compete.
  - Financial plans are only tested a handful of times in a client's life. Client's can go years without being tested (market correction, career change, marriage breakdown, sickness, death, retirement) and then when their plan is tested or needed, an advisor may not be there to assist, nor have the knowledge of the client's history.
- Once a client trusts their advisors it is very unlikely they will move and they will keep their portfolio in tact which benefits performance. The 36 month time frame, will incentivize some advisors to move clients between portfolio managers every 36 months to encourage payment, hence putting the clients portfolio at risk. Instead of churning of DSC or LSC fees, the proposed regulation may encourage account churning between portfolio managers.
- Regulating “market value” usually doesn't work. If portfolio managers and clients don't see value in paying a referral fee, they will stop or reduce. Setting an arbitrary price on advice will create incentives for “off book” compensation, something regulators have worked hard to eliminate.
  - Some advisors (the ones that need to be regulated) and portfolio managers will find alternative arrangements that will fall outside of the scope of regulation creating a large number of “side deals”, pushing disclosure underground and in the dark.
  - The compensation gap will widen and be harder to identify and track
  - It does seem counterintuitive that clients are being encouraged and asked to invest in “free markets” but then faced with restrictions and limitations on how to compensate that “free market” advice.
- Access to advice could be further reduced to middle-class consumers who have already seen access to quality advice decline in the financial services industry.
  - Insurance industry is trying to reclaim middle market

- Banks eliminating advisors with smaller investment accounts
- My clients have not questioned the compensation model. They are seeing value in the fees that they pay. If the a client does not see value in the fees being paid there are no restrictions on the transfer of their accounts.

## Case Studies

Here are three examples of how entering a referral arrangement has benefited clients:

- A) Retired business owner, has more significant investable assets. Client has been happy working with myself for a number of years. We moved them to a new platform saving them 0.5% on their investment fees and I took a 25% reduction in revenue. The client is happy to have better performance, lower fees, lower volatility. As an advisor I am happy to be able to deliver the right advice with the right tools. With the better reporting the client has a clearer idea of what their money is doing.
- B) New prospect in their 70s. Previously had self invested, then looked for a new advisor, then fired that advisor and went back to self directed, then hired another advisor and then fired them. She then came to us. A knowledgeable investor with decades of experience and her words were "This is the type of platform and team approach I have been looking for." The client at her age does not want to self manage, wants capital preservation, wants access to some direct investments and wants advice from a team.
- C) Retired clients in their 70's very concerned about capital preservation. Rising interest rates have had a significant impact on their performance. Currently, bond indexes are -3.5%. Giving the client access to an active manager and small exposure to private or direct investments, the client has returned 0.5% performance, hence meeting their mandate of capital preservation. If the client had only public market access they would have seen their capital depreciate. The client also saved .25% on their fees.

## Registrant - Conflicts of interest - Compliance

I support the CSA recommendation that referral payments only be made to a registrant. Though what qualifies as a registrant should be chosen carefully and further clarification provided.

I was a registrant with the Mutual Fund Dealers Association (MFDA) and forced by my dealer (Quadrus Investment Services) to drop my mutual fund license because of the restrictions imposed by the MFDA, when I wanted to engage in a referral arrangement. Many advisors and financial firms choose referral arrangements to avoid the conflicts of interest that, captive or non captive, distribution channels impose.

Due to my relationship with a registrant, I was unable to act in my clients best interest. I was aware of a more suitable, lower cost, better performance option for my client but restricted from discussing and sharing with my client, even though I hold my CFP designation, completed the Canadians securities course, have a B.com and the FMA designation. I am aware of other colleagues who have been put in similar situations who have further education, credentials and experience.

I would encourage the CSA to have a broad selection of registrant options, including the Certified Financial Planning designation. If the focus is narrowed, ie. "investment professional", there is a risk of clients getting advice with a single perspective. Clients seek financial advice from a team with a deep sense of expertise in a number of areas like tax, financial behavior, investments, insurance and estate. If the scope of registrant is singularly focused on investments, clients may lose the expertise they were seeking from their advisor and is part of the reason and value of the referral to the registered firm.

Registered firms are already being regulated and responsible for compliance of accounts, ie. KYC, KYP. The advisor acts as another layer of eyes and compliance for the client. When creating the specifications for a registrant it is strongly suggested not to duplicate compliance practices that often end up frustrating clients and enticing some advisors to circumvent compliance protocol.

## Conclusion

Protection for Canadian investors and their financial plans is critical for a solid financial industry and appropriate regulation is a key to that success. The process of how Canadians select, compensate and work with their financial and investment advisors needs to be incorporated into effective regulation, if the true goal is to serve clients best interest. A client's best interest is served best when they are allowed to freely choose who they want to be part of their advisor team and when those advisors are given a regulatory framework that supports:

- Continuous and ongoing client relationships
- Transparency and disclosure
- Access to product and specialization

I appreciate you giving consideration to my submission in the pursuit of serving Canadians need for regulatory protection and financial well-being.

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