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Attn:

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

[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)  
and [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

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

Thank you for the opportunity to comment on the proposed amendments to NI 31 -103 and Companion Policy 31-103CP. There are many positive changes proposed that I believe will enhance and improve the investor protection concerns cited in CP 33-404. However, I do have several serious concerns that stand to negatively affect the business I've help build over the last 12 years. I would like to direct my comments specifically to the changes and rationale given in Annex E, most specifically the ones dealing with Referral Arrangements. In following up a discussion that I had with peers on July 17<sup>th</sup> with the Manitoba Securities Commission, I would like to give my personal perspective on these proposed changes.

I entered the financial services industry in 2000 and held previous roles as a registered representative as well as a mutual funds salesperson at both an IIROC and MFDA firm respectively. I have spent the last twelve years in my current role as a portfolio manager at BCV Asset Management, we are a twelve-year-old firm based in Winnipeg with clients across Canada. Our firm has been quite successful in managing portfolios that meet and sometimes exceed our client's investment objectives, which will always be the primary focus at the firm. As a result of solid investment management and key financial planners, the publication Canadian Business® ranked us the 13<sup>th</sup> fastest growing firm in Financial Services in Canada; we were also ranked the 8<sup>th</sup> fastest growing business in our city of Winnipeg over the same 5-year period from 2012-2017<sup>1</sup>. Our firm now manages approximately 3000 clients and has over \$1.5 billion under management. **If the proposed changes to referral arrangements had been in place over these last twelve years, our firm would probably not exist.** These proposed changes are anti-competitive from that perspective as they increase concentration risk in an already concentrated vertically integrated financial services industry.

Independent financial planners have referred over 90% of our clients to us. These planners have relationships with our clients and they have earned their trust over many years. They generally have engaged them and previously sold insurance products, mutual funds and have been their primary financial planner for many years. Our business model is to persuade them to utilize us by having them enter into a contract where our firm provides portfolio management services to the clients and in turn we remit a portion of the management fee as a referral fee. So instead of financial planners trying to figure out the best mutual and segregated funds for their clients, they refer them to us. Our firm performs all regulated tasks and builds customized transparent portfolios for the clients. This results in lower costs and professionally built tailored portfolios. The model has worked well for clients, referral parties and ourselves. The clients appreciate the specialization of having their financial planner coordinate their financial affairs and provide insurance and consult on estate and tax planning. Our firm directly engages clients on their investment portfolios and whether any changes are needed based on our direct understanding of their situations and the Investment Policy Statement on which we have agreed.

In reviewing the five-investor protection concerns originally highlighted by the CSA in Consultation Paper 33-404, the 10 changes you hope to see and cite in Schedule 1 (Page 252) are already being fulfilled utilizing a referral arrangement-Portfolio Manager model we use at BCV Asset Management. I've listed them below and my comments follow each point.

1. *raise the standard of conduct for registrants towards what clients expect it to be,*

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<sup>1</sup> <https://www.canadianbusiness.com/growth-500-canadas-fastest-growing-companies/>

Our firm operates under a fiduciary responsibility to clients. That is what clients desire and expect.

2. *result in more specific and more useful advice for clients,*

We offer tailored portfolios to meet each client's unique investment goals and objectives.

3. *result in better engagement between clients and registrants,*

Our clients are engaged in how their investment portfolio is managed and performs.

4. *result in portfolios with better diversification, lower costs and higher risk-adjusted returns over time,*

Our client portfolios are directly managed by an experienced investment management team all of whom have the CFA® charter and we seek to generate above average risk-adjusted returns with lower than average direct costs when compared to average mutual fund fees in Canada

5. *increase the probability that clients will reach their investing and savings goals,*

We review Investment Policy Statements with clients annually for changes, and constantly seek to deliver on achieving clients' investment goals.

6. *increase market transparency and confidence and increase trust in registrants,*

Our portfolios are fully transparent, and we constantly seek to earn the trust given by our clients

7. *allow registrants the flexibility within the new framework to re-evaluate business models and business practices to find those that best meet their circumstances,*

The changes to referral arrangements are **less** flexible and will restrict our ability to grow our firm. It will cause us to re-evaluate our business model, but unfortunately in a negative way.

8. *make it easier for new entrants and less well-known registrants to compete in the market,*

The proposed changes to referral arrangements, specifically the proposed restriction to limit referral agreements to 'registrants only', will **hinder** new entrants entering the marketplace. Power is already concentrated in vertically integrated dealers as they restrict access to registrants for competitive reasons. As a direct example, I was told early in our firm's history that my request for a referral relationship would only be considered after our firm has net assets over \$400M. We currently have >\$1.5B and no referral agreement exists with that dealer. The ability for new entrants to access prospects and grow is **hindered** by the proposed changes to limit referral arrangements to registrants only.

9. *make it easier for registrants to compete based on their unique value proposition, and*

As above, when you **hinder** distribution options, the unique value proposition is harder to communicate and disseminate.

10. *support enhanced market oversight and enforcement.*

Our firm is directly regulated and overseen by the Manitoba Securities Commission. All firms similar to us are directly registered by their local commissions. We believe that is sufficient oversight for our clients, and this objective is fulfilled. I trust you would agree.

The three large impactful changes you are proposing are anti-competitive. I will demonstrate how I believe each point is counter-productive to achieving the spirit of most of the good intentions proposed. On Page 258, you detail why you've proposed these three changes to referral arrangements. I've copied the rationale given and my comment follow each point.

- *the prohibition of the payment of referral fees to non-registered firms and non-registered individuals (subsection 13.8 (1)),*  
*"First, there is a concern that referral fee payments provide an incentive for registered individuals to give up their registration. There is a potential regulatory arbitrage concern created when registered individuals can generate similar levels of income without incurring the added oversight and cost of being registered. Remaining players in the system all pay higher costs as more registrants give up their registration and investor protection suffers as more of the advice and relationship chain is held outside of the purview of regulators and compliance officers."*

I believe the point noted above "*investor protection suffers*" is incorrect and cannot be demonstrated or proven. In fact, in reviewing the recent OBSI® 2017 Annual Report<sup>2</sup>, Portfolio Managers have a dearth of complaints. If regulators were to choose a channel, one where the best interest standard is legally enforceable, I would say that would protect investors comprehensively. It is simply not a correct statement to say '*investment protection suffers*' when clients are referred to Portfolio Management firms by non-registrants. In continuing to allow non-registrants to refer clients to Portfolio Management firms you are increasing investor access to generally lower-cost and intelligent investment management from fiduciary professionals in Canada. This is insourcing the "*advice and relationship chain*" to those most competent to make investment decisions. I would argue in preventing and restricting this referral arrangement you will encourage higher-cost segregated fund options as the next best option for many financial planners who do not want to join MFDA or IIROC.

We have referral agreements with registrants under MFDA and IIROC compliance and with agents at unregistered investment firms that focus exclusively in insurance and financial planning. Our client intake requirements and know your client obligations are independent of the referring party. We are solely responsible for the investment decisions and outcomes. Our clients fully understand we are responsible. There is no regulatory arbitrage as we are registered and provide all relevant investment advice. The referring party's registration is irrelevant and has nothing to do with our relationship with the client. There is **no** extra investor protection gained based on the referring parties' registration, whether IIROC or MFDA.

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<sup>2</sup> <https://www.obsi.ca/Modules/News/index.aspx?feedId=c84b06b3-6ed7-4cb8-889e-49501832e911&lang=en&newsId=04f89285-891d-4861-bbfb-4670304fa8dc>

We do have positive growing relationships and referral agreements with a few MFDA and IIROC dealers. These dealers have an understanding that we can help their advisors grow their HNW business, and they encourage their advisors to refer clients when appropriate to our Portfolio Management firm. However, we also have many dealers who have refused our entries, cancelled or restricted relationships with us where new clients are forbidden, and advisors face challenges to refer clients that they think would be better served with us. (A few dealers have closed relationships recently, citing this proposed regulatory change.) None of these dealer restrictions have anything to do with performance or compliance reasons; it is done for competitive reasons. In some situations, we have seen advisors drop their registration as they believed dealer restrictions were not in their client's best interest. They simply don't think mutual funds are a good solution for their clients, and/or their dealer has restricted their options. They have largely left the MFDA industry and choose to focus on financial planning and have delegated the whole investment process to a regulated Portfolio Management firm. This is no regulatory arbitrage as these individuals no longer sell mutual funds or any investments. The MFDA dealer firm may want to collect fees for compliance, but if an agent has no mutual funds, there is nothing to regulate from that perspective. Whereas previously these referral agents had advised on mutual funds as a MFDA representative, they now have left the investment industry and delegated this function away. **The regulation of the client has simply changed.** In our situation, the client now has investments at an IIROC custodian, and the client is under the purview of a provincial securities commission which regulates Portfolio Management firms. The definition of a referral denotes a delegation for someone to fulfill a role. Requiring registrations to make a referral blurs the responsibility of who is ultimately responsible for the investment process. I would hope this would remain clear and unrestricted as I believe our fiduciary responsibility to the client is in their best interest, and it allows competition to flourish. The requirement of registration to make a referral is anti-competitive and hurts firms like BCV Asset Management.

Furthermore, the fact that *"Remaining players in the system all pay higher costs as more registrants give up their registration"* should be irrelevant as the CSA is not in the business of propping up one SRO or another regulator. As I said, clients that are referred to us are regulated through our PM firm's compliance responsibility, and extra regulation from an IIROC/MFDA firm on referring agents is superfluous. If the MFDA or IIROC firm is not able to keep registrants from leaving, and hence fixed costs are allocated across fewer registrants, they need to shrink costs or find better solutions for clients. It is uncompetitive to bind a portfolio management firm exclusively to IIROC and MFDA firms, it only enhances the power balance that is already in their favor. IIROC and MFDA vertically integrated firms hold the bulk of investment assets in Canada (over 90% according to OSC Risk Assessment Questionnaire 2016). Portfolio Management firms are a minority growing disruptive force for positive change in the investment industry. Let's not go backward by restricting competition and increasing concentration and market power in the investment industry.

- *the limitation on the referral fees payments amounts to 25% of the of the fees or commissions collected (paragraph 13.8.1(b)), and*  
*“Second, and related to the first issue, we have noted several instances where non-registrants are receiving the bulk of the revenue generated through registerable activity. In some cases, registrants are reporting that greater than 80% of the revenue generated through registerable activities such as portfolio management is being handed over to non-registrants as referral fee payments.<sup>11</sup> As a principle, there is a belief that if an individual is receiving the bulk of the revenues from the registerable activity then that individual should be registered.”*

You cite several instances where you have discovered non-registrants receiving the “bulk of revenue” from a registerable activity. The fact other firms are willing to pay what is likely a long-term unsustainable referral fee is not a reason to prescribe a cap of 25% of the referral fee that would apply to all Portfolio Management firms. We compete for referrals from investment advisors and capping our percentage payout will simply allow other solutions to be more attractive to advisors. In fact, as this idea was proposed 119 days ago, I have spent a lot of time with business associates re-evaluating whether financial planners will continue to make referrals at all. This 25% capping of referral fees proposal, whether it remains in the final document or not, has already hindered our business. We pay referring agents approximately half our management fee and this is generally less than they could have received in selling a mutual fund. Our referring agents have already made a choice to lower fees for their clients, this proposal would encourage them to find other alternatives for investment management.

This 25% cap is another example of preferring one channel over another. This helps IIROC/MFDA registered vertically integrated firms who can pay percentages on production or higher trailer fees to their advisors. But this proposal would halt our independent business, as we simply can't compete to attract referrals. I guess unless we charged exorbitant fees so that the 25% portion that is referred would be competitive with a 75-100 basis point trailing fee? This makes no sense. If you have found instances where you believe referral fees are irregular, such as over 80%, then deal with those specific instances rather than picking a 25% value to prescribe to all referrals to all Portfolio Management firms. If you have found individuals with a track record of irresponsibility, then deal with it 'surgically' as you have ultimate control over how a Portfolio Manager conducts business. We do and will abide by all regulatory requests. But this 25% cap is regulatory overreach to an extreme. In some sense, if you are going to prescribe fees, why stop with referral fees? You could decide on an appropriate percentage trailing fee, or perhaps prescribe what you think is an appropriate fee for fee-based accounts at IIROC firms across Canada? Maybe that wouldn't be so bad for investor outcomes, but it would certainly be unpopular to the industry. However, you can't prescribe fees for one part of the industry and let others pay whatever they want. All portfolio management firms ask for is a level playing field; it is already tilted uphill given the concentrated industry dynamics. This 25%

referral fee cap will serve to cap our future growth to the benefit of other industry players who don't have such restrictions.

- *the limitation on the length of time a referral fee can be paid to 36 months from the date of referral (paragraph 13.8.1(a)).*

*“Third, there are market power concerns regarding the ability of referring agents to extract referral fees from registrants. Certain registrants may not want to pay the referral fee or current referral fee levels but are being forced to under the current system.”*

I can only speak to the experience I have had here at BCV Asset Management. I can confirm we do not share your *'market power concerns'*. Nothing is *"extracted"* from us. We pay referral fees according to the contract we signed with the client and dealer/agent. We only have agreements with those we choose to do business with, and we comply with the contract for as long as we manage the clients' investment assets. If we no longer want to have an agreement with a referring party, we cancel it. There is no *'market power'* concerns. But what is correct is that investors in general rely on individuals to give them financial direction and planning. The trust engendered by these individuals is powerful in the sense that they can be directed to a variety of investment solutions. This can be positive or negative depending on the direction given. But what is clear is that by limiting referral payments to 36 months, once again exclusively applied to the Portfolio Management/referral channel, is anti-competitive. If this proposal is to be consistent, it should apply to all fee-based accounts and trailer fees in the industry. You should not be hindering the ability of Portfolio Management firms across this country to attract and retain clients utilizing referral relationships. Overall our fee and service needs to be competitive and meet the long-term investment needs of the client. This 36-month fee limit would only promote churning and turnover as referral parties seek to maintain their livelihood. The only market power that would increase is the current concentration of assets in vertically distributed firms. Why would the regulator choose a solution that benefits large integrated firms over smaller specialty firms? Do you really want assets to move from a fiduciary Portfolio Manager back to mutual funds?

I would strongly urge you to remove all three of the proposed changes to referral arrangements. On page 259, in paragraph three as you contemplate and suggest how PM firms can adapt to these proposed changes, you suggest PM firms turn to *"traditional advertising"*. I can just tell you from personal experience, that we did this in the early days of our firm. We were on a popular radio show weekly for a year, and also did some direct mail campaigns. That didn't work at all. But we were able to negotiate a referral relationship with a few MFDA dealer firms in 2007 and following. We have been able to expand our business and contract directly with financial planners since 2009. Our firm is growing, clients are happy, it would be

unfortunate to force us to change our business model that has none of the 5 problematic concerns below.

The 5 concerns in CP 33-404:

1. Clients are not getting the value or returns they could reasonably expect from investing
2. Expectations Gap
3. Conflicts of Interest
4. Information Asymmetry
5. Clients are not getting outcomes that the regulatory system is designed to give them

These five concerns are not a problem with our investment service. We manage portfolios and generate value from the investing process. We have no expectations gap as clients know we manage in their 'best interest'. Our clients understand potential conflicts and know exactly how much the custodian charges, the investment management fee, along with how the referral fee applies to their account. They rely on our professional judgment and hence there is no information asymmetry problem when it comes to investment decision-making. We believe the regulatory system is appropriate for our clients, our primary regulator has received no complaints regarding our service to my knowledge.

I believe the three impactful changes proposed to referral arrangements are based on a limited subset of cases and disgruntled MFDA dealers. There are so many clients that have benefitted from this arrangement through us and my peers. If the proposed changes are implemented, there will be more harm than good to the Portfolio Management – referral model, and future potential clients will not materialize. The unintended consequences have not been well understood. If you want to find a solution to the five concerns, you should be encouraging and not discouraging the referral model. I believe if all assets in this country were managed by Portfolio Management firms with a best interest standard, the five problem issues cited above would largely disappear.

Thank you for the opportunity to comment on the proposed changes.

Sincerely,



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