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

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

RE: CSA Notice and Request for Comment Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations

Dear Sirs/Mesdames:

We are a Portfolio Manager whose head office is in B.C. as well as an Exempt Market Dealer and an Investment Fund Manager in several provinces. We market securities of a number of proprietary non-reporting investment products (mutual funds and Limited Partnerships) to our clients and the clients of a registrant in which we have an equity interest. The overwhelming majority of the purchasers of these securities are our own clients who have accounts that are fully managed by us.

With respect to the following topics:

- RDI
- Training
- Books and Records

We wish to state that the outlined provisions in the proposals seem very sound and reasonable to us. We applaud the regulators' intentions with these reforms as well as those below though we have concerns we trust will be addressed.

Our other comments are primarily directed towards critical matters including the categories of **KYC, Suitability, KYP, Conflicts of Interest and Referral Agreements and a basket of factors we feel are being overlooked**.

*1. **KYC***

We collect KYC not only via the standard prescribed forms but also through the development of a portfolio management strategy with clients. As portfolio managers with fiduciary obligations to all our clients, we must know all the relevant facts in order to ensure our advice is in the true best interests of the client. We support the intentions of the regulators in requiring in-depth insight into client financial affairs in order for registrants to provide quality advice. However, we are always conscious that prospects contemplating becoming clients are new to trusting the advisor and their firm. We are dubious as to how some of the proposed KYC information to be collected such as asset lists would be acquired prior to an account being opened and a more fulsome relationship being developed with a prospect if not all assets will be managed by the advisor. The nature of relationship building is that it is gradual, that some investors will only allow a new advisor to manage some, not all, of their assets and will provide only generalities around asset allocations and investable asset levels. Some prospects will view these requests at such an early stage as intrusive and evade detailing the specifics requested (regardless of what they sign), others in some cases will decline to proceed with the relationship. Neither of these unintended negative consequences of this new level of information collection serves the industry or the investing public nor do they lead to the achievement of the aims of the regulatory proposals.

In addition, the Companion Policy suggests investment professionals should turn away clients with a certain level of consumer debt and instead advise them to reduce this debt. The Companion Policy dictates that advisors and brokers, who may not be qualified in any way as financial planners, inform clients they may not invest with them advising them instead to reduce consumer debt (though another advisor of a differing opinion might take them). We have a number of issues with this. One, clients may believe the advisor is also a fully qualified financial planner. Two, we'd ask the CSA to be specific as to address the issue that most integrated firms are in the business of selling consumer credit for profit and rewarding registrants for optimizing client personal credit use and to contemplate the unlevel playing

field this creates (where in-house registrants at the mutual fund dealer/branch level will be able to access credit information, unlike independent advisors, and insert themselves into the management of such credit; where such in-house advisors will be more likely to accept investment instructions than a competitor given the bias towards justifying a substantial level of indebtedness; and such matters as how independent firms and registrants will maintain knowledge of high-interest debt balances if they change more frequently than every KYC update (i.e. daily or weekly, which is not uncommon). In addition, we are unclear on what proportion of "debt to income" or "debt to net worth" is supposed to be appropriate and is to be targeted. We'd ask what ratios registrants who again are not qualified as financial planners are to use, for example. Also, we are mindful that prospective and current clients do not seek this advice on their spending habits and will find these assessments of their personal spending habits and rejection of their business to be intrusive and even patronizing.

Finally, we'd ask the CSA to add specifics around when clients can or should or should not employ investment leverage. Consider the *fungibility* of money i.e. a mortgage or a line of credit is to build a second home. This option is chosen by a client so that personal savings can be used to invest. Is this portfolio a leveraged portfolio? What if they put a dream vacation on a credit card? Is the portfolio leveraged? The fungibility of money means it is. So when and how it is ANY client's debt suitable - and when is it proposed that all investment service be declined in order for firms to act appropriately, for all firms to give identical advice and make identical decisions about refusing business (which is a competitive matter) and to ensure compliance in the context of the overall opening of discussions around KYC and borrowing?

Recommendation: We **recommend for all the proposals made** that we discuss in this comment letter that the regulators provide a mandatory industry-wide educational brochure/memo for new retail clients of investment firms, similar to the templated style of the IIROC Account Brochure and even the OBSI brochures, at whatever length is appropriate. In the referenced "Investor Education" paper, IOSCO provides this timeless advice:

> *"Educated investors better understand their rights and are more likely to contact market intermediaries and regulators to obtain additional information or file complaints. Educated*

investors play an important "watchdog role", which increases the likelihood that regulators will identify potential fraud and abuse situations before effective damage occurs (p. 4) and a regulator is quoted as saying, "(t)o raise investor awareness to preserve their rights ... is viewed as one of the principles of good regulation" (p.28, IOSCO, 2003, emphasis ours, refer to footnote 1).

This should coach these retail investors on what to expect to provide, to receive and to do when operating an investment account as well as outline the guidance you wish them to follow in their decision-making and relationship with the broker or advisor and on the matters of importance you wish them to consider carefully. This is not dissimilar to what our major American competitors are doing under the SEC. Addressing the issues the reforms appear to want to resolve through regulation instead through **direct** communication with each of those persons who are to be protected is more efficient.

2. Suitability

Referring to the Proposal NI 31-103 13.3 (1), this states:

*(1) Before a registrant acts **by opening an account for a client**, purchasing, **selling, depositing**, exchanging **or transferring securities** for a client's account, taking any other investment action for a client or making a recommendation or decision to take any such action, the registrant must determine, on a reasonable basis, that the action satisfies the following criteria: **(lists suitability criteria; emphasis ours)***

Our comments on this proposal are as follows:

Re: Selling. As portfolio managers (with a fiduciary duty) we are obligated to liquidate/sell securities that an analysis would not deem to be considered "unsuitable" for a variety of reasons: we rebalance portfolios, we take appropriate and cautious steps when funding client withdrawals, we act to limit risk, to take profits, and to take advantage of other investment opportunities. The language above raises the question of what a "suitable" liquidating trade looks like.

In addition, will clients be permitted to sell their own securities if an advisor deems the liquidation "unsuitable" without firms delaying the transaction and documenting that the client did so at their own risk? Further to this question, we believe this obligation to assess liquidating trades for "suitability" and refuse "unsuitable" transactions when referring to liquidating trades will lead to legal claims against firms for market losses due to administrative delays such as these. We believe this may be an unforeseen negative consequence to clients, firms and the industry.

Re: Deposits. As portfolio managers, we accept deposits from clients of securities by many different means. The language above raises the question of what firms and investors are supposed to do with securities that firms might deem to be unsuitable that they receive by delivery electronically or by mail or in person from a client if they cannot deposit them for the purpose of liquidating them if they are unsuitable. Clients will be unable to liquidate shares in a timely way if there is this administrative tangle. Again, losses may be incurred due to ever-shifting market conditions and we ask who in these situations would bear those losses. The logistics of this proposal are technically not possible to reconcile, and securities will be at risk if custody cannot be taken.

Re: Opening an account and transferring securities. As portfolio managers with a fiduciary obligation, we open accounts and accept assets to initiate the relationship with a new client or to consolidate a relationship with a more tenured client. The proposal states that an account cannot be opened nor securities transferred for the client unless the securities are first investigated and deemed to be suitable. We are unclear how then the receiving firm is to transfer the client in if they have determined the portfolio is unsuitable in their professional opinion OR if the delivering firm or client will not sell and transfer cash because to sell is deemed 'unsuitable' or in the case that selling is contrary to the client's wishes. The advisor taking over the account has argued successfully is that in his or her opinion, the advice being provided to the prospect at the existing (delivering) firm is not optimal. They will have had conversations with the client on elements of their portfolio that may easily be identified as suboptimal or unsuitable. Yet a transfer is not permitted under these proposals. **We refer to the above and to the section below on KYP For the full picture of what's feasible in the industry to address KYP and Suitability.** To be clear, the logistics of this proposal are technically not possible to reconcile without breaching the regulations. This appears to be anti-competitive and that investors will be denied the right

to deposit or move their securities and accounts with ease or to change advisors meaning they will be both frustrated and potentially financially harmed by volatile market conditions that occur during delays in these situations.

Recommendation: **We again recommend the regulators instead require full disclosure to investors opening accounts, depositing securities, selling securities and/or transferring securities of all costs, any potential taxes and risk/reward/suitability impact on the portfolio of these key actions at the time the transfer is completed instead of assessing "suitability" for each action, prior to each action.** We'd also respectfully suggest these prescriptive rules and those discussed in this letter under the KYP subsection be set aside, re-considered and redrafted with a) an eye to more principle-based regulations and b) the input of Operations and Compliance professionals from the industry who would be pleased to offer their support for the overarching aim of greater client protections.

3. ***KYP:***

As portfolio managers with a fiduciary obligation, we perform fulsome reviews of all securities that are permitted to trade within our firm. Where we cannot make a suitability determination due to limited information, we inform the client of this fact and decline to hold or buy the security.

Referring to the Proposal NI 31-103 s.13.2.1 (6), this states:

> *(6)* ***In the case of a security transferred by a client from another registered firm that is accepted by the registered firm*** *or of a client-directed trade of a security, the requirements of subsections (1) and (3) apply to a registered firm or registered individual, as the case may be, only insofar as, under those requirements,*
>
> *(a)* ***the firm must not permit the security to be transferred into the client's account*** *or the trade in the security to be made unless the firm*
>
> *i. takes reasonable steps to understand the structure, features, returns and risks of the security,*

ii. *takes reasonable steps to understand the initial and ongoing costs of the security and the impact of those costs, and*

iii. *monitors and reassesses the security, including monitoring for significant changes to the security;*

and

(b) ***the individual must not permit the security to be transferred into the client's account or the trade in the security to be made unless the individual takes reasonable steps to understand:***

(i) the structure, features, returns and risks of the security; and

(ii) the initial and ongoing costs of the security and the impact of those costs

We will address the duplication of regulation for portfolio managers in our recommendation. The CSA is no doubt aware that all transfers between investment dealers (custodians) are conducted electronically for the bulk of securities held in investment accounts, that these electronic transfers utilize **ATON**. If you refer to IIROC Rule 2300 (Appendix A) you'll find that an industry-wide electronic methodology exists via CDS to execute transfers between such investment dealers (custodians) subject to these rules. The Rules require that dealer members expedite the transfer of accounts against a **specific two clearing day timeline**. Please see **Rule 2300.6** for the details of "Failure to Settle" the transfer on time.

This rule came into effect to create efficiencies but also to eliminate the delays (sometimes deliberate) that would arise from the less efficient, less regimented primarily manual methodology previously in force prior to this Rule.

It is not unusual for a client to initiate a transfer themselves, meaning the first notification a firm has of the transfer is the ATON notice with the two clearing day window. The proposal above requires that tens of thousands of securities be adjudicated annually as suitable or not suitable for a client in a two clearing day period. This is not operationally possible for firms, or perhaps especially non-bank owned firms to accomplish on a centralized basis as required by the proposal. This is anti-competitive.

Also, it is not unusual for accounts to hold a mix of listed and unlisted securities. While only those securities able to be processed via CDS are eligible for ATON, all others must be processed manually which means hundreds, if not thousands, more positions across the industry would need to be **manually** adjudicated and this somehow accomplished **prior** to the firm or the advisor becoming the party of record responsible for and **entitled to material information and details of the client's holdings affecting suitability.** For example, such necessary information as may be set out in the Offering Memorandum, if it is not available from the issuer online, the client's cost base, the registration of the security, the redemption costs, the tax consequences of holding, buying more or selling the position are not available through the client and means the registrant may have no ability to obtain such information as they are not the custodian of the position. As with the comments on **Suitability**, the proposals set out tasks that are not technically possible to fulfill.

Also, the troubling trend in the KYP section towards an argument that past performance returns, ***an assumption of equivalent management skill across all products within a sector,*** and fees should be the only criteria for portfolio inclusion of a security and the new definition of suitability, rather than factors such as the quality of economic or fundamental analysis, and/or experience, research or insight into the sector, a company and its management that a registrant may possess. There is no mention of knowing the economic, political, industry, sector or market risk of the security as part of Know the Product. Yet these are significant factors in making a recommendation.

Also, it appears that only one type of portfolio will be deemed acceptable to regulators based on these criteria. Where differing opinions and objectives are literally what "make a market" of simultaneous buyers and sellers, the proposal seems to conclude that there are to be no product differentiators other than past performance and fees. Opinions vary across the industry as to investment strategies such that some advisers may refuse to consider certain asset classes. This raises concerns about this provision and the position it implies. That is, should an adviser refuse to provide or be required to provide a client access to government debt or convertible debt or private debt? These differing opinions are the foundation of markets and capitalism. The proposed regulations appear to want to eliminate the risk of variability in a portfolio under the guise of eliminating any portfolio risk through "suitability". This is not a realistic aim. Yet a certain one size fits all advice that we counsel against in our practice appears to be

what this regulatory model implies may perhaps be the only "suitable" approach to investing in the eyes of auditors.

Recommendation: We respectfully submit the finding that the KYP sections need further consideration or will be of doubtful value. The operational limitations are outlined above.

We question why for reasons not stated in support of the massive change in direction outlined by the proposal, **CSA Staff Notices 33-315** and **31-336** appear to have been discarded with no analysis of their effectiveness published by the regulators. Staff Notice 33-315 states: "This notice reminds registrants of their duty under securities law to satisfy their suitability obligations to clients, including the requirement to fully understand the products recommended to clients." It also provides guidance to registrants on how to meet their obligations. And Staff Notice 31-336 details what is required of portfolio managers and has the force of law. IIROC has extensive rules in place that achieve the aims of the regulators around KYP as well.

Our recommendation is that CSA Staff Notices 33-315 and 31-336 simply be enforced along with the KYP notices from IIROC for dealer member firms and this complex, prescriptive, technical unfeasible portion of the proposal be set aside until such time as the Staff Notice can be evaluated for its effectiveness in the field by regulatory audit.

We'd also respectfully suggest that such prescriptive rules and those discussed in this letter under **Suitability** again be re-considered and redrafted with a) an eye to a principle-based approach and b) the input of Operations and Compliance professionals from the industry who would be pleased to offer their support for the overarching aim of greater client protections.

As well, we would argue that the portfolio manager, by virtue of their fiduciary duty, is already expected to meet the aims of this draft proposal and each does so without being subject to the conditions being imposed herein under these prescriptive rules raising the question of their necessity.

4. *Conflicts of Interest*

Referring to the Proposal NI 31-103 Introductory Section, this states:

> *Conflicts of interest: the application in practice of the current rules is, in many instances, less effective than intended in mitigating conflicts of interest.*

We respectfully ask what documented evidence of this failure exists. We are unaware of serious breaches of the practice of disclosure and consent that have resulted in significant public harm purely as a result of a failure to disclose a conflict, as the proposal implies, rather than malfeasance by parties far beyond the scope of merely failing to disclose and obtain consent from an investor to a conflict that arises between themselves and the advisor or dealing representative.

We agree that client interests must be prioritized and that any disclosure given to a client must be prominent, specific, clear and sufficient to be meaningful to the client so that the client understands the conflict and its implications.

The primary problem is that it fails to take into account the myriad of business models that registrants have, and that some of them have systemic conflicts that cannot be "responded" to in a manner that "prioritizes the interests of the clients ahead of the interests of the firm..." without negatively affecting the firm. It is these latter words that are in need of attention because there can be, and in fact are, circumstances in which the client's interest and the firm's interest, while conflicting on the surface, are actually mutually compatible. This is likely true for many other registrants.

At Nicola Wealth, our business model is, among other things, to provide a suite of non- reporting issuer investment products that can be purchased for our clients, based on suitability, KYC, etc. Each of these products is a mutual fund, Limited Partnership or other proprietary product that charges management fees (and in some cases, a performance fee) payable to Nicola Wealth, as compensation for managing its products. These fees are indirectly payable by the client. As previously stated, most of Nicola Wealth's clients are managed account clients, who pay a fee to Nicola Wealth calculated as a percentage of the

dollar value of the clients' account as compensation for managing the account. The design of these pooled products provides clients with access to various asset classes at a lower cost than would be incurred if the assets were held directly (via reduced trading fees, for example) and these products also provide clients access to alternative products often inaccessible to retail clients due to high minimum investment requirements; the use of pooled funds which allow clients to hold smaller positions than the minimums and access this otherwise inaccessible opportunity for diversification and investment growth.

While Nicola Wealth can and does explain the implications of it investing client assets in its own investment products and what the management fees are, and obtains the clients' acceptance and consent to this conflict, it is not possible to "respond to each material conflict of interests in a manner that prioritizes the interests of the client ahead of the interests of the firm..." as opposed to "the best interests of the client" unless the acceptance and consent of this conflict by the clients is sufficient . This is unclear from the language in the proposal. We must avoid having to restructure our entire pooled fund architecture to eliminate this purported conflict (which we see as an aggregate benefit to our clients). The resulting overall cost of executing our investment advice for NWM investors is lower because of our proprietary product structure, in comparison to industry standard fund management fees. The product management fees are still payable, indirectly, by the client as would the direct costs of transactions if we did not use our proprietary products (pooled funds with management fees) to deliver our investment recommendations and execute our advice to clients.

Systemic, unresolvable conflicts arising for both dealing representatives and portfolio managers such as ourselves include:

<u>Collection of AUM fees or commissions</u>

Read literally, firms may be unable to charge commissions or collect AUM fees in light of the obligations imposed in the proposed reforms. All commercial activity falls under these conflict rules.

Collection of fund management fees

Read literally, firms may be unable to collect management fees on pooled funds (as we do, and as Mackenzie, Fidelity and RBC do, to name a few) in light of the obligations imposed in the proposed reforms. All commercial activity falls under these conflict rules.

Collection of fees from proprietary product and all revenue from advising when one is a shareholder

Read literally, shareholders (of private or public companies, many of which offer Employee Share Ownership Programs) may be unable to charge commissions or collect AUM fees or recommend any proprietary product such as pooled funds in light of the obligations imposed in the proposed. All commercial activity falls under these conflict rules.

Funds reflecting all or part of a model portfolio- transactions in one's own pooled funds (not subject to 81-107 IRC)

Read literally, firms may be unable to operate fund of fund pooled funds (as we do and many major firms do) in light of the obligations imposed in the proposed reforms. At Nicola Wealth, all trading activity for our flagship fund and a number more would cease as no purchases or redemptions could be processed. All interfund activity falls under these conflict rules. Eliminating an entire sector of funds from the marketplace reduces innovation and firms' competitiveness - it reduces the choices and products available to the investor and to those raising capital.

With respect to the issues above, in the CP on pages 192-193 the case is made for not avoiding these conflicts but instead seeking an external opinion on how they are managed and controlled, with a basket of suggestions around "controls' which are subjective and that would allow a firm to please its interests ahead of a client's. We would like clarity on this apparent contradiction.

We believe a clients' **best interests** must be served at all times and that in order for a conflict to be acceptable it must be in the best interest of the client not only the firm, as assessed by the client (it is unclear who will adjudicate the effectiveness of mitigation efforts such as those described in the CP but we believe it should be the client) and that the existing policies in place mandating a client must be

informed of a conflict and consent to the conflict if this is determined by them to be in their best interest should remain in force.

Concerning assumptions underpinning the proposals

- *Clients are not getting the value or returns they could reasonably expect from investing: in their suitability analysis, some registrants fail to consider all of the factors relevant to helping clients meet their investing goals.*

This implies that "returns" can be forecasted and "reasonably expected" by investors. We would respectfully ask what the foundation is for this statement and what underlying assumptions about investing and investment strategies are being relied upon to draw this conclusion. We respectfully submit it appears the proposal intends to mandate a specific investment style or approach to deliver to clients this "expected return". Furthermore, it appears an unintended negative consequence of the proposal is the elimination of divergent professional opinions (which we note are the essence of markets and competition) and this does not appear to be one of the primary aims of the reforms. We are concerned that the drafting of the proposals imply the aim of the reforms may be to regulate the investment process so that all investment risk of negative returns is eliminated as this is not a reasonable expectation of the capital markets.

In addition, the value and performance of any investment are determined by forces outside the control of the regulator, the advisor and the client. Investments are made into companies, baskets of companies or derivatives of those companies or financial instruments - all of which reflect anticipated changes and inefficiencies in managerial skill and economic, political, sector and industry conditions. Opinions on these anticipated changes vary, based on research, experience, insight, familiarity and assumptions. The underpinning assumption here is that only investment gains are to be expected or tolerated, a fundamentally flawed perspective on investing that every investor is warned about by the regulators and professionals within the industry alike. **The fundamental function of the wealth management industry is to supply capital to firms in a risk-reward scenario that incurs investment risk.** Potential reward is tied to risk. The reward received by investors is to compensate them for the risk they take in supplying capital to firms (so firms in turn can invest in economic activity providing goods, jobs and

more to the country) or in supplying liquidity in the marketplace to other investors. Such economic (investing) risk cannot be eliminated through portfolio models, procedures or regulation yet this seems to be an underpinning principle. To suggest that all investors can reasonably expect a specific return based on regulatory reforms is concerning.

- *Expectations gap: clients often have misplaced reliance on or trust in their registrants, which exacerbate the agency problem inherent in the client-registrant relationship and can result in suboptimal investment decisions.*

First, this suggests that registrants are not in general honest professionals that investors can trust. We are unclear on how the industry regulator whose aim is to facilitate the raising of capital in the public arena represent that for a party in need of professional advice, their reliance in a trained, experienced, registered professional is misplaced. We recognize there are bad advisors with poor ethics who have caused harm and strongly wish to see them eliminated from the industry but these regulations don't address those issues. The implication here is that the proposal conflates all industry participants into the same category of malefactors.

Second, this positions the public as unable to operate in their own best interests when they choose to consent to conflicts of interest disclosed to them that arise between themselves and the firms with whom they deal. The public is aware that the relationship being entered into is a business relationship, that it is for profit, and that there is a dynamic tension of interests between the investor and the advising firm/advisor. This relationship is controlled entirely by the client who can remove their business at any time or seek redress for improper action. Holding this control, suggesting they are incompetent to adjudicate the conflicts of interest that arise between themselves and the advising firm and so must be protected from their own "bad judgment" does a disservice to everyone, most especially the client. Many investors hear the nature of the conflicts, wherein a firm may invest in the same securities as the investor, and see an alignment of interests, not a conflict to be avoided or to be protected from choosing. The proposals suggest this is not their choice to make and that regulators will choose for them.

Recommendation: In addition to the recommendation made under **Suitability,** as is required of Directors of Corporations in Canada, conflict situations should be dealt with **through full, true and plain language disclosure to the client, confirmed understanding and either acceptance or rejection of the conflict.** This serves in professions of medicine, engineering as well as public companies and *other industry participants*. We refer to the requirements for ***disclosure*** versus the *avoidance or elimination* of material and immaterial conflicts with respect to underwriting under National Instrument 33-105.

In addition, IOSCO in examining conflicts of interest among some of those most conflicted in the industry, sell-side and buy-side analysts, stated that:

> "Buy-side analysts (*NWM comment, tactically the equivalent of advisors)* generally work for money managers – such as mutual funds, hedge funds, pension funds, or investment advisers – that purchase and sell securities for their own investment accounts or on behalf of others. Buy-side analysts counsel their employers about which securities they should buy, hold or sell and their research is usually not distributed to anyone but the employer.... success or failure is a function of the accuracy and value-added nature of their analysis; buy-side analysts are successful if their analysis results in good performance for their employers' accounts *(NWM comment: client accounts)*. **Thus, their interests' generally are perceived to be more aligned with those of the money managers they work for and those of their clients (p. 4)**

And:

> "Two of IOSCO's three core objectives are "the protection of investors" and "ensuring that markets are fair, efficient and transparent." The integrity and objectivity of research (*NWM comment: tactically the equivalent of advice)* provided to investors is crucial to promoting these objectives. The integrity of an analyst's research can only be achieved if situations of potential conflicts of interest are avoided as much as possible ***and, if not avoidable, properly managed and disclosed to investors.(p. 2)"***

And state that the top line practice of jurisdictions is to:

> "...require the **disclosure** in research reports of actual and potential conflicts of interest faced by the individual analyst issuing the report and/or the firm employing the analyst. **The level of detail required in such disclosures varies by Jurisdiction, but may include mandatory disclosures**"

And in addition:

> "Many Jurisdictions require that firms *establish internal procedures and mechanisms* to minimize and/or manage securities analyst conflicts of interest."

(Refer to Footnote 2- p.13, IOSCO, 2006, emphasis ours, refer to footnote and Appendix B).

We are unclear on how conflicts faced by analysts can be subject to lower tolerances than advisors as is proposed and mandated in these new proposals. We note, however, a trend in the CSA document towards looking for **scientifically validated evidence and assessment methodology** and we submit that this change should be supported by an academically robust, *peer-reviewed body of evidence* which has not been available to the industry to date in this process.

We recommend deleting the appearances of the words "ahead of the interests of the firm and/or representative" and replacing them with the language "in the best interests of the client" to allow both the registrant and the client to have a relationship based on trust, honesty, and fair dealing as is already required under the *Securities Acts in each province* while enabling the registrant to conduct its business in a way that benefits both parties.

5. ***Referral arrangements***

We are a portfolio manager with fiduciary obligations who employ referrers in building our business. We foresee the following unintended negative consequences of the proposed regulation as written:

3 yr cycle- For registrants who wish to retire and for whom their retirement planning hinges upon the ability to receive the referral fee from their current book of clients over a period of many years, whose

relationship with the client both on the job and outside the firm is the glue that binds the client to the firm (this rarely, sometimes never, changes for clients who have been with an advisor for a long time), and who cannot receive an ongoing referral payment under these new proposals, one unintended negative consequence may be that they are unable ever to retire. The industry has a predominance of older advisors entering into or already in their senior years who have expressed these concerns to us. These changes would have wide-ranging consequences for them individually as they age and for firms.

3 yr cycle- Churning of referrals- an unintended negative consequence may be that a registrant may withdraw support for referral recipient after three years in favour of a new party, churning referral fees.

Registrant requirement- In integrated firms and small firms alike, unregistered employees work hard to attract new business to the firm. Compensation to such employees will have to cease unless a) the firm eliminates rewards to employees for helping to build the business which is anti-competitive or b) the firm does a PV calculation of the estimated lifetime value of the client (which is not a certainty, unlike the referral fees paid only based on actual current AUM not original AUM (it can decline)) and pay that out instead of splitting the revenue generated by the referral which rewards the referrer only for actual revenue to the firm. This is a costly unintended negative consequence to the industry.

Registered persons only- We believe this is anti-competitive. Ours is not the only industry that provides investment opportunities to the public. The uneven playing field created by the imposition of this requirement will disadvantage the capital markets. In addition, unregistered employees will no longer be motivated to refer clients to the business.

We see the bottom line as this: the conflicted unregistered party (the referrer) is not to conduct registerable activities and the registrant can be held responsible by regulators for any breach of this requirement. Please refer to the attached referral agreement template for language ensuring that referrers are operating in a proper capacity. We respectfully ask what public service this new proposal performs and what risks to the public it mitigates and whether bad actors are again being conflated with all industry participants.

Recommendation: We recommend the proposals be set aside for further study and consultation. Also, we comment that if the underpinning concern is that referred clients are being misled by referrers that the recommendation under **Suitability** would serve to render this action harmless. In addition, if referrers are conducting registerable activities improperly and are outside the reach of the regulator, that the registrant should be disciplined in these cases. We enclose our template **Referral Agreement** (see Appendix C) as an example of a compliant approach to referral arrangements that do not require the imposition of these proposals.

Critical factors that are being overlooked:

The Proposals make the following statement:

> *Examples of the harms giving rise to these concerns include, among other things*
>
> • *research that shows financial self-interest may inappropriately influence registrants' recommendations to clients,*
>
> • *persistent findings in compliance reviews of inadequate KYC information collection, affecting registrants' capacity to make sound suitability determinations for clients, and*
>
> • *the persistence of suitability as a leading source of client complaints*

Yet the reforms do not structurally address the agency problem for brokers and advisors- if true reform was intended, then a bifurcation of compensation from transaction decisions would be required. The reforms do not address the underpinning issue around KYC which is not that the rules don't already make clear that all material facts must be known to provide proper advice but that there are those that flout the rules and forcing increased documentation on the mass of compliant advisors will not resolve that issue. Stronger oversight obligations for firms and more effective regulatory audits are the keys to resolving these issues- to mandate firms address suitability issues immediately and effectively as the passage of time is what makes many suitability issues so serious- so the regulatory liability and answer to the problems stated should reside to a greater extent with firms than individuals from a regulatory perspective.

We also note the USA has a different regulatory landscape than when these reforms were first proposed and have begun to dismantle nearly identical regulatory reform proposals under the new administration

(Bloomberg, 2018, Footnote 3, Appendix D). We believe that a number of these reforms will result in unforeseen negative consequences including capital raising activities moving to firms south of the border and that Canadian investment firms (and subsequently investors) will be harmed as a result of downstream effects of regulatory and cost arbitrage. We believe the *absence of regulatory concern* over cost of implementation is not in the public interest and biases outcomes in the favour of large, integrated firms and foreign competitors and that this has not been *contemplated, analyzed or assessed* by those making the proposals. The anti-competitive factors that arise from overly prescriptive regulation have real consequences for the public (who bear the cost, take note) as well as for capital markets participants and the Canadian economic landscape. We believe the prescriptive proposals are anti-competitive and that the proposals would, if they proceed as written, lead inexorably to the further elimination of smaller firms and the subsequent reduction of not only options for investor advice and product options for the investing public but similarly a reduction in innovation in Canada around capital-raising *noting again the **fundamental purpose of the investment industry** is raising capital and providing liquidity for Canadian firms in support of Canadian economic growth.*

In the absence of any data on this point and in the interests of fairness to all concerned, we recommend that in the coming year the CSA and its members engage an independent auditing firm to conduct an impact analysis of the last 10 years of regulation (since the recovery from 2008 started) on the impact of the increased regulations on three things: a) the achievement of the aims of the regulators as stated in the regulatory proposals b) competitiveness of investment firms of all sizes in the industry and in the North American framework and c) the economic health of the capital-raising and investment industry to ensure that these reforms have i) been effective and ii) have not had a negative impact on either Canadian capital-raising firms or Canadian investors and the firms that serve them. Finally, we recommend that this practice of impact analysis become a foundational principle of regulatory reform introduction.

We do believe the aims of the CSA are to be applauded and appreciate these proposals are provided to explore better solutions to the important issues identified through the work of the CSA and other regulators and we thank you for the opportunity to comment.

Sincerely,

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/enclosures

Footnote 1: "Investor Education". IOSCO. 2003. Found at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD140.pdf

Footnote 2: "Report on Analysts' Conflicts of Interest". IOSCO. 2003. Found at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD152.pdf Also attached as Appendix B.

Footnote 3: "Trump SEC Poised to Rewrite...". Bloomberg. 2018. Found at https://www.bloomberg.com/news/articles/2018-04-18/trump-s-sec-poised-to-rewrite-fiduciary-rule-dreaded-by-brokers Also attached as Appendix D.

RULE 2300

ACCOUNT TRANSFERS

2300.1. Definitions. In this Rule 2300 the expression:

"**Account Transfer**" means the transfer in its entirety of an account of a client with a Dealer Member to another Dealer Member at the request or with the authority of the client;

"**CDS**" means The Canadian Depository for Securities Limited / La Caisse Canadienne de Dépôt de Valeurs Limitée;

"**Delivering Dealer Member**" means in respect of an account transfer the Dealer Member from which the account of the client is to be transferred;

"**Receiving Dealer Member**" means in respect of an account transfer the Dealer Member to which the account of the client is to be transferred;

"**Partial Account**" means in respect of an account transfer, any assets and balances in the account of a client to be transferred from a delivering Dealer Member to a receiving Dealer Member which comprise less than the total assets and balances held by the delivering Dealer Member for that account;

"**Recognized Depository**" means a clearing corporation or depository which has been recognized by the Board of Directors pursuant to Rule 2000.

2300.2. Account Transfers. Each account transfer shall be effected wherever possible through the facilities or services of a clearing organization or depository which has been recognized by the Board of Directors. The procedures to be followed for full or partial account transfers shall be as set out in this Rule 2300.

Written communications by Dealer Members with other Dealer Members required in connection with compliance with this Rule 2300 including, without limitation, delivery of Request for Transfer forms and Asset Listings shall be transmitted by electronic delivery through the Account Transfer Facility of CDS, unless both Dealer Members agree otherwise. Each Dealer Member shall bear its own costs in respect of the receipt or delivery of such communications. Each Dealer Member shall be responsible for the selection, implementation and maintenance of appropriate security products, tools and procedures sufficient to protect any communications sent by electronic delivery by such Dealer Member.

Each Dealer Member acknowledges that communications sent by it by electronic delivery pursuant to this Rule 2300 will be relied on by the other Dealer Members receiving them and such Dealer Members sending a communication shall indemnify and save harmless any such other Dealer Members against and from any claims, losses, damages, liabilities or expenses suffered by such Dealer Members and arising as a result of reliance on any such communication which is unauthorized, inaccurate or incomplete.

2300.3. Authorization. Each receiving Dealer Member which receives a request from a client to accept an account shall provide the client with an Authorization to Transfer Account form in a form approved by the Corporation.

On return of the Authorization to Transfer Account form to the office designated by the receiving Dealer Member, duly executed by the client, the receiving Dealer Member shall promptly send a Request for Transfer form (as approved by the Corporation) by electronic delivery through the Account Transfer Facility of CDS providing the prescribed information required by CDS. The original copy of the Authorization to Transfer Account form shall remain on file pursuant to Rule 200.1 with the receiving Dealer Member and will be made available at any time upon request.

In addition, the receiving Dealer Member shall ensure that such forms or documents as may be required in order to transfer trusteed accounts, provincial stock savings plan accounts or other accounts which cannot be transferred without such other forms or documents are duly completed and available on the same day as the electronic delivery of the Request for Transfer form.

2300.4. Response to Request for Transfer. On electronic receipt of the Request for Transfer, the delivering Dealer Member shall either deliver electronically to the receiving Dealer Member the Asset Listing of the client account being transferred by the return date as specified, or reject the Request for Transfer if the client account information is unknown to the delivering Dealer Member, or is incomplete or incorrect. The return date shall be no later than two clearing days after the date of electronic receipt at the delivering Dealer Member.

If for any reason, an impediment exists which prevents the requested transfer of an asset for an account from the delivering Dealer Member to the receiving Dealer Member, the delivering Dealer Member shall forthwith notify the receiving Dealer Member electronically, identifying such asset(s) and the reason for the inability to deliver. The receiving Dealer Member shall obtain instructions or directions from the client and deliver them electronically to the delivering Dealer Member with regard to that asset.

Transfer of the balance of assets belonging to the client shall be completed in accordance with this Rule 2300.

2300.5. Settlement. Within one clearing day after the return date specified on the Request for Transfer, the delivering Dealer Member shall input, or cause the Account Transfer facility at CDS to implement automatically, the set up for settlement of those assets which are to be settled through CDS. All other assets shall be delivered using the standard industry practice for such assets.

No Dealer Member shall accept transfer of an account from another Dealer Member which is not margined in accordance with regulatory requirements, unless at the time of the transfer, the receiving Dealer Member has in its possession sufficient available funds or collateral for the credit of the client to cover the deficiency in the account.

Any assets which cannot be transferred through recognized depositories shall be settled over the counter or by such other appropriate means as may be agreed between the receiving Dealer Member and the delivering Dealer Member, with the same time limits specified above for assets which can be transferred through a depository.

2300.6. Failure to Settle. If the delivering Dealer Member fails to settle the transfer of any asset in the account of a client within 10 clearing days of the receipt of the Request for Transfer form by electronic delivery, the receiving Dealer Member may complete the account transfer by, at its option:

(a) Buying-in the unsettled position in accordance with Rules 800.39 to 800.44;

(b) Establishing a loan of the assets from the receiving Dealer Member to the delivering Dealer Member through a recognized depository, which loan shall be marked to market and the relevant assets shall be deemed to have been delivered to the receiving Dealer Member for the purpose of settling the account transfer; or

(c) Making such other mutually agreed arrangements with the delivering Dealer Member such that the account transfer can be deemed to have been completed for the client.

2300.7. Non-Certificated Mutual Funds. Assets in an account to be transferred in the form of non-certificated mutual fund securities shall be considered transferred upon delivery by the delivering Dealer Member to the receiving Dealer Member of a duly completed Dealer to Dealer Mutual Fund Transfer form as approved by the Corporation and a properly completed and endorsed power of

attorney, or by entry of transfer instructions in the electronic account transfer facility of Mutual Funds Clearing and Settlement Services Inc.

2300.8. Miscellaneous Balances. Balances comprising interest or dividend receipts shall be settled promptly between a delivering Dealer Member and receiving Dealer Member and the failure to so settle such balances for any reason shall not constitute grounds for not complying with the account transfer procedures contained in this Rule 2300.

2300.9. Capital Charges. Delivering Dealer Members shall not be subject to capital or margin charges in respect of assets which are in the process of being transferred in accordance with this Rule 2300. The receiving Dealer Member shall be required to margin all assets or balances which are in the process of being transferred in accordance with this Rule 2300.

2300.10. Fees and Charges. The delivering Dealer Member shall be entitled to deduct any fees or charges on accounts to be transferred prior to or at the time of transfer in accordance with that Dealer Member's current published schedule for such fees and charges.

2300.11. Exemptions. The Corporation may exempt a Dealer Member from the requirements of this Rule 2300 where he or she is satisfied to do so would not be prejudicial to the interests of the Dealer Member, its clients or the public and in granting such exemption the Corporation may impose such terms and conditions, if any, as he or she may consider necessary.

REPORT ON ANALYST CONFLICTS OF INTEREST

A REPORT OF THE TECHNICAL COMMITTEE OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

SEPTEMBER 2003

REPORT ON ANALYST CONFLICTS OF INTEREST

In order to examine the issues that must be considered by securities regulators in addressing conflicts faced by analysts, the IOSCO Technical Committee established and directed the Analyst Project Team to:

- assess in the constituent jurisdictions[1] (the "Jurisdictions") the actual and perceived conflicts of interest that confront sell-side analysts and the firms that employ them;

- survey the existing rules, industry practices, and professional standards that address issues related to analyst conflicts of interest in the Jurisdictions;

- assess the means available to regulatory authorities for addressing the conflicts confronting analysts; and

- determine whether, and in what form, IOSCO should make any statements addressing the conflicts of interest faced by analysts.

The Analyst Project Team conducted an extensive survey in the Jurisdictions the results of which are discussed in this Report. As well, this Report explores the conflicts of interest analysts employed by firms face and the measures in place or proposed in the Jurisdictions to address these conflicts as of December, 2002.

The Report of the Project Team to the Technical Committee addressed the Technical Committee's mandate and discussed future directions and proposed that a set of high-level principles be developed as a next stage. This proposal led to the Technical Committee's adoption of the IOSCO Statement of Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest approved contemporaneously with this Report. Contemporaneously with the adoption of its Statement of Principles, the Technical Committee also endorsed the Project Team's report as a report of the Technical Committee. The report of the Project Team to the Technical Committee follows:

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[1] The Project Team was chaired by Mr. Tatsuya Kanai of the Financial Services Agency of Japan. Members of the Project Team included: Commission des valeurs mobilières du Québec, Québec, Canada; Ontario Securities Commission, Ontario, Canada; Commission des Operations de Bourse, France; Bundesanstalt für Finanzdienstleistungsaufsicht, Germany; Securities and Futures Commission, Hong Kong; Commissione Nazionale per le Societa e la Borsa, Italy; Financial Services Agency, Japan; Comissão do Mercado de Valores Mobiliários, Portugal; Comisión Nacional del Mercado de Valores, Spain; Swiss Federal Banking Commission, Switzerland; Commodity Futures Trading Commission, United States of America; Securities and Exchange Commission, United States of America; Financial Services Authority, United Kingdom and Australian Securities and Investment Commission.

I. INTRODUCTION

Information is the lifeblood of modern capital markets. The flow of timely and accurate information among market participants promotes investor confidence in the markets, which aids in the flow of capital to businesses. However, the volume and complexity of information and raw data which is available – including, issuer disclosure statements, economic and employment statistics from governments, and marketing and purchasing trend reports from private sources – can often be overwhelming and confusing for investors. As a result, research analysts play an important role in the relationship between companies and investors, both retail and institutional. Research analysts study companies and industries, analyze the disparate raw data, and often make forecasts and recommendations about whether to buy, sell or hold securities. Investors often view analysts as experts on and important sources of information about the securities they cover and rely on their advice.

However, analysts (also referred to in this Report as securities analysts or sell-side analysts) employed by full-service investment firms[2] often face conflicts of interest that can interfere with the objectivity of their analysis. Conflicts arise because these firms ("firms" means in this Report full-service investment firms unless otherwise stated) often undertake many, potentially conflicting, roles – for example, firms may act as retail brokerage houses for individuals wishing to purchase or sell securities, while at the same time offering underwriting services to issuers of those securities – and research analysts are often called upon to assist with these conflicting activities. If an analyst's firm's activities place the analyst in conflict situations – for example, if the analyst has powerful financial incentives to direct clients towards specific securities, or if the analyst's job security depends on dissuading clients from selling certain shares – the advice the analyst offers may no longer be objective. These conflicts risk eroding investor confidence in research and, potentially, the markets as a whole if not adequately addressed.

Two of IOSCO's three core objectives are "the protection of investors" and "ensuring that markets are fair, efficient and transparent."[3] The integrity and objectivity of research provided to investors is crucial to promoting these objectives. The integrity of an analyst's research can only be achieved if situations of potential conflicts of interest[4] are avoided as much as possible and, if not avoidable, properly managed and disclosed to investors.

This Report is structured as follows:

Section I – Introduction.

Section II – Discussion of the types of activities performed by analysts employed by firms in the Jurisdictions.

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[2] The term "full-service investment firm" as used in this Report is intended to refer to entities that provide a variety of financial and financial-related services to clients. In some Jurisdictions such entities may be referred to as broker-dealers, sell-side firms, banking groups or multi-service firms.

[3] *See* IOSCO, Objectives and Principles of Securities Regulation (Sept. 1998).

[4] In this report, the words "conflict" or "conflicts" refer to a conflict of interest or conflicts of interest.

Section III – Discussion of the types of conflicts of interest faced by analysts and their firms.

Section IV – Description of certain statutes, rules and regulations that the Jurisdictions have designed to address conflicts of interest faced by analysts and their firms.

Section V – Discussion of the key issues facing securities regulators in addressing analyst conflicts of interest.

II. SELL-SIDE ANALYSTS

A. Types of Analysts

Sell-side analysts historically have served an important role in the markets, promoting efficiency by compiling publicly available information and offering analysis and insights on companies and industries. The term analyst encompasses individuals with varying functions within the securities industry. Analysts are generally classified into one of three broad categories depending on the nature of their employment: sell-side, buy-side and independent.

Sell-side analysts are the focus of this Report.[5] They are typically employed in the research department of full-service investment firms. Analysts on the sell-side typically publish research reports on the securities of companies or industries that they cover. These research reports are distributed to customers of the firm and often include a specific recommendation – such as a recommendation to buy, hold, or sell the subject security – and often include the analyst's expectation of the future price performance of the security ("price target"). As will be discussed in this Report, sell-side analysts often perform functions other than producing research. Many analysts work for firms that also provide investment banking services for corporate clients – including clients whose securities the analysts cover.[6]

Unlike sell-side analysts, buy-side and independent analysts typically are not associated with firms that underwrite the securities they cover and generally have few, if any, other conflicts that could impair the objectivity of their research.

Buy-side analysts generally work for money managers – such as mutual funds, hedge funds, pension funds, or investment advisers – that purchase and sell securities

[5] The potential for conflicts of interest is not limited solely to sell-side analysts; buy-side and independent analysts may also encounter conflicts. The Project Specification, however, instructed the Project Team to focus on sell-side research in order to conclude the project within a reasonable period. Moreover, sell-side research has the biggest impact on retail and small institutional investors, and sell-side analysts face numerous conflicts of interest. Among other things, the second stage of this project can consider whether to review conflicts that pertain to other types of analysts.

[6] Some firms that have discontinued their investment banking operations now market themselves as more independent than full-service investment firms, emphasizing their relative lack of conflicts of interest.

for their own investment accounts or on behalf of others. Buy-side analysts counsel their employers about which securities they should buy, hold or sell and their research is usually not distributed to anyone but the employer. For buy-side analysts, success or failure is a function of the accuracy and value-added nature of their analysis; buy-side analysts are successful if their analysis results in good performance for their employers' accounts. Thus, their interests' generally are perceived to be more aligned with those of the money managers they work for and those of their clients.

Independent analysts work for research originators or boutiques that are legal entities separate from full-service investment firms and sell their research to others on a subscription or other basis. Because their research is sold, and because this constitutes their unique or main source of income, independent analysts have a strong incentive to produce objective analysis for the subscribers of their company's research.

There are other entities that provide research, such as, newspapers, consensus instruments and consolidators of information (such as Multex.com Inc.) but this Report does not address such research.

B. Activities Performed by Sell-Side Analysts

Sell-side analysts provide clients with analysis and investment recommendations. Their work is often disseminated in written research reports that include their analysis and recommendations on whether to buy, sell or hold a security and often include target prices for securities. Research is often provided by a firm as part of a package of services to clients in return for trading commissions directed to the firm. Research information is often provided to clients indirectly through the firm's salespeople who have direct contact with clients.

In recent years, analysts have become involved in other services provided by firms in addition to research. Some Jurisdictions report that the other services sell-side analysts provide to firms include:

- supporting the firm's investment banking department;
- assisting in securities marketing efforts;
- providing help to the firm's investment management department; and
- giving presentations to the firm's sales and trading staff.

*1. **Investment Banking Support.*** Most Jurisdictions report that sell-side analysts are often brought over the "Chinese Wall"[7] that separates their firms'

[7] A "Chinese Wall" is an internal structure aimed to ensure physical and/or informational separation among the departments of a full-service investment firm to prevent the circulation of "inside information." Crossing "over the wall" refers to a situation where an analyst in the research department is formally brought over the informational barrier that exists between the research and investment banking departments and is temporarily considered part of the investment banking unit. The head of the research department and/or head of the legal and compliance department must usually approve such instances of wall-crossing by analysts. In some Jurisdictions, while an analyst is over the

research department from other departments to add their expertise to corporate finance transactions. These duties may include evaluating prospective investment banking clients and performing "due diligence" examinations. Analysts may also attend marketing meetings with their investment bank colleagues that are intended to persuade a prospective client to use the firm's banking services. Indeed, issuers may award investment banking business to firms based on the reputation and stature of the firm's analysts. Several Jurisdictions have noted that analysts may also generate ideas for corporate transactions for the investment banking department.

*2. **Securities Marketing.*** In some Jurisdictions, analysts may be involved in marketing, and even selling, securities that they cover to institutional investors. For example, they may assist investment bankers during "road shows" where they make marketing presentations to potential institutional investors.

*3. **Investment Management Assistance.*** In some Jurisdictions, analysts assist their firms' investment management departments in evaluating transactions.

*4. **Presentations to Sales and Trading Staff.*** Analysts sometimes provide internal presentations and briefing sessions to their firms' sales staff and trading staff concerning the securities they cover. These analyst presentations are meant to provide staff in the sales and trading departments with background and overview concerning current events and company announcements.

C. Analyst Qualifications and Registration Requirements

Most Jurisdictions report that, currently there is no particular set of minimum qualifications or particular registration required to work as a securities analyst conducting strictly research activities. In only one Jurisdiction was an analyst required to pass an examination testing the analyst's general industry and regulatory knowledge. Regulators in another Jurisdiction recently proposed a new registration category and corresponding qualification examination for research analysts.

Despite the general lack of specific qualification or registration requirements, several Jurisdictions note that it is common for analysts to possess some combination of a post-graduate degree, certain professional qualifications (such as a CFA (certified financial analyst) or CPA (certified public accountant) certification), and to have some experience in the industry they cover.

Securities analysts may incur other qualification requirements if their position within the firm entails certain other obligations (in addition to their research activities), such as a managerial responsibility or client interaction. In certain Jurisdictions, analysts that meet with customers or publish their name and contact information in a research report are required by self-regulatory organization ("SRO") rules to pass an examination for general securities representatives. Those Jurisdictions also report that analysts who act in a supervisory capacity and approve

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wall and for a certain period thereafter, an analyst is not permitted to write a research report on the subject issuer, since the analyst is considered part of the banking team and therefore possibly privy to inside information.

research reports for distribution must pass an examination for supervisory analysts and be deemed sufficiently experienced or "fit and proper."

Several Jurisdictions report that analysts may voluntarily opt to take examinations administered by industry groups or professional analyst associations as a condition of membership in these organizations. However, in many Jurisdictions, passing such an examination is not itself a qualification to work as an analyst, and membership in such associations is often voluntary.

Most Jurisdictions do not require that analysts' qualifications or backgrounds be specifically disclosed. However, some SROs and analyst associations make qualifications of analysts available on websites. Likewise, some firms publish their analysts' *curriculum vitae* along with their research reports.

D. Oversight of Sell-Side Analysts and Full-service Investment Firms

Oversight of analysts is complex, layered, and varies by Jurisdiction. Generally, the conduct and professionalism of sell-side analysts is monitored and supervised by one or more of: (1) the firms that employ the analysts; (2) self-regulatory organizations; (3) government regulators or other authorized securities regulatory authority; and (4) professional associations. Not all of these four types of oversight are present in all Jurisdictions.[8] The degree of oversight conducted by each of these entities varies among Jurisdictions, and may even vary within a given Jurisdiction depending on the position and duties of a particular analyst.

Complicating this picture, the depth of oversight by each of these entities and the coordination among the oversight entities is currently under extensive examination in several Jurisdictions. As discussed below, until recently most Jurisdictions reported that there was little, if any, direct regulation of analyst conflicts at the statutory or regulatory level; most oversight was performed at the firm or professional association level. However, several Jurisdictions have recently enacted – or are considering – legislation at the statutory and/or regulatory level to address conflicts faced by analysts.

*1. **Internal Firm Rules.*** According to the survey, internal firm rules currently appear to have the largest role in addressing the conflicts of interest faced by securities analysts. In some of the Jurisdictions, laws and government regulations require firms to be organized in such a way as to be able to address conflicts of interests faced by their employees (including analysts). For example, most firms have internal rules restricting analysts' investments in the securities of the companies (and sectors) they review, or in firm clients.

*2. **Self-Regulatory Organizations.*** In some Jurisdictions, analysts' activities are overseen by SROs in the analysts' capacity as employees of firms that are members of a SRO. These SROs have rules that their member firms must adhere to and that require the firms to adequately supervise securities analysts who work for them. In some Jurisdictions, these rules tend to relate to full-service investment

[8] In some Jurisdictions the securities regulatory authority is neither a SRO nor a government regulator but an independent body created by statute.

firms' employees generally and require firms to address all types of conflicts of interest that financial-sector employees may face. In others, these rules may specifically single out analysts and require member firms to address analyst conflicts of interest through specific internal supervisory procedures. These types of rules – and proposed rules currently being considered – are described in Section IV.

*3. **Government Regulators.*** Although few Jurisdictions impose specific regulations on analysts, in most Jurisdictions analysts are subject to regulations or policies that may affect their activities, such as business conduct rules, best practices, principles for business, organizational requirements and laws prohibiting insider dealing and the dissemination of false or misleading information. In many countries, the analyst needs to be approved or registered with a securities regulatory authority if the analyst trades with or advises clients. In most of the Jurisdictions, a securities regulatory authority is responsible for monitoring compliance with and enforcing adherence to the statutes, laws or regulations regarding analyst's conflict of interests as part of the conduct of firms.

Most of the Jurisdictions surveyed had no statutes or regulations specifically addressing analysts' conflicts of interests. However, one Jurisdiction recently issued a regulation directly concerning analysts and disclosure of conflicts of interest and, in another Jurisdiction, regulations specifically dealing with disclosure of conflicts of interests of analysts have been passed by the national legislature. A more detailed description of the legislative and regulatory oversight currently in place and recently proposed in the Jurisdictions is contained in Section IV.

*4. **Industry Groups and Professional Associations.*** Membership in certain industry groups and professional associations require analysts to adhere to codes of conduct and/or best practices, which are designed to enhance analyst integrity in the production of research. Some countries oblige the analyst to disclose in their reports if they are members of an industry association or group. Many of these associations stress the need to produce independent research and always act in the interests of the client, and often require the members to observe standards of conduct in addition to those required by statues, rules and regulations. Failure to abide by these codes may result in expulsion from the association. However, since membership in these organizations is voluntary and not a requirement to do business in most Jurisdictions, sanctions for violating these association codes are relatively limited.

Several Jurisdictions have national professional associations that issue codes of conduct for their securities analyst members. Securities analysts or their firms in other Jurisdictions may belong to a "multinational" professional organization with membership standards of conduct.

III. CONFLICTS OF INTEREST FACING SELL-SIDE ANALYSTS

Sell-side analysts work in an environment with many inherent conflicts of interest and competing pressures. On the one hand, full-service investment firms want their individual investor clients to be successful over time because satisfied long-term investors are a key to a firm's long-term reputation and success. An investment research team that is well respected for its objective analysis and recommendations is,

therefore, an important asset to a firm. At the same time, several factors can create pressure on an analyst's objectivity. Non-research functions that sell-side analysts are often required or requested to perform may create incentives to issue recommendations that conflict with investors' interests.

A number of potential conflicts of interest faced by sell-side analysts in the Jurisdictions have been identified. These conflicts generally arise as a result of:

- the various commercial activities pursued by full-service investment firms;
- analyst compensation arrangements;
- financial interests in covered companies held by analysts and their firms; and
- the reporting relationships within full-service investment firms.

A. Conflicts Created by Services Provided by Full-Service Investment Firms and Proprietary Trading

Understanding the importance of sources of income for full-service investment firms helps to identify and understand potential conflicts within these firms. In particular, the commercial requirements of investment banking activity, proprietary trading by the firm and the provision of brokerage services may create conflicts of interest for analysts.

1. Investment Banking Relationships. Providing investment banking services, such as underwriting an initial public offering ("IPO") or advising clients on mergers or acquisitions, can be a lucrative source of revenue for full-service investment firms. Sell-side analysts at these firms may be inhibited from making statements or publishing research reports that could jeopardize existing or potential client relationships for their investment banking colleagues.

Indeed, an analyst may be substantially involved with the investment banking unit that takes a company public and thus be part of the "banking team." Underwriters assisting a company with a public offering have a strong interest in the success of the offering and the performance of the company's securities in the post-offering period. An analyst assisting the investment bankers with a company's public offering may be expected to issue research reports containing favorable recommendations about the company's securities.

These conflicts can manifest themselves in variety of ways. For example, an analyst may refrain from issuing a negative report against a company with whom his or her firm has a relationship or he or she may publish research that presents the issuer in a positive light, but in fact does not accurately represent that analyst's actual assessment of the issuer. An analyst may also cease to issue research altogether on a particular company in order to avoid issuing a negative report. As well, the pressure to refrain from presenting a company in an unfavourable light can result in misleading terminology being used in research reports.

Analysts often use a variety of terms – buy, strong buy, near-term or long-term accumulate, near-term or long-term over-perform or under-perform, neutral, hold – to describe their recommendations. The meanings of these terms can differ from firm to firm. In some cases, the use of these terms may involve a "code" for more sophisticated investors. For example, when an analyst issues a "hold" recommendation, retail investors understandably may believe this to mean a recommendation to maintain ownership of the security, whereas institutional investors recognize that the analyst is really recommending the sale of the securities. The coded terminology may be used to avoid making a negative statement about a present or prospective investment banking client.

In addition to confusing terminology, the research distribution channel at full-service firms also may raise concerns. Some clients of a firm may enjoy a type of "preferred status" and receive notice of important information – including research reports and intentions to issue an upgrade/downgrade – before the other clients of the firm are informed of such information. One Jurisdiction expressed concerns regarding analysts distributing reports to banks or other companies with which the firm does business, allowing these companies to buy and sell shares in anticipation of the report's publication.

2. Proprietary Trading and Discretionary Trading for Clients. Conflicts of interest may arise where a firm trades, for its own account or for clients, securities of companies covered by the firm's analysts. Firms may trade securities in companies covered by their analysts for several reasons, such as market making (or other liquidity provision), private equity investments, or portfolio management services for clients. Because research recommendations often have the ability to impact the price of a company's securities, analysts may be inclined to produce favorable reports and recommendations in an attempt to maintain or boost the value of the securities held by the firm, or its clients. Similarly, a firm may take advantage of pending research and position themselves ahead of its publication, effectively "front-running" their own recommendations.

3. Brokerage Services. An analyst's report can help his firm make money indirectly by generating the buying and selling of covered securities – which result in commission revenue for the firm.

B. Financial Interests in Covered Companies

A firm, its analysts and other employees may own significant positions in the companies the firm's analysts cover. Analysts also may participate in employee stock-purchase pools that invest in companies they cover. In a recent trend called "venture investing," a firm, analyst, or colleagues may obtain discounted, pre-IPO shares and thus acquire a significant stake in start-up companies. These practices allow firms and their analysts to profit, directly or indirectly, from owning securities in companies the analyst covers, which creates an incentive to issue favorable research.

Commercial relationships between a firm and a company may create conflicts for analysts. For example, where a firm, or its affiliates, has granted a significant loan to a company resulting in a large credit exposure, the analyst may be encouraged by

the firm to issue a favourable report on the company in order to decrease the risk that the company may default on the loan.

C. Conflicts Stemming From Analyst Compensation and Reporting Arrangements

Compensation and reporting arrangements for sell-side analysts can result in substantial conflicts of interest that may impinge on their objectivity and credibility.

Compensation arrangements can be complex and vary by Jurisdiction and by firm. Several Jurisdictions report that firms consider multiple factors in determining an analyst's remuneration, which may include the analyst's ranking, the performance of the analyst's recommendations, investment banking revenue and trading revenue attributable to the analyst, and overall firm profitability. Some Jurisdictions report that firms significantly link the compensation of their research analysts to investment banking revenue generated by the analyst. One Jurisdiction indicated that some senior analysts at one firm have contracts that provide for bonuses based on the amount of investment banking revenue generated in the business sectors the analyst covers. In a few Jurisdictions, analyst compensation is explicitly tied to the ability of an analyst to "collaborate" with other groups within the firm, including the investment banking division. In other Jurisdictions, the link between analyst compensation and investment banking deals is not always explicit, yet is still perceived to be considerable.

While analysts in some Jurisdictions are compensated almost entirely through fixed salaries, analysts in most Jurisdictions receive some combination of salary and bonus. How and by whom bonuses are set also varies widely from firm to firm. Bonuses may be linked to firm or individual analyst performance (often both), with the individual analyst's performance bonus frequently linked to investment banking transactions they generate or facilitate. One Jurisdiction noted that as much as 90 percent of an analyst's bonus could be based on such a consideration. In some Jurisdictions, the bonuses received as part of an analyst's role in an investment banking arrangement can be much larger than the analyst's fixed salary or bonuses related to research duties.

Some Jurisdictions report that sources external to the firm also may have an effect on an analyst's compensation. These sources include institutional clients' opinions of analyst performance and third party rankings of analysts.

Several Jurisdictions report that reporting structures of full-service investment firms may also be a source of conflict for sell-side analysts. For instance, requiring the research department, or the individual analyst, to report to other business units within the firm may compromise the integrity of research. Likewise, requiring analysts to submit pending research reports to the investment banking department or other divisions prior to publication can result in pressure being exerted on analysts to slant research to meet the objectives of the other divisions of the firm.

D. Other Sources of Conflicts

The management of companies that the analyst covers may exert pressure, subtle and overt, on analysts to issue positive research coverage. Companies may contact the analyst or complain to firm management about an analyst after a negative report or recommendation. In some Jurisdictions, companies have acknowledged that they would deny an analyst access to management – a vital source of information for analysts – should an analyst issue a negative report about the company. Significant firm clients also may pressure analysts to issue favorable research or refrain from issuing negative research about securities in which they hold large positions.

IV. Regulation of Research Analyst Conflicts of Interest

A. Legislative Requirements

Traditionally, few Jurisdictions have directly regulated securities analyst conflicts of interest through legislation, although in the last few years some Jurisdictions have started to review, or have proposed legislation to address these issues. Many Jurisdictions currently apply anti-fraud, market manipulation and insider trading laws to analysts as they do to other market participants. Analysts who promote shares they own in order to increase the market price for the security, for example, can be charged with fraud or market manipulation by securities regulators and criminal authorities. In some Jurisdictions, investors can also sue securities analysts to recover damages caused by analyst fraud.

Analysts pursuing their own (or their employers') interests at the expense of their clients often violate criminal and civil laws in addition to securities laws that prohibit such conduct. Moreover, investors and regulators have charged such conflicted securities analysts with (among other things) negligence, breach of contract, fraudulent misrepresentation and breach of fiduciary duty.

Depending on their specific duties, analysts in some Jurisdictions may be regulated under securities legislation governing "investment advisers," "securities traders" or other regulated activities. Such laws frequently require that those individuals and firms offering investment advice to act fairly and in the best interests of their clients. Furthermore, securities statutes in some Jurisdictions prohibit analysts and the firms that employ analysts from recommending securities whose issuers have some form of relationship with the analyst or firm unless a full and complete description of the relationship is prominently disclosed in the research report or recommendation.

B. Regulation by Securities Regulators and SROs

Some countries manage and oversee analyst conflict issues through a combination of government securities agencies and/or self-regulatory organizations. Government agencies typically possess broad regulatory authority over market participants, which is often supplemented by oversight by SROs. Government regulators usually oversee SRO rule-making and enforcement. SROs impose rules on

their members and penalties (including expulsion) for non-compliance. Unlike voluntary professional associations, the law often mandates SRO membership. Consequently, adherence to SRO rules is compulsory for members and violations of SRO rules may entail significant sanctions (particularly if the violator is expelled from the organization and prohibited by law from doing business within the Jurisdiction).

The measures that countries utilize to address analyst conflicts differ widely, vary according to the size and structure of the securities market, and the nature of the conflicts analysts face. In addition to current rules and regulations, several Jurisdictions are now considering new initiatives to further address analyst conflicts issues. Among the current rules and regulations already in place and the new initiatives under consideration are the following:

1. Current Rules and Regulations in Project Team Jurisdictions

- ***Conflicts Disclosure.*** Several Jurisdictions require the disclosure in research reports of actual and potential conflicts of interest faced by the individual analyst issuing the report and/or the firm employing the analyst. The level of detail required in such disclosures varies by Jurisdiction, but may include mandatory disclosures:
    - if the analyst receives compensation that is based on giving a specific recommendation;
    - if any part of analyst compensation is related to other investment activity performance;
    - if the analyst or analyst's employer has a relevant financial interest in the company being reviewed;
    - if the analyst's firm has an investment banking relationship with the issuer;
    - if the firm employing the analyst is a market-maker or liquidity provider for securities in the company being reviewed;
    - of the percentage of recommendations in the buy, hold and sell categories; and
    - where the research is paid for by the subject company
- ***Prohibitions on Boilerplate Disclosures.*** Some Jurisdictions require that all conflicts disclosures, whether written or oral, be unambiguous (i.e., prohibit the use of boilerplate language such as "may have a position") and that written disclosures be clear and prominent.
- ***Public Appearances.*** Several Jurisdictions require appropriate conflict disclosures not only in research reports, but also in public appearances by analysts, such as television and radio interviews. In recognition of the

characteristics of these media, the conflict disclosures required may be different depending on the characteristics of the media.

- ***Analyst Trading Restrictions.*** Some Jurisdictions bar analysts from investing in a company's securities prior to its IPO if the company is in the business sector that the analyst covers. In addition, "blackout periods" prohibit analysts from trading securities of covered companies for a certain period of time before and after they issue a research report about the company. Some Jurisdictions also prohibit analysts from holding shares in companies that they cover. In one Jurisdiction, analysts are expressly prohibited from trading contrary to his/her recommendation.

- ***Analyst Compensation Arrangements.*** There are few restrictions on analyst compensation arrangements, as most Jurisdictions do not directly regulate this activity. Other Jurisdictions require that the nature of an analyst's compensation arrangement be disclosed to firm clients, and other Jurisdictions have banned -- or are considering banning -- links between analyst compensation and specific investment banking deals.

- ***SRO Membership Requirements.*** Several Jurisdictions report requirements that analysts or firms employing analysts be members of SROs or professional associations that have rules of conduct.

- ***Filing of Research Reports.*** One Jurisdiction requires that research reports be filed with the securities regulator and made public after a certain length of time has passed.

- ***Immediate Disclosure and Filing Obligation.*** One Jurisdiction requires an immediate disclosure obligation of the contents of a research report if rumors of the contents of reports reach the market prior to the release of the report.

- ***Internal Firm Procedures.*** Many Jurisdictions require that firms establish internal procedures and mechanisms to minimize and/or manage securities analyst conflicts of interest. Though the details of such internal procedures and mechanisms may not be specified in the regulations, in practice these procedures may take the form of information barriers between a multi-service firm's research and investment banking divisions and internal restrictions on analysts owning shares in companies they review.

2. Recent Initiatives in Project Team Jurisdictions

As previously noted, securities regulators and SROs in several Jurisdictions are currently considering a variety of regulations to address analyst conflicts issues. These proposals are detailed in the survey and include:

- ***Legal separation of research from investment banking.*** Some Jurisdictions are considering whether it is feasible to force a legal separation of research departments from other investment banking activities.

- ***Compensation Committee.*** Establishing a compensation committee to review and approve research analyst compensation. The committee may not have

representation from the firm's investment banking department and may not consider a research analyst's contribution to the firm's banking business. The committee would consider the associated person's individual performance (e.g., quality of research product), correlation between a research analyst's recommendations and stock prices, and overall ratings from various internal or external parties exclusive of the firm's investment banking personnel.

- ***Pitch Meetings.*** Prohibiting research analysts from participating in solicitation or "pitch" meetings with prospective investment-banking clients.

- ***Analyst Certification.*** Requiring research analysts and/or head of research to certify the truthfulness of their views in research reports and public appearances, and disclose whether they have received any compensation related to the specific recommendation provided in those reports and appearances.

- ***Termination of Coverage.*** Requiring notification to customers when a firm terminates research coverage of a subject company. This addresses situations where an analyst may have discontinued coverage of a company rather than lower a rating or change a recommendation.

V. KEY ISSUES TO BE RESOLVED IN ADDRESSING ANALYST CONFLICTS OF INTEREST AND OTHER ISSUES

This Report and its appendices have addressed the conflicts of interest faced by sell-side analysts in the production of equity research and by the firms that employ them. This Report and its appendices have also provided a comprehensive survey of existing rules, industry practices and professional standards that address issues related to analyst conflicts of interest in the constituent Jurisdictions.

The Technical Committee agreed at its meeting in October, 2002 that a brief discussion on future directions from the Project Team would be helpful. The following comments are in response to that request from the Technical Committee.

The Project Team recommends that its work should continue in order to formulate a set of high-level principles that IOSCO members could look to for guidance when drafting measures to address conflicts of interest faced by sell-side analysts in the production of equity research. Since many IOSCO members are currently in the process of considering what action to take to address analyst conflicts of interest, the Project Team recommends that the Technical Committee consider giving high priority to developing these high-level principles.

The key areas that the Project Team suggests be considered when developing the high-level principles for addressing analyst conflicts of interest in order to ensure investor protection include:

1. **Integrity** – how do regulators ensure that analysts and the firms they work for act with integrity when producing research reports?

2. **Conflicts of Interest** – what conflicts need to be avoided, what conflicts need to be managed and when and in what form is disclosure of conflicts required?

3. **Proficiency** – should there be specific entry criteria or proficiency requirements to work as an analyst?

4. **Investor education** – what role should investor education initiatives play in addressing analyst conflicts of interest?

A Jurisdiction's assessment of how to address analyst conflicts of interest may also include consideration of:

- the cross-border dimension of the dissemination of research;
- cross-border considerations in regulating analyst conflicts of interest; and
- the balance between government regulation, SRO rules and internal firm rules.

The following is a brief discussion of the key areas.

Integrity

As with all areas of financial service, it is important for investor confidence that analysts and firms act with integrity when producing research.

Integrity of research can be impacted by the integrity of the analyst producing the research, the integrity of the firm disseminating the report and the integrity of the research itself.

Some points that could be considered when addressing the issue of integrity include:

- responsibility within the firm for the integrity of research reports;
- firm reporting structures;
- standards for producing research reports and the infrastructure necessary for implementing and monitoring these standards at a firm, SRO and regulator level;
- the way in which regulators carry out monitoring and enforcement of rules and regulations concerning conflicts of interest faced by analysts and their firms;
- ethical guidelines and education for firms and analysts to emphasize the importance of integrity and the responsibilities of analysts and managers; and
- the use of market forces, such as analyst surveys, to improve integrity by highlighting a firm's objectivity in the research it produces.

Conflicts of Interest

Integrity is closely allied to the topic of conflicts of interest. As we have already discussed in this Report, there may be many conflicts of interest inherent within a multi-service firm that could compromise the objectivity of the research it produces. Regulators have tried to address some of these conflicts by prohibiting certain practices that lead to these conflicts, or by adopting regulations designed to help manage these conflicts fairly so that they do not disadvantage the investor. In other cases, regulators have required conflicts to be disclosed to investors so investors can judge whether the conflicts may have biased the research produced.

Some points that could be considered in determining whether to adopt a policy of prohibition, management and/or disclosure of conflicts are;

- the effectiveness of the disclosure – is the disclosure meaningful, pertinent and easy to read and understand? – related to this issue are the following considerations:
  - what information do investors need to make informed decisions?;
  - whether the disclosure relates to an "actual conflict" or "potential conflict"; and
  - where is the disclosure being made (e.g., written report, web-site, television, radio);
- does the disclosure about "potential conflicts" affect other aspects of the market (by, for example, "tipping off" a potential deal)?;
- what role can and/or should Chinese Walls play in addressing analyst conflicts of interest?;
- how should the structural arrangements (e.g., reporting relationships) within a firm that give rise to conflicts of interest for analysts be addressed?;
- what role, if any, should an analyst play in the investment banking process?;
- how do regulators address the possibility that compensation structures can compromise an analyst's objectivity if the analyst is being rewarded more for his or her contributions to other divisions rather than the quality and objectivity of his or her research?;
- what trading by a firm and its analysts is appropriate? and
- the impact a particular policy may have on all the firms a regulator regulates – for example, prohibition of some practices might force smaller firms out of business and reduce competition within the industry.

With respect to the financial interests an analyst or a firm may have in a particular company or industry sector that could give rise to a conflict of interest, future work on regulating potential analyst conflicts of interest might consider issues such as:

- what financial instruments represent a financial interest? – is it only cash equity instruments that are considered or should derivatives or related instruments also be considered?;

- what level of financial interest is a meaningful indicator of a conflict of interest?; and

- should the financial interests of associates and affiliates of a firm and its analysts and household members and other relations of an analyst also be considered?

Because analyst conflicts of interest can take different forms, future work might also consider potential conflicts that are not directly tied to an analyst's financial interest, compensation or the reporting structure within a firm. For example, future work might consider addressing issues such as "retaliation" by issuers against analysts who issue unfavourable reports (i.e., situations where issuers refuse to provide disfavoured analysts with key information which is given to other analysts) and situations where firms may use their ability to produce or withhold the production of research as an inducement to obtain or retain clients. As well, future work might consider how research reports are disseminated to investors including, questions of whether research is disseminated fairly to investors or selectively to certain investors.

Analyst Proficiency

Future work on the regulation of analyst conflicts of interest might also consider whether investors benefit from mechanisms designed to ensure that analysts are suitably skilled and knowledgeable to offer research recommendations, as is the case with other professions and is required of some analysts in some Jurisdictions. Likewise, future work may consider whether or not investors are better served through standardizing certain aspects of research reports, such as a standard meaning for recommendations (i.e., buy, hold and sell) and through the use of "plain language".

Investor Education

Future work on analyst conflicts of interest might also consider the role investor education plays in managing these conflicts. Such work might analyze the degree to which investor education successfully addresses concerns about analyst conflicts and which groups are best positioned to educate investors about potential conflicts that may influence their investment decisions.

REFERRAL AGREEMENT FOR ADVISORY SERVICES

THIS REFERRAL AGREEMENT is made as of this ____ day of _____, 2_____.

BETWEEN:

Insert Referring Agent Name and address (the **"Referring Agent"**)

AND:

Nicola Wealth Management Ltd., a corporation incorporated under the Laws of British Columbia ("**Nicola**")

WHEREAS the Referring Agent is (licensed as an insurance agent but not registered as a dealer or advisor under the MFDA, IIROC, or other securities regulatory body) ***complete or delete as appropriate and remove this phrase***;

AND WHEREAS Nicola is registered in the category of Portfolio Manager in each Province and Territory of Canada where it carries on business as a Portfolio Manager;

AND WHEREAS the Referring Agent and Nicola desire to enter into a referral arrangement whereby the Referring Agent shall refer clients requiring **"Advisory Services"** (as defined in Schedule A hereto) to Nicola in consideration of the payment to the Referring Agent of the **"Referral Fee"** (as defined in Schedule A hereto);

AND WHEREAS the Referring Agent and Nicola are entering into this Referral Agreement (the **"Agreement"**) in order to set forth their mutual understanding with respect to the referral arrangement described in this Agreement;

NOW THEREFORE THIS AGREEMENT WITNESSES that for good and valuable consideration, the receipt and adequacy of which is hereby confirmed, the parties hereto agree as follows:

1. REFERRAL OF CLIENTS

1.1 The Referring Agent may refer to Nicola clients or contacts of the Referring Agent that require Advisory Services. Advisory Services include financial planning and investment portfolio management. A further description of these services can be found in **Schedule A: Roles, Responsibilities and Associated Referral Fees** attached hereto.

1.2 The Referring Agent shall not engage in any activities in respect of any of the referred clients for which the Referring Agent's registration under applicable securities regulation is insufficient. The Referring Agent will not provide advice on investments or securities or trade in securities, and understands that any act in furtherance of a trade in securities is itself a trade in securities.

2. REFERRAL FEE AND DISCLOSURE TO REFERRED CLIENTS

2.1 With respect to each referred client that retains Nicola to provide Advisory Services, the Referring Agent will be paid the Referral Fee set out in **Schedule A** attached hereto. For clients in fee-based accounts, their fee rates are set out in **Schedule B: The Fee Agreement** attached hereto.

2.2 The Referring Agent agrees to record all Referral Fees paid to the Referring Agent hereunder in his books and records.

2.3 Nicola shall keep an independent record of all Referral Fees paid by Nicola to the Referring Agent hereunder in its books and records.

2.4 Nicola shall inform, in writing, every client referred to it under this Agreement of the existence of this Agreement and of the Referral Fees in accordance with securities regulation and substantially in the form set forth in **Schedule C: Client Disclosure Document** attached hereto, which form may be supplemented, replaced or amended by Nicola as required by securities legislation.

3. REPRESENTATIONS AND ADDITIONAL COVENANTS OF THE REFERRING AGENT

3.1 The Referring Agent is a resident of Canada and has all requisite authority to enter into this Agreement.

3.2 This Agreement constitutes legal, valid, binding and enforceable obligations of the Referring Agent subject to: (a) bankruptcy, insolvency, reorganization, arrangement, winding-up, moratorium or other similar laws of general application relating to or affecting the enforcement of creditors' rights generally; and (b) general principles of equity, including the fact that equitable remedies, such as specific performance and injunctions, may only be awarded in the discretion of a court having jurisdiction.

3.3 The Referring Agent is licensed as an insurance agent but not registered as a dealer or advisor under the MFDA, IIROC, or other securities regulatory body. ***complete or delete as appropriate and remove this phrase***;

3.4 The Referring Agent shall act in accordance with all applicable securities regulation.

3.5 The Referring Agent shall instruct his/her employees and representatives regarding the procedures required by this Agreement and shall update such instructions from time to time, as he/she deems necessary.

3.6 The Referring Agent agrees to keep confidential knowledge all information with respect to the business affairs of Nicola.

4. REPRESENTATIONS AND ADDITIONAL COVENANTS OF NICOLA

4.1 Nicola is a corporation incorporated under the laws of British Columbia and has all requisite authority to enter into this Agreement.

4.2 This Agreement constitutes legal, valid, binding and enforceable obligations of Nicola subject to: (a) bankruptcy, insolvency, reorganization, arrangement, winding-up, moratorium or other similar laws of general application relating to or affecting the enforcement of creditors' rights generally; and (b) general principles of equity, including the fact that equitable remedies, such as specific performance and injunctions, may only be awarded in the discretion of a court having jurisdiction.

4.3 Nicola is registered under applicable securities regulation in the Provinces and Territories of Canada in which it carries on the business of a Portfolio Manager.

4.4 Nicola shall instruct its employees and representatives regarding the procedures required by this Agreement and shall update such instructions from time to time, as it deems necessary.

4.5 Nicola agrees to keep confidential knowledge all information with respect to the business affairs of the Referring Agent. Nicola will keep referred client information strictly confidential according to **Schedule D: Privacy Policy.**

4.6 Nicola reserves the right to limit the aggregate investment of clients referred by the Referring Agent to a certain percentage of the market value of any one of the Nicola pooled funds (collectively, the **"Pooled Funds").**

5. SALE OR MATERIAL CHANGE IN THE OWNERSHIP OF NICOLA

5.1 In the event that Nicola sells, assigns or transfers all, or any portion of the beneficial or legal interest in the revenues from referred client accounts, or there is a material change in the share ownership of Nicola, Nicola shall, prior to any sale, assignment or transfer, or a material change in the share ownership of Nicola:

(a) make full and complete disclosure in the sale, assignment or transfer agreement to the proposed purchaser, assignee or transferee (the "**Proposed Purchaser**") of the existence of this Agreement and without limiting the generality of the foregoing, Nicola shall provide to the Proposed Purchaser a copy of this Agreement; and

(b) cause the Proposed Purchaser to execute and deliver in favour of the Referring Agent an assignment of this Agreement, whereby the Proposed Purchaser agrees to be bound by the terms and conditions of this Agreement.

6. TERMINATION AND BUY OUT OF THE REFERRING AGENT'S INTEREST

6.1 The Agreement may be terminated upon either party providing the other party with thirty (30) days' prior written notice of its desire to terminate this Agreement, or upon such other notice as the parties may mutually agree upon. Upon termination, Nicola shall remain obligated to pay the Referring Agent all accrued Management Fees (as defined in Schedule A) to which the Referring Agent is entitled pursuant to this Agreement in respect of all referred clients referred to Nicola by the Referring Agent prior to such termination.

6.2 In addition to the amount referenced in section 6.1, following termination, Nicola shall pay the Referring Agent according to the following schedule, multiplied by the Referring Agent's most recent referral rate (currently ____%):

First 12 Month Period:	X% of the Management Fees
Second 12 Month Period:	X% of the Management Fees
Third 12 Month period:	X% of the Management Fees
Fourth 12 Month period:	X% of the Management Fees
Fifth 12 Month period:	X% of the Management Fees
Thereafter:	X% of the Management Fees

By making these payments, Nicola shall have extinguished completely all of the Referring Agent's interest in income generated by clients he has referred to Nicola and the Referring Agent shall have no further claim on the Referral Fees derived from these clients. The payments will continue to be made in accordance with Nicola's Management Fee billing calendar (currently quarterly) and not later than 60 days after client accounts are debited Management Fees. In addition, the Referring Agent understands and agrees that the Referring Agent shall not be paid any additional amount of Insurance Commissions, accrued or otherwise, upon termination of this Agreement.

6.3 Without limiting Nicola's right to terminate this Agreement with thirty days' written notice as set out in section 6.1, at such time as the Referring Agent ceases to refer two profile clients per year to Nicola, Nicola has the option to request termination of this Agreement and Nicola will be obligated to pay out the Referring Agent in accordance with sections 6.1 and 6.2.

7. GOVERNING LAW AND INTERPRETATION

7.1 The Agreement shall be governed by and construed in accordance with the laws of the Province of B.C. The Referring Agent and Nicola hereby submit to the non-exclusive jurisdiction of the courts of the Province of B.C .in respect of any dispute arising under this Agreement.

7.2 The use of headings and the division of this Agreement into numbered and lettered articles, sections and subsections are for convenience of reference only and not for the purpose of interpretation or construction of the terms of this Agreement. The Schedules to this Agreement are incorporated into and form part of this Agreement.

7.3 In this Agreement the plural shall include the singular and *vice versa* and the masculine gender shall include the feminine and neuter genders, unless the context otherwise requires.

8. ASSIGNMENT

8.1 Unless otherwise agreed in writing by the parties hereto, neither party shall assign any of its rights or delegate any of its responsibilities under this Agreement without the prior written consent of the other party.

9. ENTIRE AGREEMENT

9.1 This Agreement sets forth all of the terms, conditions and agreements of the parties relative to the subject matter hereof. No amendment to this Agreement shall be effective unless made in writing and executed by the parties hereto.

10. COUNTERPARTS

10.1 This Agreement may be executed and delivered in any number of counterparts, each of which when executed and delivered is an original but all of which taken together constitute one and the same instrument.

IN WITNESS WHEREOF the parties have executed this Agreement effective as of the date first above written.

The Referring Agent

_____
Name of Referring Agent

_____
Signature of Referring Agent if an Individual

(Sign below if Referring Agent is a Corporation)

_____
Authorized Signatory
Name:
Title:

Nicola Wealth Management Ltd.

_____
Authorized Signatory
Name:
Title:

Schedule A: Roles, Responsibilities and Associated Referral Fees

1. NICOLA'S ROLES AND RESPONSIBILITIES

Nicola has developed an investment platform through which clients have access to diversified asset classes such as equity, fixed income, commercial real estate, private equity, preferred shares, mortgages and alternative strategies. Nicola has also developed in-house reporting solutions which provide clients with easy-to-follow summaries of their investment holdings and performance.

Nicola will:

- Prepare the necessary paperwork to open accounts for referred clients.
- Determine an appropriate investment portfolio for referred clients, perform the account trading, and make changes to the portfolio based on market conditions and client-specific considerations.
- Monitor the portfolio and rebalance when the Portfolio Manager deems appropriate.
- Provide clients with regular reporting, including periodic holdings statements and periodic management fee statements.

(Collectively called in this Agreement and all Schedules thereto the "**Advisory Services**")

2. THE REFERRING AGENT'S ROLES AND RESPONSIBILITIES

The Referring Agent will:

- Identify appropriate prospects and introduce them to Nicola.
- Cause the referred client to provide Nicola with sufficient biographical and background information, in the form and manner requested by Nicola, to carry out its fiduciary and regulatory duties to Know-Your-Client (KYC) and otherwise to comply with securities regulation.

3. ADDITIONAL MATTERS

- Transfer-ins shall be made "in cash" unless Nicola has approved, in advance, that an asset can be transferred in "in kind".
- Client accounts are normally opened as managed or discretionary accounts.
- Account minimums apply and may be specific to each Nicola Advisor.

4. THE REFERRING AGENT TO COMPLY WITH ALL APPLICABLE SECURITIES REGULATION

The Referrer agrees not to trade in securities held in accounts managed by Nicola. The Referrer must not offer any investment advice, comment on the merits or expected returns nor make investment recommendations on the products or services offered by the Nicola. These actions could result in action being taken by a regulator. All investment management services requiring registration will be provided by Nicola.

5. REFERRAL FEES

As consideration for the client referral and the performance of activities set out in Item 2 of this Schedule, Nicola will pay the Referring Agent the following, plus all applicable value added taxes:

- **Fee-based Investment Accounts**: ___% of management fees received from the referred client. This consideration will be paid by Nicola to **the Referring Agent** directly (the **"Management Fees**").

- **Insurance**: ___% of insurance commissions collected from the client, unless a different split is agreed to by the Referring Agent and the Nicola Advisor due to the nature of a given case. This consideration will be paid to the Referring Agent by Nicola ("**Insurance Commissions**").

(The fees described in this Section 5 are collectively called the **"Referral Fees**" in this Agreement and all Schedules thereto)

Politics

Trump's SEC Proposes Obama-Era Broker Conflict Rules Rewrite

By Benjamin Bain and Robert Schmidt
April 18, 2018, 7:35 AM PDT
Updated on April 18, 2018, 4:08 PM PDT

- ▶ Financial regulator unveils plan for 'best interest' standard
- ▶ SEC approach is softer than Labor Department's 2016 regulation

LISTEN TO ARTICLE

4:47

The U.S. Securities and Exchange Commission on Wednesday proposed overhauling its conflict-of-interest rules for brokers, a move likely ensuring that Wall Street won't have to comply with much tougher regulations approved at the end of Barack Obama's presidency.

SEC Chairman Jay Clayton *Photographer: Andrew Harrer/Bloomberg*

At a public meeting in Washington, SEC commissioners led by Chairman Jay Clayton voted 4-1 to seek public comment on a "best interest" obligation for brokers. While the standard is stiffer than existing SEC requirements, it's not as stringent as the fiduciary duty that forces investment advisers to put clients' interests ahead of their own.

Replay

In 2016, Obama's Labor Department sought to extend a fiduciary obligation to brokers who offer retirement advice, but those strictures are in limbo after being struck down by a federal appeals court.

The SEC proposal comes after weeks of wrangling among the agency's commissioners and months of input from investor advocates and industry groups. The regulations mark an attempt by Clayton -- a former big bank lawyer

appointed by President Donald Trump -- to address legal and regulatory uncertainties triggered by Labor's controversial rules.

If the SEC's roughly 1,000-page plan goes into effect, the industry expects it to replace the Obama-era constraints.

Clayton called the proposal "sound" and said it is "an effort to fill the gaps between investor expectations and legal requirements."

How a Fiduciary Rule Became a Presidential Issue: QuickTake Q&A

Specifically, the SEC proposal requires that brokers disclose all "key facts" about potential conflicts and mandates that they have a "reasonable basis" to conclude investment products are in their clients' best interest, the agency said in a statement. It would also require that firms note and mitigate "material conflicts of interest" related to financial incentives.

The proposal drew criticism from several commissioners because it doesn't specifically define what "best interest" actually means. It also wouldn't expressly prohibit practices that investor advocates say can encourage bad behavior, such as offering free vacations to brokers who meet sales targets.

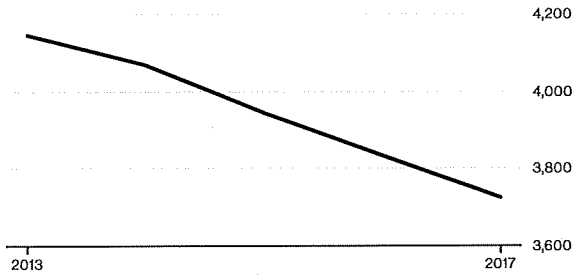
To address confusion over titles used in the financial industry, the SEC proposed that brokers be banned from referring to themselves as "advisors" or "advisers." The agency voted to propose guidance clarifying the fiduciary responsibilities that investment advisers face.

The SEC is also calling for brokers and advisers to provide clients with a disclosure form, which can't exceed four pages, to explain their services, fees and conduct standards.

The full proposal -- which hasn't been released publicly -- is also expected to expand how the agency defines churning, a practice in which brokers inappropriately make money off customers by excessively buying and selling securities, according to a person familiar with the plan. That change could make it easier to sanction brokers for misconduct, said the person who asked not to be identified discussing details that hadn't been made public.

Registered Brokerages on the Decline

Firms exiting market even as number of representatives has remained steady near 630,000



Source: Finra

Consumer advocates contend that long-standing guidelines, which only mandate that brokers offer "suitable" investments, can lead to customers being overcharged or steered to high-fee products. SEC Commissioner Kara Stein, a Democrat, said the agency's proposal won't eliminate such conduct.

"Despite the hype, today's proposals fail to provide comprehensive reform or adequately enhance existing rules," said Stein, who voted against seeking public comment. "In fact, one might say the emperor has no clothes."

Trade groups representing brokers, financial firms, mutual fund companies and insurers said they were generally pleased with the SEC proposal.

"This package of proposals has the potential to be a real win for all types of investors, from the young family starting to invest for the future to an older investor approaching retirement," David Hirschmann, president of the U.S. Chamber of Commerce's Center for Capital Markets Competitiveness, said in a statement.

The chamber was one of a number of associations that sued to overturn the Labor Department's fiduciary rule. A federal appeals court vacated the regulation in a March decision, and it's unclear whether the department will appeal.

Consumer advocates panned the proposal, agreeing with Stein that it would do little to help investors -- and could, actually, confuse them more.

"What we need is a straightforward, enforceable rule that would clearly require brokers to act in their clients' best interests when giving advice," said Marcus Stanley, policy director for Americans for Financial Reform, in a statement. "The proposal we heard described today does not come close to measuring up."

And on Twitter, AFL-CIO President Richard Trumka panned the SEC's action, calling it "insufficient to hold Wall Street accountable."

"We won't stop fighting," Trumka wrote.

The SEC will solicit feedback for 90 days. It will then amend its proposals before holding a second vote by commissioners on whether to make the regulations binding.

(Updates with proposal details starting in seventh paragraph.)