Borden Ladner Gervais

One step closer to harmonization: CIRO's proposed Incorporated Approved Person Compensation model

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The Canadian Investment Regulatory Organization (CIRO) has published rule amendments to harmonize advisor compensation (the Amendments). Following CIRO's 2024 position paper that consulted on three potential regulatory approaches to allow payment of advisor compensation to advisor-owned corporations for all CIRO-regulated dealer members (Dealers), the Amendments propose to adopt the Incorporated Approved Person compensation option.

In a material shift from the 2024 proposals, under the proposed Amendments, both ancillary activities *and* regulated Canadian financial services sector activities can be conducted by the advisor's corporation (Incorporated Approved Person) on behalf of the sponsoring Dealer, subject to certain constraints. CIRO views the proposed Amendments as addressing the lack of flexibility, consistency and tax certainty under the current directed commission model, which will be phased out.

We encourage firms and advisors to review the potential impact of the proposed Amendments on their business model and provide feedback to CIRO by the November 6 comment deadline.

We invite you to **REGISTER** for our webinar on **September 22, 2026, from noon to 1 p.m. EST**, during which we will share additional insights on the proposed Amendments.

What the proposed Amendments do

The proposed Amendments are designed to harmonize CIRO's advisor compensation rules by:

- *Repealing* the directed commission arrangement option for mutual fund dealers' client-facing Approved Persons. This option is currently available to client-facing advisors with mutual fund dealer firms or firms dually registered as both mutual fund dealers and investment fund dealers;

- *Retaining* the current option for advisors to be either employees or agents of their Dealer; and
- *Introducing* the option that all client-facing advisors may adopt an Incorporated Approved Person arrangement with their sponsoring Dealer, which would allow permitted regulated Canadian financial services sector activities, and ancillary activities, to be carried out by the Incorporated Approved Person.

While Dealers are not required to make the Incorporated Approved Person option available to their advisors, CIRO notes that there may be competitive advantages in terms of attracting and retaining talent for those Dealers who do make it available, versus Dealers that do not provide this option.

What does the Incorporated Approved Person model entail?

The Amendments propose the following requirements in connection with the Incorporated Approved Person model:

Who can have an Incorporated Approved Person and for what purposes?

- The individual associated with the Incorporated Approved Person must be a client-facing Approved Person of the sponsoring Dealer.
- The Incorporated Approved Person must be registered in the required category (or exempt from registration) in the applicable Canadian jurisdictions in which it operates.
- An individual using an Incorporated Approved Person must be approved by CIRO (to ensure there is a chain of accountability between CIRO, the Dealer and the Approved Person).
- The Incorporated Approved Person may only carry out activities that have been approved in advance by the Dealer, are not contrary to securities laws and do not bring the industry into disrepute. The activities are limited to being:
    - *Ancillary* to the activities performed by the Incorporated Approved Person on the Dealer’s behalf; or
    - *Regulated* Canadian financial services sector activities, provided the Approved Person is a qualified individual financial services advisor in the Canadian jurisdiction where the activities are being performed, who is not prohibited from engaging in such activities.

CIRO is requesting stakeholder feedback on the appropriate scope and prohibitions of the activities that can be performed, whether more than one client-facing Approved Person sponsored by the Dealer should be able to be employed by the Incorporated Approved Person, and any associated conflicts of interest that should be considered and managed.

Relationship between Approved Person, Incorporated Approved Person and Dealer

The proposed Amendments prescribe the key terms of the written agreement that will be required between the Incorporated Approved Person, the Dealer and the individual

Approved Person. However, we anticipate that tax considerations will drive the structure of these tripartite agreements and advice should be sought at the outset to ensure that the desired tax benefits are able to be realized.

CIRO prescribes the following contents for the agreement:

- Compliance with all applicable laws, securities laws and CIRO requirements (indeed, CIRO retains the discretion to require a Dealer to obtain a legal opinion in support of this compliance);
- The Approved Person must conduct all securities and derivatives-related business for the Dealer through the Incorporated Approved Person;
- The Dealer must be responsible for supervision of the Approved Person and the activities of the Approved Person conducted for the Dealer through the Incorporated Approved Person;
- The Approved Person must provide disclosure to impacted clients of the nature of the incorporated advisor relationship; and
- The Incorporated Approved Person must obtain prior approval from the Dealer before engaging in activities other than those being conducted on behalf of the Dealer.

Dealers are required to supervise each Incorporated Approved Person as they would an employee, are responsible for ensuring that the Approved Person and the Incorporated Approved Person comply with applicable laws and CIRO requirements, and are liable to clients and other third parties for the Approved Person and Incorporated Approved Person's conduct for activities performed on behalf of the Dealer.

We anticipate the adoption of an Incorporated Approved Person model will increase Dealers' supervisory burden, as CIRO will expect adequate systems to approve, monitor and supervise Incorporated Approved Person activities and prevent unpermitted outside activities, a risk which may be greater under these new structures.

We may also see an uptick in client complaints of misrepresentations related to confusion about the legal relationship among the Dealer, the Approved Person and the Incorporated Approved Person. To mitigate this risk, Dealers will want to ensure clear and consistent client disclosure.

In the event that CIRO or a securities regulatory authority commences an investigation related to misconduct by the Approved Person or Incorporated Approved Person, or in the event the Dealer has reasonable grounds to believe that the Approved Person or Incorporated Approved Person has breached CIRO requirements or securities laws, the Dealer is permitted to immediately, without notice, assume direct responsibility for the impacted clients, to the exclusion of the Approved Person and Incorporated Approved Person. The Dealer is permitted to designate another qualified person to provide services to the impacted clients, and that person may receive remuneration that would otherwise have been paid to the Approved Person and the Incorporated Approved Person.

Legal structure of the Incorporated Approved Person

A single Approved Person is the only permitted voting shareholder of an Incorporated Approved Person. This Approved Person must also be the sole director. The voting shareholder, as well as family members who qualify as a “related person” to the voting shareholder under the *Income Tax Act* (Canada), can be non-voting shareholders.

Approved Persons sponsored by other Dealers, and anybody subject to sanctions, are prohibited from being a voting or non-voting shareholder of an Incorporated Approved Person.

CIRO poses several questions about the appropriateness of these shareholder/owner limitations, including whether non-client-facing Approved Persons who meet certain criteria should be permitted to conduct business through, and own voting or non-voting shares in, the Incorporated Approved Person.

Critical tax considerations

Tax considerations will be central to the viability and structure of any Incorporated Approved Person arrangement. In particular, the written agreements among the Dealer, the Approved Person and the Incorporated Approved Person will need to be carefully structured so that the services being compensated are properly provided through the Incorporated Approved Person and so the arrangement can withstand the security of the Canada Revenue Agency (CRA) and Revenu Québec and avoid negative tax consequences.

If the arrangement is off-side applicable tax rules, the consequences may not be limited to the Incorporated Approved Person: the individual Approved Person owner may be assessed personally, including where amounts paid to the Incorporated Approved Person are treated as having been directed, transferred or assigned by the individual Approved Person. The potential tax implications for the Incorporated Approved Person can be significant, including loss of deductibility of certain expenses, loss of access to favourable corporate tax rates, punitive tax treatment applicable to personal services businesses (PSB) and potential double taxation. When structured in accordance with applicable tax laws and the proposed Amendments, an Incorporated Approved Person can provide individual Approved Persons with considerable tax benefits including (i) deductions for certain expenses not available to an employee; and (ii) potential tax deferral on the income. For example, in Ontario, services income earned by an individual is subject to a tax rate of 53.53 per cent, whereas a corporation earning such income may be subject to a corporate tax rate of 12.2 (for income that qualifies for the small business deduction) or 26.5 per cent (for all other active business income). This income will be subject to further tax (at 47.74 per cent and 39.34 per cent, respectively) when paid to individual shareholders as dividends, resulting generally in tax integration when the income is ultimately distributed to the individual.

Dealers and Approved Persons should seek tax advice at the outset, prior to structuring the new relationship, as the tax analysis will drive key terms of the agreements, including the persons entering each agreement, the terms of each agreement, the allocation of services, the legal and factual relationship among the parties, and the documentation needed to support the intended tax treatment.

While the tax considerations in Québec generally mirror the federal rules, Québec-specific issues should also be considered, including the risk of PSB treatment, which must be analyzed in light of the Québec *Taxation Act* and the *Civil Code of Québec*. Moreover, Revenu Québec has repeatedly indicated that its concern is not the commission-sharing arrangement itself, but rather determining who is legally entitled to the remuneration based on the parties' contractual arrangements. On that basis, Revenu Québec has audited a number of mutual fund advisors who allocated commission income to their corporations (using the 'directed commission' model), taking the view that the income remained personally attributable to the advisor for tax purposes. Whether this position will be revisited following CIRO's proposed Amendments remains uncertain. Several reassessments issued by Revenu Québec are currently under objection and are being held for review by a Revenu Québec officer pending the outcome of a similar case before the Québec court.

Practical implications of the proposed Amendments

New corporations

When evaluating whether and how to make Incorporated Approved Person arrangements available, Dealers and advisors will want to assess:

- Whether the tripartite agreement between the Dealer, the Approved Person and the Incorporated Approved Person will permit each party to have the desired level of control or flexibility.
- The cost, resources, and other practicalities of structuring the arrangement in a way that is compliant with both securities regulatory expectations and tax requirements.
- While the proposed Amendments are intended to provide greater flexibility for Approved Persons, the parties will need to carefully manage the allocation of risk and responsibility among the Dealer, the Approved Person and the Incorporated Approved Person. In particular, Dealers may face increased regulatory and litigation exposure as a result of being required to supervise the activities of an Incorporated Approved Person. Disputes could also arise over whether conduct was Dealer-related or whether it was outside of the Dealer-approved scope of activities for the Incorporated Approved Person.

Existing mutual fund dealer directed commission structures

Existing directed commission structures for representatives of mutual fund dealers will need to be assessed to determine:

- Whether existing share ownership and director structures align with the requirements in the proposed Amendments.
- How to restructure the existing corporation to comply with the proposed Amendments in a manner that is tax efficient.
- Whether CIRO is proposing a sufficient transition period and transition guidance (given the remaining ambiguities) for existing directed commission corporations to become compliant Incorporated Approved Person arrangements.

CSA registrants: Portfolio managers and EMDs too?

While the Amendments are not proposed to apply to CSA-registered portfolio managers or exempt market dealers, such registrants should consider whether to advocate for the inclusion of a non-individual registration category being equally available to them.

The path ahead

We see a lengthy path ahead before the proposed Amendments can be enacted.

The extent of the Canada Securities Administrators' (CSA) support for the proposed Amendments is as-yet unknown. Changes to securities law will be required, including to the securities legislation of various Canadian jurisdictions (Acts) and to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) to allow for advisor-owned Incorporated Approved Persons to carry out registrable activities and impose the corresponding regulatory obligations. Changes to the Acts will require provincial and/or territorial legislative changes by the relevant government, while changes to NI 31-103 will require public consultation, evaluation of the feedback, publication of finalized amendments and ministerial approvals. Currently, it is unclear whether changes to the Acts and NI 31-103 will (i) create an exemption from registration for Incorporated Approved Persons that carry out securities-related activities or, (ii) establish a new, less burdensome, non-individual registration category for Incorporated Approved Persons.

CIRO poses transition period questions in the proposed Amendments. Stakeholders will want to consider the extent of the efforts required to restructure, draft and negotiate these arrangements, as well as repaper policies and procedures to address the new requirements, and other considerations, to assess the sufficiency of the transition time proposed.

We urge Dealers and advisors to carefully consider how these proposed Amendments will apply to them and to provide suggestions and comments to CIRO by the November 6 comment deadline.

By

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