IIROC OCRCVM
Investment Industry Regulatory Organization of Canada
Organisme canadien de réglementation du commerce des valeurs mobilières

IIROC NOTICE

Rules Notice
Notice of Implementation
Dealer Member Rules

Please distribute internally to:
Legal and Compliance
Retail
Operations
Senior Management
Trading Desk
Training

Contact:
Charles Piroli
Director, Member Regulation Policy
416-943-6928
cpiroli@iiroc.ca

18-0075
April 9, 2018

Guidance on Order Execution Only Services and Activities

IIROC is publishing final guidance (**Guidance**) regarding order execution only (**OEO**) services offered by Dealer Members pursuant to existing IIROC Dealer Member Rules (**Appendix A**). The Guidance outlines our expectations and requirements currently applicable to all Dealer Members engaged in OEO activities (**OEO firms**).

We published a draft of the Guidance (**Proposed Guidance**) for comment on November 3, 2016 in Notice 16-0251 - *Guidance on Order Execution Only Services and Activities* (**Notice 16-0251**).[1] We refer you to that Notice for additional background information. In response to the comments we received we made certain revisions reflected in the Guidance. **Appendix B** is a blackline of the Guidance showing the changes made to the previously published draft.

The Guidance replaces Member Regulation Notice MR-098 – *What Constitutes a "Recommendation"? Is a Suitability Determination Required Under Regulation 1300.1,* dated September 6, 2001 (**Notice MR-098**).

[1] See Appendix A of Notice 16-0251.

1. Related Matters

We considered a number of related matters in developing the Guidance. These matters, once finalized, may require us to amend the Guidance, provide additional guidance, or amend our rules.

(a) *CSA targeted reforms*

The CSA is continuing to work on proposed amendments[2] to the core elements of National Instrument 31-103 - *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. These amendments may impact our rules applicable to OEO activities or the Guidance. We will continue to monitor this work and its implications.

(b) *CSA consultation on discontinuing embedded commissions*

The CSA is also continuing its work on embedded commissions[3], and exploring options to address, among other things, conflicts of interest. OEO firms offering funds that pay a trailing commission for ongoing advice (e.g., Series A funds) is an example of a conflict of interest.

The outcome of the CSA's work on this matter may require us to make amendments to align our rules and this Guidance with the CSA's requirements. In the meantime, we include in the Guidance a discussion on the need for OEO firms to address the conflicts of interest relating to embedded commissions. Section 2 below discusses this issue in more detail.

(c) *Evolving Advice & Service Models*

In IIROC's Priorities for 2018[4], we indicated that we would be working with industry to:

- determine whether our requirements present any unnecessary barriers for evolving business models
- ensure that our core regulatory obligations (including know-your-client, know-your-product and suitability rules and guidance) are appropriately scalable and flexible for the level of service and nature of advice provided by each business model.

(d) *PLR Project*

Several years ago, IIROC started a project to rewrite, reformat, rationalize and reorganize its rules in plain language. We published proposed plain language versions of our rules, in multiple parts and in its entirety, at various times since 2010. Most recently, we published the proposed PLR, in whole, in March 2017[5] and, in part, in January 2018[6].

As a result of comments received on the March 2017 PLR publication, we amended a few of the OEO-related rules and published them for comment in January 2018.[7] Generally, we made

---

2 See CSA Staff Notice 33-319 - *Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*.
3 See CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions.*
4 See section 1.2 of Administrative Notice 17-0117 - *IIROC Priorities for 2018.*
5 Notice 17-0054 - *Re-publication of Proposed IIROC Dealer Member Plain Language Rule Book*.
6 Notice 18-0014 - *Re-publication of Proposed IIROC Dealer Member Plain Language Rule Book.*
7 Please refer to Notice 18-0014 for additional details.

these proposed amendments to maintain existing practices of OEO firms and client expectations (e.g., the exemption from the Product/Account Type Appropriateness requirement, as described in section 3(a) below).

To assist readers, we have included references in this Notice and the Guidance to applicable PLR provisions. Since PLR is not yet effective, we have shaded these references in grey. Upon implementation of PLR, we will remove the grey shading.

2. OEO firms offering Series A funds

We acknowledge that funds that pay an ongoing trailing commission to registrants (often described as a payment for advice and services provided to the investor by the registrant), and are made available by OEO firms (e.g., a Series A fund), raise a conflict of interest. Under our rules, a Dealer Member must address conflicts of interest considering the best interests of the client or clients.[8]

In the Guidance, we indicate that OEO firms should consider how they will address any compensation-related conflicts when deciding which series (or series equivalent in the case of a PTF) of a fund to make (or not make) available on their platforms. We recognize that many OEO firms have already implemented practices to address this conflict.

We expect that OEO firms will make available, whenever possible, funds that do not pay a trailing commission for ongoing advice (often referred to as a Series D fund).

When a Series D fund is not available (e.g., because a fund family does not offer that type of series) and an OEO firm makes available another series that pays a trailing commission, we also expect the firm to address the conflict by rebating to the client the portion of the trailing commission for ongoing advice, or taking other similar steps.

A large majority of the publically available funds include a trailing commission. Management of the conflicts of interest relating to trailing commissions by OEO firms allows investors continued access to the widest possible range of investments.

3. Comments received on the Proposed Guidance

We received 32 comment letters in response to Notice 16-0251. A summary of the comments and our responses is available in **Appendix C**.

The two areas that received the most attention from commenters were *account appropriateness* and *model portfolios*.

(a) *Appropriateness*

In Part 2 of the Proposed Guidance, we discussed our expectation that, as part of the account opening process, OEO firms determine whether:

(i) it would be appropriate for an investor to become a client of an OEO firm (**Account Appropriateness**)

[8] See section 42.3 of Rule 42 – *Conflicts of Interest*.

(ii) the scope of products and account types that a potential client would have access to within their OEO account would be appropriate for that potential client (**Product/Account Type Appropriateness**).

In the March 2017 publication of the proposed Plain Language Rule Book (**PLR**)[9], we codified this concept in a rule applicable to all Dealer Members.[10] We did not consider this to be a new obligation on Dealer Members, but merely a codification of discussions contained in Notice 12-0109[11].

A number of OEO firms expressed concern with IIROC's expectations on determining Product/Account Type Appropriateness and commented that it:

- is not consistent with their existing practices and would be costly to implement
- would result in higher fees for clients (as costs would be passed through).

In light of these comments, we reconsidered the applicability of Product/Account Type Appropriateness to the OEO business model. In re-evaluating our position, we also considered the following factors:

- the potential benefits and risks to clients
- fostering investor protection
- the importance of maintaining the OEO business model as a low-cost option for investors.

In balancing these factors, we consider determining Product/Account Type Appropriateness as inconsistent with a suitability-exempt business model. Accordingly, as part of the January 2018 PLR publication, we confirmed that OEO firms are only required to conduct Account Appropriateness and not Product/Account Type Appropriateness (by providing OEO firms with an exemption from Product/Account Type Appropriateness).[12] We believe this approach is consistent with current practices and client expectations and have reflected this in the Guidance[13].

However, we remind OEO firms that they continue to have regulatory obligations when:

- determining the scope of products they choose to make available on their platform generally (e.g., product due diligence and obligations relating to conflicts of interest)
- offering certain specific products or account types to a client(s) (e.g., margin accounts, options, futures contract and futures contract options products).[14]

---

9 See section 1(d) of this Notice for background on the PLR project.
10 See section 3211 of PLR set out in Appendix 2 of the March 2017 PLR publication.
11 Notice 12-0109 - *Know your client and suitability – Guidance*.
12 See subsection 3211(2) of PLR set out in Appendix 3 of the January 2018 PLR publication.
13 See subsection 2.2.2 of the Guidance.
14 See subsection 2.2.2 of the Guidance.

(b) *Model Portfolios*

In the Proposed Guidance we indicated that we consider model portfolios to be a recommendation and therefore should not be made available by OEO firms. Nevertheless, since we appreciated their potential usefulness to clients, we included for comment in Notice 16-0251 possible standardized exemptive relief that would allow OEO firms to make available certain *limited* model portfolios to clients (referred to as **Permitted Model Portfolios**)[15]. These Permitted Model Portfolios would be limited to class of investor, asset class, industry sector and time horizon, and would not be permitted to reference specific securities[16] or issuers.

Upon further consideration, we acknowledge that certain Permitted Model Portfolios may not provide sufficient motivation to influence a client's investment decision regarding securities, in part because of investors' general increased familiarity with model portfolios.

Accordingly, in the Guidance[17] we have indicated that, depending on the context in which they are made available, certain limited model portfolios may be acceptable, provided they:

(i) are limited to class of investor, asset class, industry sector and/or time horizon,

(ii) do not reference specific securities (as defined in the Guidance) or issuers, and

(iii) are only made available on OEO firms' websites to be "pulled" by the client, without prompting or influence by the OEO firm, and are not "pushed" to clients.

This approach is consistent with our position on research reports[18].

If an OEO firm wants to make available a model portfolio tool that extends beyond these conditions (e.g. if it would like to include specific securities in the model portfolio), it would need to be approved by us to offer advisory services[19]. We currently have full-service dealers that have similar offerings. OEO firms may offer advisory accounts through a separate legal entity or separate business unit within the existing legal entity. Such arrangements are subject to IIROC approval and compliance with IIROC's requirements applicable to advisory accounts.

We encourage firms to speak with us about how their current or proposed tools can be accommodated on the IIROC platform.

4. Meaning of "recommendation"

Part 3 of the Guidance provides our views on what may or may not constitute a recommendation. We also provide our analysis of the more common tools currently offered by OEO firms and the circumstances where they may constitute a recommendation.

We have not made significant changes to Part 3 of the Guidance (other than as described above relating to model portfolios) from what we originally proposed, but we updated the

---

15 See section 6.1 of Notice 16-0251.

16 As set out in the clause 3.3.12(e) of the Guidance, we interpret "specific securities" broadly to include any security which may be purchased by an investor, including any equity, debt or fixed income product, mutual fund, exchange traded fund and/or platform traded fund.

17 See clause 3.3.12(e) of the Guidance.

18 See clause 3.3.12(b) of the Guidance.

19 Advisory services includes both discretionary and non-discretionary account offerings.

discussions as a result of the Related Projects (described above) and developments in the OEO business since the original publication. These updates concern:

- clarifying when (a) new issues, and (b) tools that are integrated with third-party tools may constitute recommendations
- *Series A funds* – we confirm we do not consider it to be a recommendation when an OEO firm informs a client of the availability of a lower cost series of the fund the client holds or is in the process of acquiring (e.g., the availability of Series D, or the equivalent platform traded fund (**PTF**), where the client holds or is in the process of acquiring Series A of that fund)
- *Conflicts of interest* – we remind OEO firms of their obligation to address conflicts considering the best interests of the client[20] when they decide which series (or series equivalent in the case of a PTF) of a fund they make available on their platforms
- *Bias towards certain products* – we clarify that it is inappropriate for OEO firms to favour certain products (e.g., proprietary products) over other products (e.g., third-party products) by making it more difficult to execute trades or access research in the less favoured products.

5. Implementation

The Guidance replaces Notice MR-098 effective immediately.

OEO firms should evaluate their existing and future activities against this Guidance to determine whether they are consistent with the OEO regulatory framework. Whether or not a particular tool is appropriate under the OEO regulatory framework depends on the relevant facts and circumstances of the particular case. As a result, the Guidance is not intended to be exhaustive. We encourage OEO firms to speak to us about any current or proposed tools if they have any questions.

If an OEO firm determines that it is not conducting business consistent with the OEO regulatory framework, including the Guidance, we would expect the OEO firm to:

- amend its business model to be consistent with its regulatory obligations;
- cease such activities; and/or
- contact us to discuss other options.

[20] For example, see Rule 42 – *Conflicts of Interest* and Part B of Rule 3100 of PLR and Notice 17-0093 - *Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review*.

6. Applicable Rules

The Guidance relates to the following IIROC Rules:

- Rule 1201(2) - Definition of "order execution only account"
- Rule 2155
- Rule 3211
- Rule 3241
- Rule 3404
- Rule 3955
- Rule 3980

7. Previous Guidance Note

The Guidance replaces Member Regulation Notice MR-098 – *What Constitutes a "Recommendation"? Is a Suitability Determination Required Under Regulation 1300.1,* dated September 6, 2001.

8. Appendices

Appendix A - Notice **18-0076** - *Guidance on Order Execution Only Services and Activities*

Appendix B - Black-line comparison of the Guidance marked to show changes made from the previously published draft

Appendix C - Summary of comments received and our responses