IIACACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Zach Masum
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British Columbia Securities Commission
701 West Georgia Street
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Dear Mr. Masum:

Re: BCSC Consultation on Securities Law Framework for Fintech Regulation (the "Consultation Paper")

The Investment Industry Association of Canada (the "IIAC" or "Association") appreciates the opportunity to comment on the Consultation Paper. As Fintech has been introduced into the finance ecosystem, it is clear that it has the potential not only to add efficiencies and introduce a new competitive element to the industry, but to fundamentally change the structure of the industry, insofar as how the many stakeholders (firms, clients, vendors, and regulators) interact.

The current regulation of the financial industry is characterized by the existence of regulatory silos governing the activities of entities that often undertake the same or similar activities. Firms delivering advice and products to clients can be registered as Portfolio Managers, IIROC registrants, MFDA registrants, Exempt Market Dealers, or Insurance providers. In many cases, the services delivered to clients by these entities are essentially the same, however the level of regulation imposed on the entity can vary significantly. Technology is agnostic, and can accommodate all of these platforms. Regulation imposes barriers, so that clients looking for more seamless delivery of services and information continue to experience inefficiencies in accessing these services. Clients are using technology to access a variety of services in their lives. Their expectation that financial services provide a more technologically efficient means to address their needs is driving innovation on the client services side, but regulation must keep up.

As such, when examining how the regulatory framework should be adjusted to accommodate Fintech and encourage innovation, regulators must take a very broad view of the regulatory landscape as it applies to all entities providing financial services to clients (including those outside the jurisdiction of provincial regulators). In order to ensure that Fintech is utilized to deliver maximum benefits to clients

and other stakeholders, the regulators must re-evaluate the current silo'd approach to the delivery of services. Consistent regulation should be imposed for those undertaking similar activities, rather than based merely on registration category. This approach would require a measure of re-structuring of the industry, from a more client based perspective.

Regulation should be streamlined to allow clients and registrants to use technology to operate across silos, where the technology allows for the appropriate level of investor protection for the particular activity and product involved in the transactions.

Allowing for more automated solutions to permit clients to move between the digital and traditional advice platforms would ultimately increase accessibility of advice, as it would reduce the friction between platforms by reducing dealer cost and investor inconvenience associated with starting from scratch with a new advisor on a different platform.

For example, the high cost of onboarding new clients through the IIROC and MFDA channels in particular, precludes many investors with smaller amounts of assets from accessing advice through these channels. As a result, the digital advice channel is emerging as the way in which new, and low asset investors are able to access investment products and advice. As the investor ages and their assets increase, generally their needs become more complex and it becomes appropriate for them to access advice delivered by an in person advisor. Securities regulation should be designed to make that transition efficient, so that the graduation to an advisor involves a seamless or simple transfer of information and knowledge about the client's history and evolution for account handoffs within and between firms.

One means of achieving this objective is to allow dealers to incorporate digital advice platforms in their firms, without the need to totally re-paper accounts when they move from that channel to the IIROC or MFDA channel. Currently firms would need to undertake the entire new client process if they are moving from a digital advice channel to the MFDA or IIROC dealer, even if it is in the same firm with multiple platforms. In order to move between platforms, the client must leave one platform to move to another. This is a process fraught with friction and inefficiency. The silos create barriers to an efficient and cost effective client experience and limits investor flexibility in accessing different products.

At a minimum, firms offering a digital advice channel should be permitted to allow clients to "graduate" in-house to their dealer advice channel without the process required when moving from one firm and advice platform to another. The client onboarding process should be closely examined to ensure that there is consistency in respect of the required information and processes, and that efficiencies provided to Fintech platforms are also afforded to dealers in respect of similar functions. We suggest that regulators compare the client opening procedures and paperwork required from each of the various platforms to highlight the differences and identify areas for harmonization.

Clients moving from, or splitting their portfolio between a digital advice platform outside of a dealer, to a dealer should be able have access to a more expedited transfer process than currently exists in order to leverage off of the information provided to the digital advice platform. We note that the idea of more data portability is being considered by the Standing Committee on Access to Information, Privacy and Ethics in their February 2018 report, entitled *Towards Privacy by Design: Review of the Personal*

Information Protection and Electronic Documents Act. The ability for consumers to transfer their data in a uniform manner among financial services would help facilitate the use of digital platforms.

In the interim, it is appropriate that in respect of Fintech, regulation should take an approach that imposes the same regulatory standards for the same activities when they are taken digitally or manually, whether through a registered firm or a Fintech provider. This may require the imposition of existing regulation on Fintech providers for certain functions, or reducing the regulatory burden for existing registrants where they are undertaking the same activity for which the regulator has determined certain provisions do not apply when they are done digitally. Existing registrants should not be held to a higher standard than that which applies to a Fintech provider for the same activity undertaken in the same manner. Given the proliferation of regulation in the past number of years, we recommend that the regulators closely examine current requirements to determine what truly is needed to promote investor protection, and what legacy requirements do not demonstrably contribute to investor protection, particularly given the implementation of CRM2.

Clients should be protected in the same manner, through the same suitability and KYC standards whether they access products through a digital platform or more traditional advice platforms. As such, where certain regulatory concessions and carve outs are granted to digital platforms (such as investment limits in respect of crowdfunding), these concessions should also be available to IIROC and MFDA dealers undertaking those types of activities. Regulators must also consider what is appropriate to ensure OEO platforms are not unduly burdened with regulation that applies to advice-based platforms.

It is important that regulators consider the broad investment landscape when introducing regulation to accommodate Fintech. The introduction of these new tools and platforms to an already complex investment environment is likely to result in investor confusion and uncertainty about the characteristics, protections and appropriateness of specific channels for their specific circumstances. As the investment landscape becomes more complex, and regulators allow for new participants, their investor education and guidance must reflect the current environment including its risks and opportunities. Regulators should provide investor education on how to navigate the various channels, outlining the key characteristics of the various platforms to assist investors in making informed choices about where they may wish to access advice.

In respect of the application of Fintech to industry infrastructure, such as the use of blockchain for clearing purposes and adoption of cryptocurrencies, regulators should be mindful of the cost of significant market structure changes on smaller industry participants that do not have the resources to be proactive in adoption of emerging technologies. In approving and encouraging the use of Fintech, regulators must consider the implications in the short and medium term of whether it affects a subset of participants willing to adopt new technology, or whether its adoption by entities operating critical market functions will effectively require all market participants to adopt the technology in order to effectively carry out their business. Technology that has implications for significant changes to the underlying market infrastructure must be carefully evaluated and regulators should consider where it is appropriate to require parallel systems to be operational for an appropriate transition period.

Specific Issues:

Crowdfunding

As we have stated in previous submissions, the IIAC has several concerns about the investor protection element of crowdfunding. The crowdfunding process is characterized by minimal or non-existent KYC and suitability assessments, depending on the portal and exemption utilized. Crowdfunding also represents an example of a non-level playing field, in that registered investment dealers cannot set up a portal without being subject to all of their suitability requirements, meaning that using this exemption or setting up a portal is not possible from a cost perspective.

The result is that investors participating in crowdfunding are extremely exposed to losses, from inappropriate investments, fraud or market failure. Investor and issuer limits provide an effective means of limiting the risks and regulatory imbalance, and should be retained as part of the regulatory framework.

Low utilization of crowdfunding may be due to the risks, and that it does not present as an attractive investment vehicle. We do not believe raising the investment limits will remedy this problem, and will only increase the potential risk, while also increasing the overlap in respect of the well-regulated registered dealer space. We believe crowdfunding is best utilized outside the securities area, for charitable projects or product based ventures where subscribers receive the actual product in development, rather than shares in an issuer.

Research should be undertaken to understand the effectiveness for issuers and investor outcomes in respect of crowdfunding projects. Only after a thorough analysis of the effect of this means of capital raising has been undertaken, should changes be contemplated.

Online Advisors

The question of how online advisors fit into the advice continuum raises a number of issues. There are a number of different models employed in different jurisdictions; some requiring human contact and others that only involve digitally generated advice. The Canadian model, which includes a requirement for personal contact, adds complexity to the process that is not present in the US model.

Certain IIAC members are of the view that digitally managed portfolios are comparable to more traditionally managed accounts. Although the computer models make the decisions, the parameters and considerations taken into account by the algorithm and the human are the same, or very similar. The differences in digital vs human advice should be more closely examined to determine if there are differences in outcomes and investor protection.

Some members suggested that the decision as to whether personal advice is provided be left up to the investor, with different channels having different options as to the degree of advisor contact. For instance, clients could choose a digital-only channel with no expectation of advisor contact, or a hybrid model with advice on demand, either through an advisor dedicated to their account or from a pool.

A number of questions arise in respect of the issue of the use of Artificial Intelligence in the KYC and suitability assessment process. Currently, the digital advice platforms use their algorithms to place

investors in ETFs, but not individual securities. The current premise underlying the regulation is that personal contact is not required where the products are simple. Once products move beyond simple ETFs, personal contact is required.

Regulators should consider whether products sold through digital channels should be limited to simple ETFs, or perhaps the amount of non ETF securities offered without advice be limited to a specific percentage of a client's portfolio.

In making these decisions, it is important that regulators review the practices, and outcomes of other jurisdictions that have accommodated digital advice in their regulatory structure. The analysis should also include the types of investors that are utilizing the platforms (ie: millennials, seniors, other)

Cybersecurity

The introduction of new technology based services involving large scale data use and sharing, raises increased concerns about the cybersecurity stature of all participants using and accessing data. In order to ensure the industry as a whole is protected, and given the value and sensitivity of client information uniform security standards should be developed for those with access to this information.

Cryptocurrency Funds, ICOs and Cryptocurrencies

The current ICO and cryptocurrency landscape presents a number of problems. There is no consistent methodology to assign value to cryptocurrencies, making them subject to manipulation. The many failed ICOs and cryptocurrencies are a testimonial to their risk. Without proper and consistent regulation and means of valuation, the cryptocurrency market will be marked by ongoing failures and fraud, which will impede the growth of credible and useful crypto-based Fintech.

As with other elements of Fintech, we believe the premise of regulatory level playing field is critical in regulating cryptocurrency funds. If the funds are deemed to be securities, they should be regulated as such. It is important to distinguish between the cryptocurrency funds and the cryptocurrency itself in how it is regulated. Whether a cryptocurrency is regarded as a proxy for cash, a security or is restricted to purchase certain assets will make a difference in the regulatory treatment.

Given that cryptocurrencies represent an asset that is significantly different from what advisors generally deal with, new proficiency requirements specific to this asset should be developed. It would be helpful to investigate if other jurisdictions have developed any such requirements.

The area of custody of cryptocurrencies requires significant analysis. The current rules regarding the role of the custodian should be carefully reviewed and adjusted for cryptocurrencies, as current custody rules are likely too rigid to accommodate cryptocurrency.

Some of the questions that arise in respect of cryptocurrencies include: who is the custodian of the currency, and how does one verify how it's held, beyond the crypto-wallet. It is also unclear whether dealers have to adjust their margin to accommodate these holdings. Currently there are no regulated entities that are qualified custodians for cryptocurrency in Canada, so foreign custodians may have to be used.

Cybersecurity is also a key element that applies to cryptocurrencies. The custody risk for these assets is different than more traditional securities and must be addressed specifically. Cryptocurrency is not designed with a central custody model, as individuals act as their own "bank". Regulators must reconcile the design of cryptocurrencies with the need for security. It is also unclear how and if holders and dealers operating in this space will be able to obtain insurance.

Guidance is also required in respect of valuation of cryptocurrencies, and how it differs from other assets. Complicating this issue is the fact that cryptocurrency exchanges do not have set hours, so closing prices are not ascertainable, and therefore mark-to-market prices cannot be determined.

It is important for regulators to continue to articulate the characteristics they consider when attempting to determine whether the distribution of coins or tokens constitutes a distribution of securities. The additional variables listed in the Notice also provide useful factors to make that assessment.

Fintech Regulation in the Future

It is important that in developing regulation for the future, that regulators not be confined by legacy models of business and regulation that were built for the past. With rapidly evolving technology, new business models will emerge and regulators will need to be flexible in the way they approach their mandate to protect investors and foster healthy capital markets.

Regulations will have to be more outcomes based, rather than process based to allow for innovation.

Investors now and in the future will be faced with many more choices as to where and how they wish to manage their wealth. With the growing number of choices, and the rapid changes to all aspects of the financial industry, it is important to educate investors and simplify the investment process to allow them to make appropriate decisions, taking into account all of the options open to them. Advisors dealing in new Fintech products and with different infrastructure should also be educated as to what they are dealing with, and how it fits into the financial ecosystems. Specific courses and proficiency requirements will have to be developed in order to ensure the products, services and infrastructure is well understood by those providing it to their clients.

The regulatory "sandboxes" and technology committees will play an increasingly important role in regulator education and their ability to foresee regulatory issues based on emerging technology. In evaluating their response to these new technologies, regulators must not only consider the direct impact of the technology on investors, but how it affects other market participants, in terms of how they will use the technology or compete with it. Regulation should not provide particular participants, whether new Fintech companies or incumbents, with a regulatory advantage when conducting similar activities. To that end, regulators should not only invite new market participants to participate in their sandbox, but also allow incumbents to test their technological innovations in the same manner.

Regulators must take steps to understand the evolving technology and financial landscape, and build a regulatory framework that can accommodate the changes, rather than attempting to retrofit regulation built for a different era. It is critical for regulators to keep abreast of the developments and experiences in other jurisdictions to foresee avoidable problems and benefit from successful initiatives.

Thank you for considering our comments. If you have any questions, please don't hesitate to contact me.

Yours sincerely,

Susan Copland