SCOTIA iTRADE™
A Division of Scotia Capital Inc.
225 King Street West, Suite 1200, Toronto, Ontario M5V 3M2

BY EMAIL: cpiroli@iiroc.ca

February 3, 2017

Charles Piroli
Director, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000
121 King Street West
Toronto, Ontario M5H 3T9

Re: Rules Notice – Request for Comments – Guidance on Order Execution Only Services and Activities

Dear Sir:

We are writing to provide you with comments on behalf of *Scotia Capital Inc.*[1] with respect to the Rules Notice and Request for Comments – *Guidance on Order Execution Only Services and Activities* published on November 3, 2016 (the "Rules Notice") by the Investment Industry Regulatory Organization of Canada ("IIROC").

In the Rules Notice, IIROC sets out its expectations and requirements for Dealer Members engaged in order execution only ("OEO") activities. Noting a significant evolution in the OEO business model, IIROC proposes an updated regulatory framework to address the wider variety of products, tools and account types that are currently offered.

We are fully supportive of modernizing regulation to address evolving business models. We are, however, concerned by the material change to the OEO model put forth in the Rules Notice with the introduction of an appropriateness analysis and by its unintended consequences both for the industry and for investors. In our view, the introduction of the appropriateness analysis will alter the existing OEO model and diminish the role of OEO firms in the Canadian capital markets to the detriment of investors. Accordingly, this letter focuses on our serious concerns regarding the appropriateness analysis.

[1] Scotia Capital Inc. is an investment dealer and a member of the Investment Industry Regulatory Organization of Canada. Its divisions include Scotia iTRADE, which provides order execution only services to its clients.

Appropriateness

As noted by IIROC, one of the basic tenets of the regulatory framework for OEO firms was an exemption from suitability-related obligations on the basis that the firms did not provide recommendations. The appropriateness analysis set out in the Rules Notice represents a material regulatory change for OEO firms, effectively requiring a suitability analysis at account opening. Implementing this change raises significant operational challenges and increases regulatory/legal uncertainty for firms. For investors who seek a low cost alternative to a full service firm or who want to make their own investment decisions, the appropriateness analysis may lead to a gap in investment services that meet their needs.

Operational Challenges

From an operational perspective, the implementation of an appropriateness analysis would require a redesign of our current systems and processes, which could not be accomplished in the six month period contemplated by IIROC. Our account opening processes, our systems and our staff are not currently equipped to gather the necessary KYC information, to undertake the required analysis and to segregate our clients by account type and/or product. The ability to separate our clients based on an appropriateness analysis would require an extensive technological build. We would also have to develop new forms, new procedures and train new staff. Setting aside the operational issues, however, we are deeply concerned by the increased regulatory and litigation risk that the appropriateness analysis, as proposed, would introduce.

Increased Regulatory and Legal Uncertainty

OEO firms need regulatory certainty to structure their operations in a compliant manner. As proposed, the appropriateness analysis raises a number of concerns.

The Rules Notice speaks of conducting an appropriateness analysis at account opening. However, that analysis and a firm's categorization of its client will only remain "appropriate" as long as the client's circumstances do not change. Will firms have an obligation to update their analysis? If so, when and how?

In order to conduct an appropriateness analysis, OEO firms will have increased KYC obligations. Without the involvement of an advisor who knows the client, OEO firms would be entirely reliant on information provided by the client. As OEO clients are typically investors who want to make their own investment decisions, they may object to providing the breadth of information required to conduct an appropriateness analysis or may provide inaccurate information to ensure that they are not restricted by the appropriateness analysis.

Investors may interpret the decisions of OEO firms to allow them to access certain products/accounts as a recommendation. Should their investments in those products/accounts

not perform as anticipated, they may challenge their firm's appropriateness analysis or more generally seek to hold it responsible.

Finally, IIROC has not mandated a single model or approach to the appropriateness analysis. The Rules Notice indicates that the expectation is for "an OEO firm with a broad product shelf which includes complex, risky or illiquid securities to have a more robust appropriateness analysis than an OEO firm that only offers simple, low-risk and highly liquid securities." To ensure IIROC's expectations are met, IIROC should set out the basic requirements for firms that have these products on their shelves.

OEO firms would not be the only ones impacted by the introduction of an appropriateness analysis. It may also have significant unintended consequences for certain investors.

Unintended Consequences for Investors

Investors use the services of OEO firms for a number of reasons:

- they are unwilling to pay the fees associated with a full-service firm;
- they are not eligible to become clients of a full-service firm due to insufficient assets; and/or
- they want to make their own investment decisions.

As a result, OEO firms fill the needs of a specific set of investors in the Canadian capital markets. The introduction of an appropriateness analysis would challenge the OEO firms' ability to continue to do so.

The significant implementation costs and the potential regulatory/litigation costs of the proposed appropriateness analysis may impact the ability of OEO firms to offer their services at a cost that remains affordable or attractive for these investors.

Investors who believe they are able to make their own decisions may disagree with the appropriateness analysis undertaken by OEO firms and may be put off by OEO firms' restrictions on their investment opportunities. We are concerned that these investors may choose to turn to non-IIROC regulated alternatives.

Finally, the appropriateness analysis may create an expectations gap for OEO clients, who may assume that OEO firms bear responsibility for the investment decisions clients make within the parameters set by the OEO firms. At a time when the CSA has proposed new initiatives to reduce the expectations gap between investors and registrants, it would seem counterintuitive to introduce such confusion in the OEO world.

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In conclusion, as the harm caused to investors by the existing OEO business models has not been clearly articulated, we question whether the introduction of an appropriateness analysis is warranted and justified. We urge IIROC to work with the industry to address IIROC's concerns in a manner that would allow OEO firms to continue to play their important role in the Canadian capital markets.

Thank you for your consideration of this submission. If you have any questions or require further information, please do not hesitate to contact the undersigned.

Yours truly,

Susi McCord
OLB Managing Director, Global Online Brokerage

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