

The Registration Less Travelled

"I don't look to jump over 7 foot bars. I look for 1 foot bars that I can step over"

Warren Buffet

The Regulatory Hurdle

Few industry participants would disagree that the Canadian securities regulatory environment is getting stricter. Over the last decade, the costs and burden of industry regulation have forced many smaller dealers to either sell their practices to larger participants or to simply exit the business.

The secret to navigating this regulatory challenge lies in a recognition that "a firm's registration and its business are not the same". For example, a financial planning business can be carried out under an Investment Dealer, Mutual Fund Dealer or Investment Counsel/ Portfolio Manager registration. Some of these regulatory environments are seven foot bars, and some are one foot.

Regulatory Challenge for Small Dealers

Most small Firms that market to retail customers are either registered as Investment Dealers or Mutual Fund Dealers (with a Limited Market Dealer licence in Ontario).

Investment Dealers must join the Investment Industry Regulatory Organization of Canada ("IIROC") and Mutual Fund Dealers must become members of the Mutual Fund Dealers Association of Canada ("MFDA"). The rules, regulations and administrative practices of these Self Regulatory Organizations ("SROs") largely determine the regulatory costs and burden of operating as an Investment Dealer or a Mutual Fund Dealer Firm.

Like most regulation, the SRO rules, regulations and administrative practices are principally designed for Firms that are deemed most risky, within their group.

Within the IIROC group, integrated national dealers with remote offices and branches. (i.e. the Banks and large independents), are considered the riskiest, given the complexity of their operations and potential for conflict. As a result, IIROC firms are typically subject to greater regulatory standards such as higher capital and reporting requirements, proficiency requirements for the CCO and CFO, and greater record keeping and internal control obligations. Small independent dealers who choose an IIROC registration often find that they are wearing an oversize regulatory regime that is too cumbersome for their circumstances.

MFDA regulation, on the other hand, focuses on smaller participants. Many existing MFDA firms are relatively unsophisticated or uninformed about their regulatory obligations, as the barriers to entry for the industry were previously low. To address the risk created by these market participants, the MFDA imposes more detailed and stringent requirements. For example, through the use of compliance

bulletins and administrative practices, the MFDA has, over the years, begun to take a strong stand on a variety of topics including matters such as the definition of “unauthorized discretionary trading”, due diligence obligations for new products, and the risk classification of new products, such as Principal Protected Notes. Because of the MFDA’s relatively strict rules-based approach, many Firms that operate under an MFDA regime are finding it increasingly difficult to meet regulatory expectations.

The Regulation of Investment Counsel/ Portfolio Managers (“IC/PMs”)

Unlike Investment Dealers and Mutual Fund Dealers, IC/PMs are under the direct supervision of the Provincial Securities Commissions, rather than an SRO. Commission rules and requirements tend to be relatively more concept-based rather than detailed, which allows for greater flexibility in selecting practices that are appropriate for the business, and at the same time, still being compliant with the regulatory rules, and in keeping with the spirit of the law.

The Commissions also place greater reliance on admission standards. In other words, if you qualify for registration as an IC/PM, it’s relatively less complicated and less costly to comply with regulatory rules on an ongoing basis, even with the on-going regulatory compliance reviews that the Commissions conduct in order to police the IC/PMs.

The Commissions often rely on questionnaires, sweeps on particular topics of interest, issues or concerns brought to their attention, and interviews with management, in order to supervise IC/PMs on a risk-based approach. The SROs on the other hand, place a greater deal of reliance on field reviews to supervise their members.

Ara Compliance has developed a matrix on the relative compliance costs and benefits of operating from an IC/PM platform versus IIROC and MFDA.

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