



February 3, 2017

DELIVERED VIA EMAIL

Mr. Charles Piroli
Director, Member Regulation Policy
Investment Industry Association of Canada
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Re: Request for Comments - Guidance on Order Execution Only Services and Activities - as per Notice 16-0251 issued by the Investment Industry Regulatory Organization of Canada ("IIROC") on November 3, 2016

Dear Mr. Piroli,

The Investment Industry Association of Canada (the "IIAC") would like to take this opportunity to express its views on the "Guidance on Order Execution Only Services and Activities" as per IIROC Notice 16-0251 issued on November 3, 2016.

The IIAC is the national association representing the position of 132 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

To the extent that IIROC has requested comments on the issued Guidance (expectations and requirements) as well as comments on “any matter which it does not specifically address”, we will provide a broad range of comments from our Order Execution Only (“OEO”) member firms.

This Guidance, as per our initial understanding, seemed to add additional requirements to the OEO model. We now understand, following a meeting with IIROC held on January 24, 2017, that it is not IIROC’s intent to add requirements. We therefore believe the wording of the Guidance must be changed because it currently creates ambiguity and confusion for our members.

IIROC’s Mission

IIROC’s mission is “to **protect investors** and support healthy Canadian capital markets, while addressing the many changes impacting the industry”. We question whether the Guidance, as drafted, is achieving this mission.

Our Industry’s Position

We doubt that IIROC has received many client complaints against OEO firms regarding the use of research, data and tools. Furthermore, we feel the existing disclosures to OEO clients are very clear: The client controls the investment decisions, OEO firms are not providing recommendations.

Industry’s Key Concerns

The industry has many major concerns with the proposed Guidance. The key concern of our member firms is that clients may use online “educational” tools, products and information containing inaccurate data and information from unreliable sources in order to make investment decisions if the Guidance is implemented. Investors request tools and information from OEO firms in order to make educated investment decisions. Providing a wide range of documentation and products is to the benefit of the client and this Guidance, if implemented, will not protect the investor and is therefore not in the best interest of the client.

We also believe that there are two other major concerns with the introduction of the Guidance:

- 1) An overly broad definition of “recommendation” and its ensuing applicability to both OEO and Advice dealers; and
- 2) The introduction of an “appropriateness” test.

There is a well-established existing regulatory regime regarding account opening (such as checks for margin accounts and for certain option related strategies). The Guidance brings ambiguity and confusion with its introduction of new concepts. With the introduction of the “appropriateness” concept (as currently written), the industry would be layering on a new unnecessary regulatory definition with which to comply.

We doubt the OEO Dealer model and the OEO Industry would survive the changes proposed in this Guidance. Furthermore, we believe any extensive change proposals should only be published following a cost/benefit analysis. Such an analysis should have been performed before publishing this proposal.

The OEO Firm’s Role

The main role of an OEO firm is to provide investors with access to financial marketplaces at a low cost. Clients turn to OEO firms in order to fully control their investments. As it stands, OEO dealers execute orders based solely on client instructions. As OEO firms do not provide advice to clients, they represent a lower cost alternative to a full-service firm, and fill the need that exists for investment services to be available to individuals who do not meet the minimum investment thresholds now required by most full-service advisors.

OEO member firms are able to provide these execution services at a reasonable cost because they:

- 1) sought to leverage technology to its fullest extent in order to automate the transaction process for the client, and;
- 2) are exempted from the suitability requirement and therefore do not provide recommendations to their clients.

Over time, OEO dealers enhanced their value proposition by incorporating educational resources as well as detailed tools and products which assist investors in making their investment decisions.

The investor’s demand for these types of tools and resources has continually increased in parallel with the growth and adoption of the Internet itself. Firms now compete in the marketplace based on how resourceful and client-friendly these tools and resources are. OEO firms collectively feel that increasing the investor’s knowledge level and providing valid information that keeps the client well-informed is in the best interest of both the client and of the industry itself. We strongly believe that these developments align with the IIROC mission of investor protection.

Despite these increasing levels of sophistication in their information and educational resources, investors demand that these services continue to be rendered at a reasonable price. This is evidenced by OEO commission rates dropping, on average, by more than 60% since the onset of this industry in Canada in the late 1990’s. In many cases, trades can be completed for less than five dollars.

Survey Results

We acknowledge the results of the independent survey of OEO clients undertaken to ascertain their views regarding some of the tools OEO firms make available to them. It should be noted that the survey was limited to three specific investment tools (asset allocation tool, pick list portfolios and automated model portfolio), which were found to be “not widely seen or used and have limited appeal among non-users”.

However, the survey did not query OEO client views of the other, more widely available and used investment tools such as access to investment research, historical market data, various filters and alerts. We note that 59% of the surveyed OEO clients agree that they “enjoy doing investment research and investing”, presumably with the assistance of OEO offered investment tools. In our view, this is a critical finding that demonstrates the value of the OEO investment education offering. Preserving and building on the success of meeting OEO client needs must remain top of mind during this important consultation. Furthermore, we doubt that IIROC has received many client complaints against an OEO firm regarding the use of research and tools. As previously mentioned, we feel the existing disclosures are clear: The client controls the investment decisions, OEO firms are not providing recommendations. OEO clients are well aware of the OEO model, its characteristics, its risks.

Potential Negative Consequences of the Proposed Guidance

We want to ensure that IIROC understands the severity of the actual impact these changes would have on the entire OEO business model and industry. We believe that many elements in the proposed OEO Guidance would not protect, nor help, retail investors, as it was intended to and would in fact make a retail investor’s ability to invest in capital markets significantly more challenging for the following reasons:

- OEO firms provide many different tools to clients so that they can make their own investment decisions. Limiting the range of tools available to clients through OEO firms would likely force clients to make decisions without fully understanding a product or account type, or without having access to all the information that would assist in making that investment decision.
- If OEO firms do not provide educational data and tools, investors may rely on inaccurate information from unreliable sources in order to make investment decisions.
- We are concerned that if the products and account types are to be limited based on a client KYC information, clients may be tempted to overstate their knowledge and experience at account opening in order to have access to a greater range of products. This opportunity to “game” the account opening process is something that the industry cannot prevent as firms rely on customers self-reporting their knowledge and experience.
- Firms may decide to limit the product offering to low risk products in order to decrease their exposure to potential liability. Offering only “plain vanilla” products to investors would clearly not be in the best interest of clients with more complex investment objectives.

- Investors that do not currently qualify for the “advice-giving” threshold of some full-brokerage firms would possibly never qualify if tools/information provided by the OEO firms are not there to help them increase their knowledge, and ultimately their investment wealth.
- Subjecting OEO brokerage firms to increased requirements will inevitably result in higher costs for investors since firms will need to create the necessary infrastructure. If costs increase, clients once again may turn to non IIROC-regulated solutions to meet their needs.

IIROC must consider burdensome costs associated with system changes, training, time spent to open accounts, time to execute, human intervention costs, just to name a few. We expect a significant increase in liability risk which must also be considered by IIROC before implementing these proposed changes.

Appropriateness Analysis

The “appropriateness analysis” requirement must be clarified as, for our member firms, the term “appropriateness” means “suitability”. OEO firms do not currently have an “appropriateness analysis” requirement as it is described in the Guidance. However, the firms do have certain credit requirements (such as options, margins) which are very different from the appropriateness analysis requirement discussed in the OEO Guidance.

The Guidance states that “OEO firms should be able to demonstrate why they determined that a particular product or account type was or was not appropriate for a client”. Our members believe that such a determination by an OEO firm is advice/recommendation to a client, which is against the “No Recommendation Condition” that OEO firms are required to follow. In order to determine whether a product or account type is appropriate, a firm would have to determine the client’s investment objectives and risk tolerance. This would become very challenging without a face-to-face meeting. The Guidance is blurring the line between the OEO model and the full-service brokerage model.

It should be noted that typically only non-exchange listed products offered by an OEO firm have been approved by an internal product committee, a Due Diligence committee, or obtained similar approval. Approving particular products for a particular client would inevitably create more work for OEO employees and would therefore increase costs for clients that seek a low-cost alternative to full-service brokerage.

We also feel the proposed Guidance could potentially increase the number of litigation cases. Could a client complain if “complex” products that he/she is not allowed to trade (based on the firm’s analysis) gives a higher return than “plain vanilla” products he/she is offered?

Another issue arises regarding the continuous appropriateness analysis. Events may take place in a client’s life that would change the “appropriateness” evaluation performed by a firm. How can an OEO firm ensure the continued appropriateness of an account? What happens if a client is using margin and then somehow it is deemed inappropriate? Is the OEO firm expected to sell out the client in order to return the client to correct level of “appropriateness”? What if the client opposes these changes? There are

many challenges associated with an appropriateness test in the OEO business model which is why we do not support this proposed requirement. The appropriateness analysis cannot be performed in the OEO model.

Further to this point, what is an OEO firm expected to do when the status of an individual investment changes from being appropriate to inappropriate due to changes in the issuing company or the underlying security? The same challenges noted above would also arise.

Furthermore, an appropriateness analysis performed by an OEO firm is subjective, and would vary from firm to firm; it may be based on incomplete information. Research suggests that, in most cases, the accounts/assets clients hold at an OEO firm represent only a portion of their total investments. Clients may not divulge assets held elsewhere, nor their financial liabilities. The OEO firm could reach an appropriateness conclusion that is inaccurate since it is based only on a portion of the client's financial situation.

We remind IIROC that OEO dealers do not currently make any subjective decisions on behalf of their clients. While there are eligibility requirements for certain products and services, we note that these are clients' self-declared situations that support the execution of certain client orders. OEO dealers do not and should not make decisions about "appropriateness". We remind IIROC that OEO clients control their investment decisions in the OEO model.

We believe that the "appropriateness" determination fundamentally contradicts the reason why a client chooses to use an OEO dealer. The costs of this "appropriateness model" will not allow OEO dealers to offer its services efficiently and at a low cost, which is the very reason for their existence. As previously mentioned, we doubt the OEO Dealer model and the OEO Industry would survive the changes proposed in this Guidance.

Meaning and Application of "Recommendation"

For our members, the intent of the firm when providing tools and information is key to evaluate if a recommendation is being made. The context in which the information is provided should also help differentiate between recommendation and education. As requested by the clients, firms usually make available research done by different entities on a particular product. The research reports may have different views (buy, hold, sell) on a product. The goal of the OEO firm is to educate, not recommend. We believe a "recommendation" from a firm would necessarily be a clear "call to action" (such as "you should"). A "call to action" from a firm would be made with the intent to drive a specific behavior. This type of action should not be tolerated in the OEO business model.

The IIAC and its members understand the intent of the Guidance put forward by IIROC but, as previously mentioned, have concerns with the ambiguity and confusion it creates for the industry. While specific examples are used, IIROC bundles tools into categories that inadvertently expands the scope of tools subject to the Guidance. An example of which is "Trading Tools". IIROC refers specifically to algorithmic

trading programs, but then states that trading tools should not be offered. This blanket statement captures other trading tools that are used by clients such as a probability analyzer and technical tools.

Another example of the category ambiguity is under the Rebalancing alerts section where IIROC refers to future/predictive information. Informative tools are being captured under the umbrella of rebalancing, yet informative tools are broader than rebalancing. For example, technical tools have been available to self-directed investors for over 15 years. These tools are very informative to self-directed investors and do not appear to differ from the tools IIROC is proposing. The results generated by these tools are not pushed to clients, they are only provided based on inputs from the client.

Furthermore, Part (d) of the Rebalancing Tools section (page 12 of Appendix A) suggests, in cases where a rebalancing tool has been employed by a client to execute orders in accordance with a client's pre-determined levels, that OEO dealers must, in unforeseen circumstances, interfere with those instructions and implement safeguards to manage risks. The example given is in the case of a plummeting security. We do not understand how OEO firms would be expected to foresee an event that is unforeseen, much less make decisions about what is potentially harmful to clients. The provision of any alert based on market activity, risk and the subjective decision of an OEO dealer is indeed a recommendation. This section contradicts the "No Recommendation Condition" contemplated in this Guidance and should be removed entirely.

Regarding the "pull" and "push" information, OEO firms agree that "push" information may, in certain circumstances, be considered advice by clients. However, it should be noted that the client must log into the firm's platform in order to find product information, account type information and to execute trades. As a general practice, OEO firms do not send information to clients without the client initiating the request. Information is only made available to clients if they log into the firm's platform and "request tools and information" which are then provided through subscription to product/account specific email alerts.

OEO firms require the ability to "push" information to clients so that they are aware that educational information is available to them. To prohibit OEO dealers from providing this information could be harmful. We strongly believe that OEO clients have the right to be informed about products and account types, and educational information should be provided to them so they can effectively manage their investments and knowledge base according to their needs. It should be noted that OEO firms often host client seminars to improve financial knowledge.

Furthermore, limiting the ability of a client to "pull" research reports relating to a particular class of securities that the firm could consider "inappropriate" for a client is a substantial technological build for the systems currently in place, and would once again increase costs for clients seeking a low-cost trading option.

It should also be noted that our members do not agree that Hyperlinks should be considered "recommendations" when a firm makes it clear to a client that:

- 1) the client is leaving the firm's website; and
- 2) the firm does not endorse the content of the third party website.

Once again, we believe the existing disclosures to clients are clear.

Further clarification is required since Footnote six of Appendix A states that IIROC expects OEO firms to apply the Guidance to all investment products offered, not just securities. Further clarity on the scope of the term “investment products” is necessary.

In addition, we request clarity on the exact definition of a complex product. One might argue that leveraged ETFs are more understandable than the structure of some issued common stocks. Also, exchange-traded leveraged ETFs are very liquid and a prospectus is made available online for clients. Further, product classes such as exchange-traded options can simultaneously be considered as both an effective risk mitigation product or a speculative trading product - depending on their usage. This ambiguity adds to the challenges of the implementation of this Guidance.

It should be noted that complex products and tools are offered because clients request them. The client base has evolved since the beginning of the OEO model. Clients are now comfortable using the internet and mobile devices. The OEO firms can provide convenient, user-friendly and cost efficient “complex” tools as requested by their clients in order to meet their needs.

We also have concerns on historic vs. predictive tools. The Guidance seems to indicate that providing historical data to customers is allowed but that providing predictive tools is not. We believe that clients must have a broad range of information. Clients should have access to historical data, present data, as well as predictive tools (such as technical analysis tools) in order to have a complete understanding of a product. Removing predictive tools would force clients to make investment decisions based on the past. As you know, past performance is not indicative of future results. We believe that the more tools are made available to clients, the better the perspective they will have. These predictive tools contribute to increasing the knowledge of clients which is in the best interest of investors. We believe that predictive tools, that do not contain a “call to action” or view point, are not recommendations.

As it relates to the definition of a “recommendation” we do not believe that a definition should be included in a Guidance notice. If IIROC wishes to develop a recommendation definition, then it should be done through the formal rule making process. Specifically, to the definition itself, IIROC should consider removing the term “investor” and substituting it with “client” or “prospective client”. An investor is an overly broad term that can apply to anyone who may be interested in making a trade or an investment decision. An investor may include an institutional client, a highly sophisticated client, and a client of a full-service firm. The definition must be pared down to specify who is subject to this definition. Further, a client who goes onto one dealer’s website and reads a report or uses a tool and then executes a trade on another dealer’s platform should not be included in this definition.

Technological Impact and Implementation Time

The implementation of IIROC's Guidance would require that firms provide clients with an appropriateness test for a product or subset of a product (reverse and leveraged ETFs for example). Order Management systems are not built to limit a specific issue to a subset of clients. To accomplish this and deliver the same level of trade efficiency clients have come to expect would entail a massive technology "re-build" to create logic that customizes the product scope available to each individual client. This would mean increased fees for the client.

In addition, while firms may control account type (e.g. margin vs cash), they have never built logic into their account opening process to determine whether to accept a prospect as a client based on an appropriateness test. Furthermore, if the account opening process becomes too onerous, clients may turn away from OEO firms altogether, and may not have access to other IIROC-regulated alternatives.

Members view restricting the product or account type information available to clients based on their investment knowledge to be a major technological hurdle and are concerned that the use of KYC information collected from clients by an OEO firm to determine what products or account types are available to them could be interpreted as advice/recommendation by the clients.

Our members agree that IIROC should update this Guidance due to its negative impacts on both the clients and industry. Furthermore, our members agree that substantially more than six months would be needed to implement any technological changes to the onboarding and re-documentation processes following the publication date of a Notice of Approval. However, to be clear: the OEO dealers remain firm in their opposition to the implementation of this Guidance.

We also believe that the proposed changes contradict the industry's efforts to support Fintech innovative solutions. In fact, OEO dealers are the largest and longest standing successfully regulated Fintech organizations, who deliver technological solutions to clients at a low cost.

We strongly recommend that IIROC complete a feasibility study on whether it is possible for an OEO dealer to survive with implementation of these proposed requirements, particularly in the light of the important costs associated with these technological and procedural changes. These drastic changes need to be fully understood prior to knowing how long an implementation would take as this is an entire business model change. To be clear: the members are against many elements of the IIROC Guidance and doubt the OEO business model and the OEO Industry would survive the proposed changes.

Standardized Exemptive Relief – Model Portfolios

We believe standardized exemptive relief for model portfolios should be granted. The industry will need clearer guidance in order to obtain a better understanding of the exemptive relief process as questions remain despite details included in subsection 6.1 of the Guidance. The view of OEO firms is that providing model portfolios to clients does not mean that "limited advice/recommendations" is being provided.

We are supportive of IIROC setting standards that prevents OEO firms from trying to influence clients to execute certain transactions. OEO firms have always tried to help improve client awareness of the markets by providing tools and information. Parts of this Guidance would make it increasingly difficult to fulfil this service. It should be noted, once again, that the intent of the OEO firms is to educate, not recommend.

Furthermore, investors using the services of OEO firms are well aware that they control their own financial future. Our industry must help these OEO clients by providing appropriate applications, tools, products and account types in order to help investors reach their investment goals at a low-cost.

Cost to Clients and Industry

We believe that these proposed changes would greatly increase the cost to the industry of running an online dealer. In particular, the changes to the supervisory structure of an online dealer would increase substantially with the proposed appropriateness assessment. There would be other costs such as changes to account forms, changes to processes and systems, technology updates, and other supervisory changes. We would also see a substantial rise in costs for full service dealers that will be required to change their supervision to adhere to the new definition. All these increased costs will eventually be passed on to the client who elects an OEO model for its current low-cost investing platform. To keep the current low price of this activity, OEO brokers may decide to only offer “plain-vanilla” products which would not be in the best interest of the clients. The negative impacts of this Guidance are important.

Major Regulatory Changes through Guidance

There are systemic issues that ought to be raised at this time, as this Guidance notice highlights some of those issues: the use of a “Guidance notice” in order to effect a large scale change to the industry instead of opting for the route of a rule change.

A Guidance notice is issued in order to clarify existing regulation, not to create new regulation or laws. We see that as a significant corporate governance issue where a rule change requires the IIROC board and CSA approval, whereby a Guidance notice does not require such process.

The IIAC believes any major regulatory change should be introduced, no matter the topic, as a rule amendment and not a Guidance notice.

We also believe that a Guidance should include items that firms can easily monitor and supervise.

Conclusion

As previously stated, we doubt that IIROC has received many client complaints against OEO firms regarding the use of research, data and tools. The industry is not aware of a systemic problem of that type.

We feel the existing disclosures are clear: The client controls the investment decisions, OEO firms are not providing recommendations. The Guidance is not protecting, nor helping, the investor.

The IIAC and its members remain available for further discussions on the topic and for review of an amended Guidance.

Yours sincerely,



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