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RE: Request for Comment Guidance on Order Execution Only Services and Activities

I provide comments and analysis with respect to the above noted consultation.

Advice is moving online, models and tools are moving online and investors are moving online; this is irrespective of whether investors are looking to be advised or to take responsibility for their own construction, planning and management. There are some valid concerns arising from these developments:

- How do we regulate advice, models and tools online and how do we assign responsibility?
- How do we differentiate between those who are managing their own and those dependent on advice?
- How do we prevent those whose interests may be to push their own or a limited range of products from taking advantage of this development?
- How do we control the risk of investors opting for a DIY route when the optimal choice for some may be to seek some form of advice based relationship?
- What are the consequences of shutting down online options for DIY investors?

IIROC is right to be concerned about the development of online financial advice, within or without the OEO construct, but wrong to be shutting down the development of online wealth management service infrastructure.

All this change is coming amidst intense resistance from a retail financial services industry focused on the returns from product and security distribution as opposed to advice. Online services not only obviate the weakly regulated advisor segment (with respect to best interest standards) but risk eviscerating the returns to distribution that the current distribution model so heavily relies on. Importantly online models and tools will continue to proliferate outside of the regulated frame, if their development is hindered within it, and regulators would do well to heed this eventuality.

The solution to the regulation and development of online wealth management services will not be found in the current consultation with its limited focus on retaining an old world view of this order execution only venue.

Regulation in Canada

Regulation in Canada often suggests that investors should take responsibility for their investment decisions and to educate themselves (perhaps much more so than other markets and jurisdictions), and have placed their primary focus over the years on disclosure to force such (CRM, POS etc).

Yet, a one dimensional IIROC consultation on Order Execution Only Services appears to take the opposite tack and paints a picture of a world where responsibility and education are risks even to those investors who have expressed a clear preference to invest on their own account.

The retail model in Canada is also often portrayed as one where the "advisors" are merely helping the investor to make his decisions, more of a tool almost that helps links the investor with the necessary products. Note the following from the CSA's "Working with a financial adviser[1]":

> If you're an **experienced investor**, you may want an adviser who offers a wide range of products and **lets you choose**.
>
> If you're **newer to investing**, you may be more comfortable with fewer choices and **more guidance from your adviser**.
>
> The role of your adviser is to give you helpful, informed advice **as you build and carry out your investment plan**.

The more experienced investor appears to be assigned an even more precarious position of heightened responsibility for their decisions, even within the supposed safety of the "the regulated recommendation"! We effectively have a model where even in the regulated construct a great many investors are actually choosing for themselves.

Moreover even the less experienced investor is not being accorded with an overarching advisory relationship but one that appears to be framed as guidance. Note the following excerpt from the UK FCA's "TR14/10 - Developments in the distribution of retail investments: Purchasing investments without a personal recommendation or with simplified advice"

> Guidance is a specialised activity which helps consumers understand their options and negotiate difficult decisions. It does not, and should not, provide solutions, but helps consumers reach the best solution themselves. However, to be effective, guidance must be provided by guides who have the requisite specialist knowledge and who are unbiased and independent; otherwise it will not be trusted.

For so many years Canadian regulators have tried to distance advisors from the full blown responsibility of providing personal financial advice. Investors in Canada are already accorded with a higher level of responsibility in the investment process than those under

[1] I have to stress my continuing and deep concern over the CSA's refusal to properly define the role of the "advisor" in the present distribution model. Under the Ontario Securities Act for example dealing representatives are not registered as advisers. They are registered as salespersons. Yet all official communication portrays the relationship as being with an adviser: the CSA's own research shows investors clearly believe the representation of ad visors acting in their client's best interests.

international jurisdictions. This creates a conflict between the frame proposed by IIROC and the regulated frame.

Global Context – Model Portfolios and Robo Advisors

Regulators the world over are struggling to reconcile "*the regulation of financial advice and the recommendation*" with the ongoing march of new automated services, models and tools that are springing up on online.

Note the following papers from the UK FCA on the matter:

- TR14/10 - Developments in the distribution of retail investments: Purchasing investments without a personal recommendation or with simplified advice
  - "Non-advised sales - Firms provide information and interactive tools to aid choice and allow the customer to transact. Responsibility for the purchase lies primarily with the customer but the firm may be liable for any information or tools provided to the customer, and, where relevant, for ensuring that the customer understands the risks involved in the transaction (testing "appropriateness")."
- GC14/3 Retail Investment Advice: Clarifying the boundaries and exploring the barriers to market development
  - "For some time we (and our predecessor the Financial Services Authority) have set out our view that a well-functioning retail investment market needs different delivery mechanisms in order to be fully effective for a broad range of potential investors. We have recognized that there could be benefits from well-designed, low-cost methods of meeting customers' straightforward needs, and we encourage their development….. firms offering retail investments without personal recommendations want greater clarity on how they can support customers in making informed decisions – increasingly via technology-rich solutions – without stepping over the boundary into providing a personal recommendation."
- FG15/1 - Retail investment advice: Clarifying the boundaries and exploring the barriers to market development
- The Motivations Needs and Drivers of Non Advised Investors, by NMG Consulting on behalf of the FCA:
  - "**There is clarity when using most online services without regulated advice, that the purchase is non-advised**. However some ambiguity exists when human interaction is involved. Participants were generally able to distinguish between advised and non-advised service definitions."
  - **The key cues that signify a non-advised service are that the consumer does most or all of the research and the provider does not recommend particular products or funds over others, either explicitly or implicitly**.

- **Participants were clear about the scope of service from non-advised providers and platforms when an online channel is being used**. But when there is a degree of human interaction, particularly face-to-face, there is potential for information provision or product guidance to be misinterpreted as advice. The confusion is compounded by the fact that consumer understanding of “advice” can be very different to the regulated definition. This was evident within a few examples in the research where participants who had received guidance believed they had received regulated advice but when probed, it was clear they had not paid a fee or received a recommendation based on their personal circumstances.

- **Participants using non-advised channels take responsibility for their investment decisions**. Participants believed that responsibility for the investment decision lies with them when making non-advised purchases; even those that mistook information provision or guidance for advice.

- **The majority of non-advised investors do not appear to be exposing themselves to excessive risk and are making broadly appropriate investment choices based on current circumstances**. However, a minority are making choices that could be deemed to be sub-optimal.

- In conclusion, **providers need to respond to the diverse needs of non-advised consumers and ensure that channel design, communications and support services help deliver good outcomes for the least to the most capable**. However, the direction of travel for the industry should be to focus on the need for greater customer engagement to both support behavioural biases and limit any potential detriment

The online medium

The online medium is remote from the traditional face to face advice/sales model, a model where the tools and the models used to be on the advisors side of the desk and the investor was invariably without.

Nowadays the models, the tools, the education and much more is available to the investor on the other side, opening up the options for those who want to take control and obviate the additional costs and risks of face to face advice, especially in limited accountability retail markets (i.e. Canada). This is especially so where the quality and the cost of advice have been found wanting, or the strategy and personalization preferred unavailable.

The quandary is that many of the new model portfolios provide limited input for the ongoing management of personal financial needs - how the portfolio actually relates on a day by day basis to financial needs – and in most cases is incapable of dealing with existing assets. The solution to a certain extent is incomplete and for those who are looking for advice and not necessarily want to make their own decisions, a face to face element, a traditional advisory component with responsibility shifted to the “advisor”/er is still a necessary requirement – note that the issue of responsibility in the Canadian retail financial services market place is an issue here in that in most cases investors cannot rely on advisors to act in their best interests, so the quandary is especially moot.

But, this does not adequately address the bona fide DIY investor who has a higher level of interest in a) making their own decisions and b) understanding and finding out more about how to select, construct, plan and manage.

We know that DIY investors tend to be proactive with respect to a number of financial issues and would be more likely to look to models and tools as a means of making their own decision, or would be better able to accommodate the model portfolio with respect to their existing asset position and set of financial needs. More research is clearly needed here.

We also know that costs can alter the risk/return profile of an investment solution, and therefore the extremely low costs of portfolio solutions from many of these models should not be underestimated. When regulators are looking at how best to regulate remote advice solutions the cost factor should not be disregarded.

With respect to concerns over Robo Advisors in terms of the personalization of advice:

- The cost benefits, relative to higher cost retail solutions, in most cases quite easily overcome many of the structural shortcomings of the present online portfolio solution.

- We also know that the limitations of many portfolio constructs with respect to being able to meet and manage liabilities are the same for both the robo/model and the advised segment, where such constructs are used, as they are often derived from the same basic models.

- Therefore the constructs and outputs that investors receive online, at a fundamental level, may not necessarily be any different from the ones they would have received had they sought a professional face to face relationship, and so cost differentials loom large.

The start of the automation and innovation process and the need to delineate advice from advising yourself

We also know that we are only at the start of the automation and investment option innovation process.

The number of strategic options available to DIY investors will also improve and provide much higher levels of sophistication.

Critically here we need to be able to delineate the dividing line between an investor who is a) clearly adopting a strategy and taking responsibility for the strategy and b) using models and tools to develop their strategy, as opposed to being advised and relying on an advisor/er's interpretation of output. This trend, as technology improves, is only going to develop.

Regulators therefore need to be able to clearly delineate a) regulation from advice and b) the advised from the "I am advising myself", and by that I mean that all processes and services require a structural integrity and a transparency (the root and hence regulation of the root) that would allow those who want to be advised and those who wish to make their own decisions (the fork in the road and hence the point at which investors are advised or not) to be adequately catered for.

Should we deny investors the tools needed to construct, plan and manage

Does it make sense for a divide to open up in the world whereby only regulated investment professionals can have access to the tools and models needed to make their own strategic investment options?

Because this is where we risk going if we get regulation wrong and clamp down on what may well be a natural evolution of structured wealth management solutions.

In Canada where the retail distribution model builds in a much higher cost structure and allows for more complex, illiquid portfolio products as well as higher advisory risks due to attitudes towards leverage and the boundaries of suitability and investor responsibility, the divide is a stark one. This is especially the case given that the Canadian model implies a high level of investor autonomy even within the advised relationship – many of the metaphysical conflicts international regulators are dealing with, in terms of the dichotomy between the advised relationship and the DIY use of the constructs that produce the same, clearly do not exist in Canada. In the UK for example investors are already entitled to best interest standards and the development of online advisory platforms are also engendering much heavier regulator involvement and interest.

Moreover, if we shut the DIY investor out from tools and models then we also need to be aware of the liability we are taking on board.

Understandably, investment professionals would not normally recommend a DIY option unless an individual has the ability and disciplines and outlook needed to properly manage their own assets. But the opening up of routes to self management does have merit where the costs are low and where structures and platforms exist to allow DIY investors to make sensible decisions.

Technological innovation has changed the dynamics. It is becoming viable for those wish to make their own informed decisions to manage their own with tools and models and platforms that would aid investment decisions, with provisos, and these need to ironed out and seriously explored.

To continue to place the DIY investor in a position where they are exposed to the risks of making ill disciplined, ill structured decisions, all the while profiting from such is clearly wrong.

The guidance held within the consultation gives the impression that regulators are all too happy to allow individuals to trade without the safety of models and tools that would provide a better foundation for the construction, planning and management of their assets or to be advised without the safety of true best interest standards.

It is interesting to note, in Canada, that if an experienced DIY investor were to use a model portfolio tool to help construct their own portfolio universe that under IIROC proposals they would only be able to access the diversified outputs of such a model from advisers (registered advisers and not advisors) subject to a fiduciary standard. Yet, for all those investors who do not wish to make their own decisions, and who have clearly expressed a preference for advice, they are allowed to use advisors held to a lower standard where the responsibility for the investment decision is still with the investor.

Some research into non advised investors

IIROC have not provided access to the research it has conducted on the issue of investor use of online DIY investment services. I concur with FAIR Canada in their own submission and strongly request that this research be made available.

In the interim I would like to point out observations taken from "The Motivations Needs and Drivers of Non Advised Investors, by NMG Consulting on behalf of the FCA.

- "**There is clarity when using most online services without regulated advice, that the purchase is non-advised**."
- **"The key cues that signify a non-advised service are that the consumer does most or all of the research and the provider do not recommend particular products or funds over others, either explicitly or implicitly**."
- **"Participants were clear about the scope of service from non-advised providers and platforms when an online channel is being used**."
- **"Participants using non-advised channels take responsibility for their investment decisions**."
- **"The majority of non-advised investors does not appear to be exposing themselves to excessive risk and are making broadly appropriate investment choices based on current circumstances**."

There appears to be some basis here for allowing investors, who wish to transact and manage their own assets, access to platforms that enable the development of benchmark asset allocations, relative to risk and liability profiles, and that may also logically provide guidance for security selection. That said, the delineation between those services providing advice and those services providing tools and guidance needs to be properly defined.

Effective Service delineation

The preceding section suggests there is some support to the assertion that DIY investors may well be able to take responsibility for platforms that help construct and populate portfolios.

An important point here is that guidance within a structured process could well lead the investor to specific investment selections. Under current IIROC guidance this would be treated as a personal recommendation.

But I feel this misses the point: the point is that personal recommendations have traditionally emanated from processes and constructs over which the investor has no control. Within the evolution of online tools for construction, planning and management the DIY investor would be taking control of the process and the construct and hence would, through their interaction, define how that process and construct provides asset allocation and security selection.

At its fundamental root the issue of advice lies within the responsibility for that advice and for control over the processes and constructs that provide de facto implementation of advice. This is where the road forks, but this road has a source and the responsibility for the source would remain a regulatory responsibility in the sense that service provides, whether this be

for DIY or advised investors, would retain accountability and responsibility for the integrity of the constructs/platforms provided and for the guidance that allows for ownership of their processes.

Broad discussion of IIROC's proposed guidance:

IIROC appear to wish to take out choice and options and information and tools from the interface in which many Canadians invest on their own behalf.

The consultation provides no suggestions in which model portfolios, tools and other interfaces can be incorporated into the regulatory frame. The consultation only provides suggestions to take them out.

Perversely the most obvious item for change, that of retained trailer commissions (for what precisely?), remains off limits and unspoken of:

Clearly, if you remove commissions from online products, you remove the incentive to push. Remove or obstruct the introduction of tools to allow DIY investors to make better decisions and you end up either pushing investors to a venue (retail face to face) where advisors are still conflicted by commissions and where the investor may end up with sub optimal fund and portfolio choices. Investors without tools and guidance to a large degree remain exposed to marketing and sales material sourced from other venues.

In whose interests are the proposed rule changes? We have here a de facto capping off of the evolution of DIY investing in Canada?

You could argue that direct investors in mutual funds, given the trailer fees, have never in fact benefited from their preferred choice to go it alone. Additionally, if best execution is about obtaining the most favourable competitive market price then trailer fees I would argue clearly breach best execution and knowingly so.

IIROC appear to wish to keep those investors who transact on their own account far from the integrated disciplines of planning, construction, valuation and frame; the tools in point of fact which professionals the world over would not be without. So what is the intent?

Transactions emanate safer from robust frames than without, and we know from research on Canadian Advisors, Retail Financial Advice: Does One Size Fits All, that many advisors provide a) limited customization, b) project their own preferences onto portfolio structure so that the portfolio "may deviate substantially from what is best for the investor" and c) provide performance that after costs ends up worse or no better than that passive lifecycle funds.

We also know from much research that while direct investors outperform retail "advisors" (due to lower transaction and management costs), they are also less diversified and may clearly benefit from structural reference points. There is an angle here that has not been given consideration.

What is IIROC saving DIY investors from?

What other options are there that could help improve investor outcomes? These are not really answered or posed by the consultation.

IIROC appears to wish to tilt the independent investor choice back towards the retail "advisor", to the world of conflicts of interest, of limited accountability and responsibility, of high cost products, of leverage, of structured complex products, of money for old rope. Or at least this is what it seems.

Today's technology is driving change, providing a framework and a discipline for investors who wish to invest themselves, to invest much more proficiently and to learn and to educate themselves. Technology is linking the shoulders of giants (the universe of investment knowledge on structure, risk and return) to the person on the street, who wishes to take responsibility; not necessarily for complexity, but for the simplicity that is the environ provided by the fundamentals of structure.

The basic efficient advice structure delivered at low cost is indeed a much lower risk option than the higher cost conflicted structures, filled at times with illiquid complexity that impairs portfolio structure (structured products and leverage). Many investors who do it themselves may have only previously referenced the investment culture of the incentivized distribution system and may themselves be compromised in terms of their knowledge of portfolio structure and may well benefit from disciplined reference points.

Perhaps this is another reason why IIROC may be targeting these tools; it is not that they are providing recommendations, but that they are providing lower cost options, in increasingly large amounts, that obviate the lifeblood of the distribution model. Otherwise why the lack of creative solutions to incorporating tools and models within the transaction frame of the OEO and for changing the nature of the OEO structure itself.

IIROC quite rightly point out concerns over the development of push within the online sphere and this clearly needs to be assuaged but not by throwing the baby out with the bathwater. Clearly we do not want institutions pushing products, complex or otherwise, to individuals, capable or not and of using tools to push their own agenda. But, structural tools used to help DIY investors structure and manage their assets more efficiently need not necessarily be recommendations. Additionally, we need a wider array of venues for investors to access what I would call remotely managed asset management services and I discuss these options later.

Are model portfolios provided by regulated financial institutions the real concern here?

I believe that the decision whether or not to go with a model portfolio should be on the decision tree of the DIY investor.

I would also point out that many on line services already provide model portfolios that investors can access merely by answering say a very limited set of questions: these model portfolios may either provide detailed structural components (*high yield US bonds, domestic/international gov't bond, corp bond, dividend stock, US/Canadian/Overseas/Emerging equity market allocations*) and/or actual specific fund recommendations without the investor actually having to register or speak to anyone (*I was able to do this no problem*). Such, it would seem is already allowed for by CSA regulations. I am not necessarily endorsing this practise, but what I am saying is that there is an enveloping confusion as to what IIROC is doing and why and this I believe alludes to deeper problems within the retail financial services' market place.

Likewise, financial planning is not regulated in Canada, apart from Quebec, yet it seems to be perfectly acceptable for financial planners to provide suggested asset allocations; nothing stopping the investor then going online and populating that asset allocation.

IIROC are looking at the order execution space, which is really no longer an order execution only space, as one bordered only by the dimensions of push and pull.

If the DIY space were to live up to its billing it should not be a product/security purchase only space, but primarily a security/portfolio build/analytical space if the DIY forum is to be able to properly take responsibility for its own decisions.

Analysis that allows investors to properly quantify a high yield on a product, or the illiquidity and costs of a structured note tends to detract from the headline return or attention grabbing hook. Yes, if we keep the OEO space as one where investors can only assess based on what is being told them by a manufacturer then we remain at risk of push irrespective.

The question of what is a recommendation and when advice becomes regulated is an interesting one and worthy of attention, but it is not insurmountable once we realize the online space can be both for people who want assets to be managed for them as well as for those who want to take their own responsibility. And note, I believe that the true differentiation of advice lies with who is in control of the process that structures, plans and manages. For many of these processes, the root lies further back with academia and the many firms that develop the tools that advisors/firms and institutions use to manage/advise/construct etc.

The on line space is also at arm's length from the usual face to face persuasion and having the full view of the product/security space and the necessary tools to properly evaluate them seems reasonable in the DIY context. I note that the NMG document,"The Motivations Needs and Drivers of Non Advised Investors, points out that confusion over the service being offered by investors only appeared to be encountered in face to face settings; "**Participants were clear about the scope of service from non-advised providers and platforms when an online channel is being used**. But when there is a degree of human interaction, particularly face-to-face, there is potential for information provision or product guidance to be misinterpreted as advice."

Will IIROC proposals impact the necessary transparency that is an imperative of portfolio construction?

There are a plethora of portfolio products out there already that are freely available for purchase on an OEO platform: note the balanced fund with domestic and international bond and equity allocations. The selection is a bit more rudimentary but the point of sale documentation still provides similar links to relevant KYC data and the suitability of the product.

If an investor is looking for a low cost portfolio that more closely matches their risk/return profile, and they are aware of their risk return profile, what should prevent them from buying a model portfolio with specific recommendations? Just a point because it is contextually very similar and bear in mind that all products are already regulated: a model portfolio in itself should be subject to the same regulation that all investment products are and we already know that its suitability and risk profiles are already well defined. Indeed, model portfolios

could be subject to their own POS! So the basic model portfolio we see in Canada is in truth a simplified advice construct that is applicable to a wide range of investors.

Perhaps what we are really seeing here is a reaction to the rapidly disappearing line between the costs of portfolio solutions.

If regulators want to make sure that DIY investors are not being pushed towards these solutions they could quite easily get them to accept each of the model's underlying assumptions and then require them to make their own fund/security selection.

I think it is also worthwhile considering how regulation in Canada already views the responsibilities of investors with respect to the investment decision, especially in the advisory space. There is no fiduciary standard in terms of the "advisor" taking full responsibility for the portfolio constriction process, risk assessment, planning and management etc. Instead while the advisor is responsible for recording the KYC inputs, the suitability standard itself is quite wide and it is the investor's responsibility for accepting the risk/return profile of that asset. So the advisory space is fairly heavily "a push" environ with quite a high level of investor responsibility. A model portfolio, along the lines of those we already see in the market place, is not going to be in conflict with the KYC parameters inputted by the DIY investor.

Validation of the algorithms and model outputs relative to a range of KYC parameters should be fairly easily assessed by regulators and would be a much easier service to police, so issues of suitability are surely not the main concern here. Getting investors to sign off to the fact that they are not being advised, that the portfolio selected is a simple one, that they are responsible for ensuring that their risk profile is correctly determined, etc, etc should not be hard. I also believe that the support and guidance provided to investors when making their own decisions could also be significantly enhanced so as to mitigate many of the issues not covered/obviously communicated by the tools themselves.

IIROC talk about familiarity with research reports, documents which can be quite detailed, as a key reason as to why a research report is not considered a push is also relevant here. Many investors are becoming increasingly aware of the benefits of lower cost index funds and more passive broadly diversified asset allocation structures, such that if they are not being offered by the retail advisory sector, why then should they not take matters into their own hands and buy direct?

If IIROC are concerned about push, they would not be tilting the field in favour of the retail market place where push is indeed the name of the game.

Individual investor choices, aided by fundamental structures and guidance should not be book ended by sales quotas and bonus structures, but by best interests. This is where we should be headed: a services' architecture focused on best interest outcomes, on delivering professionalism, and structure and choice and technological solutions that can accommodate those who wish to hand hold and those who do not, those who have complex needs that require face to face and those who do not and/or wish to interact remotely from that expertise, but with the help of its disciplines, systems and structures.

Removing the architecture of push while developing that of pull would make some sense: removing trailer fees and other commissions from products while including more modeling

and tools to allow investors to better manage their portfolios would do just that. Again I reference the fact that the DIY culture in Canada seems to be a much more acceptable one and in keeping with its regulated stance "that investors, advised or not, should be held responsible for investment decisions".

We no longer live in a technology neutral environment: can regulation afford to be tech ignorant?

All the components of the current Canadian architecture (IIROC/MFDA, ROBO/PM) all point to a technological future where transaction outputs from structure, where the transaction is efficient, but secondary to structure, and where it would be insane to have a platform for wealth management construction for the private investor that removed structure and discipline. Such would be but a dead end, a wasteland of irrelevance, a backward move to the days when the order execution model itself was little different from the broker model of the transaction by transaction.

It is worthwhile referring to the 2013 report, Challenge and Opportunity, by the Cass Business School, which refers to the inevitability of technological change and its impact on the delivery of financial services:

> "However, perhaps the biggest challenge facing IFAs as they try to redefine their role in a RDR world will come from web-based services...such technological innovations were well in place pre-RDR and in an increasingly computer literate society one would expect a greater willingness by clients across the wealth spectrum to bypass advisers with DIY investing. Indeed, earlier research by Cass has already identified that a significant proportion of the UK's population would be willing to use a "financial guidance service" instead of using a financial adviser to help them make their savings and investment decisions. These non-advised or direct-to-consumer (D2C) platforms consist of either IFA branded platforms, fund manager-owned platforms or execution-only stockbroker platforms. Today this non-advised technology is accessed directly by over 6.5 million private investors in the UK"

We have all moved on and so it should be time to move the OEO model onward into the future instead of plunging it into the abyss of horse and car antiquity. Otherwise models and tools and possibly guidance will move outwards into the unregulated market place.

CSA Staff Notice 31-342 – Guidance for Portfolio Managers Regarding Online Advice"

I reference "CSA Staff Notice 31-342 – Guidance for Portfolio Managers Regarding Online Advice" with respect to tech neutrality of regulation.

Is this regulation really tech neutral or is it terra biased? Robo advisers are still required to have some interaction with investors, albeit limited, unlike other jurisdictions. Given the nature of the portfolios and the assumed limitations of the models as such to accommodate tailoring, it would seem that the element of discretion with regards to the portfolio beyond the initial agreement and selection is actually fairly limited.

Advisers-ARs (I cannot be certain because I have not seen examples of deviations from the model where they may exist) are likely not providing much which could be qualified as advice beyond that seen in the model portfolio, especially with respect to the focus of current regulation which is advice leading to a transaction (buying/selling). Regulation is therefore

not really tech neutral, but tech averse given that the preeminent requirements of suitability, albeit quite limited if you review the questionnaire on Robo sites, are clearly covered.

Portfolio recommendations are also likewise more than likely in most instances to pass the suitability test for the range of profiles considered, especially when we consider the range of portfolio distributions considered acceptable across the retail domain. There is likely a logjam at the regulatory level with respect to online wealth management services that is clearly not tech neutral, but tech averse and status quo influenced.

Why Services are moving online

In case IIROC and the CSA are not aware, financial services, in many variants, are moving online and they are moving online for a variety of reasons; none of which are in truth due to excess regulation taking out "advisors", although higher regulatory standards should indeed, if properly structured, influence the competitiveness of service delivery in this segment (a +ve):

- **The primary reason** is that investment disciplines, structures, planning and management can all be automated via a relatively small set of decision rules (how structure adapts to liabilities, investor risk profiles, relative valuations/correlations/risk (and its many dimensions)) and assumptions, amongst which governs a) risk and return, b) how a portfolio adjusts to changes in inputs (relative prices/benchmarks, mean variance stats etc) and at the extremis of current tools, c) liability modeling, planning and management.
    - Advisors who would otherwise deliver sub optimal frames, and whose only raison d'etre is to sell, are bypassed. Bypassing this layer increases margins/lowers costs. We are then faced with the simple problem of how do we best deliver this construct and the answer has to lie primarily with internet delivery and interaction in its many variants.
- We are no longer constrained by a limited supply of experts for whom it may only make financial sense to deal with clients of a higher net worth.
- For clients of a lower net worth it makes sense to seek less tailored options with lower costs offered by current online options, although this is likely to extend to greater levels of personalization over time, eliminating relevant concerns expressed by regulators. This imperative has always existed although the options have heretofore been limited.
    - The limited supply of expertise, and the larger reach of a large body of knowledge, are now being centralized and softwarised and moved to the wider market place. The medium is of course online services and the sophistication of services is expected to develop over time. **Regulation can no longer afford to be tech neutral!**
- The development of higher quality investment advice structures enables disciplined structures that meet best interest/fiduciary type standards (with respect to the process itself and responsibility for the process and its communication) to be delivered to the wider market place. The risk of unsuitable products and/or unsuitable structures and

excess costs vastly diminishes in a well regulated environment that fosters innovation and competition.

  - Moreover structures that allow for the modeling of the impact of products and securities, structures that IIROC are decrying as push factors, are in truth pull in that they allow more sophisticated DIY investors to properly screen the impact of products and test the marketed assumptions.

- We know that standards of advice, process, training, professionalism and education and conflicts of interest, in the main, vitiate the delivery of structured advice in the face to face retail product distribution market place. We know that this market place is characterized by limiting factors and is not optimal, at least in its whole.

  - The risks of unsuitable advice diminish with the softwarisation of best interest standard/fiduciary type investment disciplines and appropriate options available for induction for clients with different capabilities and service objectives. The system actually checks for KYC integrity and in advanced systems is capable of predefining suitability for the universe of relationships – the nature of the asset management/risk profile/risk/return/liability universe means that it is perfect for systemization.

- Basic advice is being commoditized/made increasingly cost effective and improved, and it can only be done so via softwarisation which also expands the reach of advice. **So why prevent the spread of this trend, why be tech averse and why retain regulatory structures that favour an imperfect product based advice delivery structure?**

  - We know that standards of advice, process, training, professionalism and education and conflicts of interest, in the main, vitiate the delivery of structured advice in the face to face retail product distribution market place.

  - We know that the risks of unsuitable advice diminish with the softwarisation of best interest standard/fiduciary type investment disciplines and appropriate options available for induction for clients with different capabilities and service objectives.

  - Areas requiring specific expertise remain the domain of professionals, but most investment planning revolves around flows, assets and asset characteristics that have an all roads lead to Rome fundamental homogeneity even within diverse universes.

- The necessary distance between advisor/er and client, that reflects the sophistication of process, increases in an online softwarisation domain where centralization and automation replace the supposed expertise of the average advisor. All that remains in essence is the relationship and a generic guidance of the recommendations of either the system or how to use the system to adjust for client preferences. It is this to which regulators are expressing an irrational fear; the supposed chaos of online platforms that compete with the long regulated face to face transaction model that is so well entrenched and protected in Canada.

So technology provides a medium for investment discipline to be delivered to the investor taking away a large slice of typical suitability risks. Transactions become secondary, or rather dependent outputs. In this respect IIROC are correct in highlighting the necessity for accountability of the foundation but wrong in suggesting it has no place. It is the other way around in that without the frame the transaction cannot have integrity and without integrity in a world capable of delivering such, the order execution only environment becomes a non sequitur. Investors will be thrust out into either a non regulated area or an advisory model with lower effective standards and of course a more intense push environment.

Choices in the on line arena

What becomes important is defining investor interaction in this online environment; we find that the proficient direct do it yourself investor will have a predominantly pull relationship (pulling out of the universe of choice that which matches their world view etc). Less proficient DIY investors may even start to move back to one of a passive relationship accepting of the fundamental boundaries of the advice structure.

In this new environment investors have the following range of choices:

- **Hand holding**: they can choose to have their portfolios and finances managed personally and benefit from the hand holding that goes with it: this costs extra and there is a trade-off between the benefits of enhanced personalization that this service may offer and the impact of costs on the outcome.
    - Nevertheless, aside from the hand holding and perhaps more detailed planning and management than that offered by the still limited personalization of ROBO portfolio constructs, portfolios in this domain will become managed via centralized constructs, if they are not already so.
    - The age of each professional constructing a portfolio from the ground up for each client profile should be a thing of the past. Suitability in the very real sense of the word is a framework and this framework is the centralized processes that govern asset allocation, security risk/return management etc. We delude ourselves if we believe that suitability is and always will be defined at the transaction level from a face to face technology neutral relationship.
- **They can choose to use an online service via an induction process** (initial guidance by client relationship manager skilled in the use of the system and the universe of options available) that uses disciplined structures to automatically manage assets – note that this is not “auto no human involvement” since the central asset allocation/security and benchmarks management as well as input and manipulation of planning data should be managed as would the return assumptions.
    - Here they will rely on a client relationship manager to explain the process and do the initial planning and analysis via system tools and provide reporting/reviews over time. The investor will need to respond regularly for updates to their financial situation and/or risk preferences to keep the systems updated. This is not a hand holding face to face service and hence has a lower cost structure than option A. It is a remote relationship, similar to that of the current regulated ROBO relationship.

- **The investor can also choose to access an online remote management option** with no on-going hand holding and may well transition to this post induction. They would be responsible for updating their financial profile to allow the system to properly structure plan and manage. In this situation all the inputs - allocations, risk management, security selection etc - would be handled by the remote asset management services. The investor does not make asset allocation/security selection decisions but would interact with the system for financial/investment planning, budgeting/saving/spending decisions.

- **For those who would be considered proficient DIY investors**: the investor who wants to manage their own would use the architecture around which portfolios are constructed planned and managed to house their assets but would be able to determine their own benchmarks, run their own security selection off their own valuation, allocation and management frames or a hybrid referencing system benchmarks. DIY investors could select their own investment style and/or security selection. This may also involve selecting one of a set of preset allocation and security selection benchmarks appropriate for their investment preferences, or completely determining their own security selection.

All of the above would need efficient transaction implementation, which is what a discount broker is meant to do. As far as the self select investor is concerned, the portal through which they would transact would be that of the discount broker or some such similar construct that may end up being no more than a back end to a more detailed system. Indeed the systems of the future may not actually have discount brokers per se as know them at the moment.

In truth what we see as the constructs offering advice and transactions today may not exist in the future, as is. Regulation therefore needs to be mindful of allowing for competitive evolution.

Options available in Canada

As we progress technologically, we realize that a discount broker on its own is likely to become irrelevant.

The base of the investment process, as far as wealth management is concerned, lies in the construction, planning and management and modeling tools, the research and the valuation, allocation and management platforms, whether this be mean variance optimized or some other valuation/relative valuation construct. A direct investor without a platform is an investor that is unlikely to be able to manage their assets efficiently. Or is that the intent of IIROC regulatory intervention? Canada likely needs its own version of the FCA's Project Innovate and their Robo Advice Unit.

Technology is likely to break down the current divisions between the service option regimes available to investors. So what are options do we have in Canada for investors?

- We have the portfolio managers registered with say the OSC (in Ontario); these offer portfolios regulated under a fiduciary standard. They are also predominantly face to face to relationships with varying degrees of personalization. The transaction is outside the model (in that the investor does not contract directly for transaction purposes) and assumed to be made efficiently. High minimum assets are required to access most of these managers.

- We have the Robo advisers, who are registered as portfolio managers and who require some form of limited adviser/investor interaction. These are structured as remote low cost advice vehicles with no face to face relationship and the transaction is outside the objective of the model and again assumed to be transacted efficiently.

    - Personalization is limited with no personalized investment planning (portfolio allocations are broad profile relevant but are not specific to the actual size and timing of client financial needs) per se being conducted, though portfolios are broadly reflective of risk and liability profiles;

    - The product is a portfolio constructed along a limited parameter base (similar to those noted in the KYC), but characterized by substantial diversification and low costs;

    - For investors looking for higher personalization/style tilts/direct equity/bond/pref/etc allocation, leverage and or ability to under/over allocate relative value, options are limited.

- We have dealing representatives regulated through IIROC and MFDA (and other advisors regulated under the insurance and model): this segment, which tends to deal with the largest number of investors, remains regulated in accordance with transaction based relationship norms.

    - This is a face to face model with transaction remuneration supporting the operations of distributors and advisors.

    - Transactions and product costs, as far the investor is concerned are high.

    - For investors who want well structured/personalized portfolios with low costs and more focused investment planning, options are limited and dependent on expertise of advisors selected.

    - Accountability for risks of strategy and structure are overly weighted towards the investor. The order execution and or Robo area may be the better value alternatives many for many small to medium sized investors.

- The order execution only segment: investors are here for lower cost transactions, although mutual funds, and similar products, still pay trailer fees.

    - Investors who use this segment either feel capable of managing their own money or are put off by costs and service limitations of other options.

    - Service options of this component are constrained by its regulatory window. IIROC review looks to be an attempt to prevent this model from evolving towards providing a more complete alternative to the higher cost advisor driven distribution model.

- The development of unregulated on line investment guidance and tools that will surely proliferate if regulators prevent access via regulated channels.

As it is, if investors wish to currently manage their own assets, they really only have one option: the order execution only avenue. Yet the ability to carefully construct, plan and

manage risk and return is dependent on the supporting architecture. Quite possibly the developing sophistication of the online model and online investors and competing online services, both domestically and internationally, are driving change in this area. It is clear that the transaction is not the base of the investment process, rather its end, even though for those engaged in shorter term trading and more sophisticated strategies it has greater import..

Is there any merit in IIROC's consultation and proposed guidance?

Complex products and leverage

On the one hand IIROC believes that it is acceptable that a range of complex products and leverage be available to investors on the Order Execution Only Platform: many of these investments are highly complex, highly leveraged with difficult to determine effective return distributions and costs to return.

I have no issue with this providing that the tools, where these exist, to properly assess the risks, costs and portfolio impact of such investments are made available to DIY investors.

That said, complex products with embedded leverage and higher costs are a product of an age where portfolio construction planning and management tools were lacking. Models and tools will help investors avoid the push of many of these products and hence serve to educate investors and help them make more appropriate decisions.

The definition of recommendation

IIROC expands its definition of recommendation in its consultation to include any communication (which includes any tool offered), or statement or opinion sent or made available to an investor:

> "a "recommendation" means: **any communication** or statement of opinion sent or **made available to an investor** that could reasonably be expected to influence that investor to make an investment decision regarding a security"
>
> "The phrase "any communication or statement of opinion" **should be interpreted broadly to include**, but not be limited to, **any tool** offered by an OEO firm, **any direct or indirect communication** sent **or made available** to an investor by an OEO firm (e.g., a posting **on an OEO firm's website**, a message sent to a client(s), **any form of communication or statement of opinion** (e.g., written or spoken)."

Importantly IIROC does not "distinguish between the terms "recommendation" and "advice" for purposes of this Guidance."

Other jurisdictions do not consider advice per se as a recommendation: note the UK FCA's FG15/1 Retail Investment Advice finalized guidance which discusses many instances where advice is not a recommendation, where it clearly delineates that not every communication or statement made available to an investor is a recommendation. All valid information influences the investment decision. There is no escaping this, but this does not necessarily mean that all information must be treated as a recommendation, especially where there is no face to face interaction.

Clearly what should be at issue here is not the fact that an investor is supposedly on an order execution only platform to buy on their own account, but that no specific recommendation for an investment is made to that investor and that no attempt is made to manipulate that investor via communications that attempt to hide the fact that a specific recommendation is being made.

The market place is always vying for a place in the investor's portfolio, that is the nature of the market place. The order execution site should not be a veil around which recommendations and conflicts of interest are pushed. The existence of trailer commissions on investment products suggests that there is a veil and there are conflicts, so what is IIROC going to do about it?

It is plausible that what we are seeing is an attempt to prevent these sites from developing into services that help investors manage their own money. Other jurisdictions have looked to encourage the development of on line services, notably the FCA, while still regulating the dividing line between advice and recommendation. Note the following from the FCA Guidance Consultation "Clarifying the boundaries and exploring the barriers to market development"

> "The development of technology over the past few years has allowed firms to introduce more innovative solutions for helping customers by providing services through the internet, some of which involve giving personal recommendations and some which do not……We have seen a number of web-based tools, designed to aid decision-making and steer the customer to consider their investment options and solutions without necessarily providing a personal recommendation. "
>
> "For some time we (and our predecessor the Financial Services Authority) have set out our view that a well-functioning retail investment market needs different delivery mechanisms in order to be fully effective for a broad range of potential investors. We have recognized that there could be benefits from well-designed, low-cost methods of meeting customers' straightforward needs, and we encourage their development"

The CESR document "Definition of Advice Under Mifid" also provides considerable leeway for the publishing of information and communications, that are not considered recommendations, on the websites of service providers, something which the IIROC consultation effectively bars:

> "…any direct or indirect communication sent or made available to an investor by an OEO firm (e.g., a posting on an OEO firm's website, a message sent to a client(s), any form of communication or statement of opinion (e.g., written or spoken)."

In other words it would appear that IIROC is preventing the OEO service option from developing into a fully functional DIY portfolio management website. Quite possibly this is because these sites are considered routes for a wider array of investors looking to manage their own money outside of the traditional face to face retail distribution market place. In this case, reform the retail advice market place!

I can understand the need to prevent these sites from being used to push products onto investors and from being used to sell advisory services without the necessary accountability, especially if higher standards in the retail face to face domain slow product sales, but the breadth of the proposed guidance suggests that this is may not be the main concern.

Additionally there is clearly a need to provide enhanced wealth management service options for those who wish to manage their own money online, as well as a wider array of online service options for those who wish to have their assets managed for them - but more cost effectively and efficiently. The costs of the main retail avenue for advice, as well as the additional suitability risks, make the online market place, drawn off centralized disciplined investment processes, arguably a more attractive domain for many investors.

One could argue that the suitability outcomes from model portfolios are less random and risky than those emanating from the retail face to face channel, so it would be rationale for investors to seek this qualitative differential.

The universe of investors is also a good deal more diverse than the current available service options, a great many of which remain compromised in terms of conflicts of interest and in terms of structural integrity of investment solutions provided.

Model Portfolios and Investment Tools

IIROC regards any tool that uses client information to provide asset allocation, benchmark, and portfolio relevant analysis as a recommendation. It does not consider portfolio analysis tools that focus solely on the current state of play of a portfolio as breaching these guidelines.

> "IIROC views any tool offered by an OEO firm that uses client (or class of client) specific KYC-type information (e.g., time horizon, risk tolerance, etc.) as a recommendation. "
>
> "A tool offered by an OEO firm may be a recommendation even where it does not use client (or class of client) specific KYC-type information (e.g., a tool advising a client to be in a particular class of security without having assessed any KYC-type information "
>
> "As model portfolios could reasonably be expected to influence clients' investment decisions regarding securities (including classes of securities), IIROC views any model portfolio made available by OEO firms to their clients as a recommendation and accordingly a violation of the No Recommendation Condition. As such, model portfolios should not be made available by OEO firms."

My concern here is that IIROC appear to be taking away the necessary analytical and structural support that most professionals have in situ when constructing, planning and managing portfolios. Many retail financial advisors will use tools with in situ assumptions (provided by either the parent firm or third party software provider, or 3rd party research). DIY investors also need tools that can react to their own financial needs, risk profile, time horizon etc and I see no valid reason for excluding these tools from the direct DIY investor's tool box. This is especially so when we note that regulatory communication implicitly discusses self directed investment as a viable option. Again I refer to the incorrectly terms CSA's "Working With a Financial Adviser":

> *Getting advice may be worth it if you're not comfortable putting together an investment plan or choosing investments on your own. For example, you may not have the time, interest or knowledge to build a portfolio that fits your investment goals and comfort level with risk.*

A portfolio construction, planning and management tool would allow investors to enter their own benchmarks and assumptions and to incorporate their own securities and product risk/return characteristics. They would take ownership of the model and its outputs, and the transaction decisions would be their own. Providing such models would require a higher level of supporting guidance and educational input.

Clearly, if portfolio construction tools of varying sophistication were provided on site to investors there would be very real competition for the retail "advisor" model. I doubt however that those investors who lack the confidence, knowledge and financial literacy to use such tools would do so. In this context we are really looking at the need for a more diverse online set of wealth management services for both manage your own and lower cost remote management options.

Most investors should not be attempting to manage their own assets, although they may be able to interact with such systems over time.

By this I mean determining the investment discipline/relative market or security positions/asset liability structures/risk and return assumptions and fund/security selection that plan, structure and manage and inhabit their portfolios. Most would be better off with either a face to face relationship or a remote management relationship, but even here a great many would be able to use the software options to aid them in their financial planning.

IIROC are clearly not knowledgeable enough about investment/financial planning imperatives to be making the types of decisions that could have long term detrimental effects on the development of advanced technological solutions for the management of personal financial wealth.

Part of the problem in the present market place is that retail distribution is involved in a fairly intense battle aimed at maintaining margins on high cost product distribution and the fairly low "suitability standards". This is pushing investors, who may not be ready to move, into the DIY market place. This is of course no reason to forestall the evolution of online DIY platforms.

Part of the incentive for investors to manage their own assets is the cost and qualitative differentials of model portfolio constructs relative to the outputs of the advisor sector: many of today's model portfolios being absent complex/illiquid products, closet high cost indexers and inappropriate leverage.

The reality is that we can deliver asset allocation and security selection from KYC data via basic models today at a fraction of the cost of the typical retail outcome. In this regard there should therefore be little incentive for the average investor to attempt to manage their own money.

The divide that IIROC feel they may be facing, i.e. the un-serviced small to medium sized investor forced into managing their own assets, is not something that is going to be allayed by cutting off models and tools that would otherwise help guide investors. This is not an investor protection initiative.

A great many investors may nevertheless be capable of having a remote relationship with a centralized and automated asset allocation/liability management system that allows the investor to update their personal preferences and circumstances, to engage in what ifs and

therefore to help in their own saving and short and long term retirement planning. Many investors will end up being able to own and interact with their investment strategy, via online platforms, while still being in receipt of regulated advice. These systems are still developing and would represent one of the many forks in the decision tree.

Model Portfolios As Products

One thing regulators forget is that many model portfolios are de facto pre packaged portfolio products, much like a mutual fund. Whereas on the Point of Sales document the mutual fund is labeled low risk, medium risk and stated as being suitable for an investor with income, capital preservation or capital accumulation objectives, so can the model portfolio be similarly delineated.

A direct investor is able to buy a mutual fund, and indeed, an advised investor is effectively required to sign off on such a fund purchase on receipt of the POS; providing the KYC parameters and the fund match that is really the end of it even under current regulation. Similarly with a model portfolio the KYC parameters must match the model portfolio recommended. Where is the difference in reality?

Summary & Conclusion

The solution, as proposed by IIROC, should not be to close down service options available to investors but to open up regulated online service options.

When addressing the online market place for models and tools we are not just addressing the DIY investor but the much wider universe of investor profiles.

For example there are many smaller investors who are either unable to afford the costs of personalized, face to face, advice, or are unable to access appropriate levels of service from existing options. Development of low cost simplified, but regulated, investment options offers a viable solution to this problem.

The costs of basic asset allocation advice and management are small as we know and the real differential cost (between that and DIY) is not something that would push an investor into a DIY stance unnecessarily.

As noted, there is no reason why discount brokerages should be disconnected from the disciplined constructs that professionals use to construct plan and manage. So the solution cannot be shutting down the tools and modeling options.

The incorrect answer being pursued by IIROC may be found in the root of the service itself: clearly it sprung from the trails of the brokerage system where the services offered by the broker were primarily transaction based. We know this transaction focus to be limited and not the prime determinant of advice and hence cost became a key differentiating factor for those investors who know what they wanted to buy and sell.

The present IIROC consultation looks to restrict the order execution only model to its original focus, that of order execution. However, the investment service's universe has moved on considerably since its origin, and just as the retail advisory segment is having to upgrade to account for the importance of advice and its fundamental underpinnings, so is the order

execution market place. For those looking for structured frameworks to manage their assets it looks as if options are going to become increasingly constrained.

Investors looking to manage their own money should be able to have access to a wide and varied spectrum of tools that a professional might use to plan, construct and manage. With respect to wider investment planning issues, this should also include the development and use of tools needed to assess appropriateness of structure to liabilities as well as risk profiles.

Investors who "DIY" need to be take control and take responsibility for the processes and the structures they use to manage their assets. Development of the online domain would allow them to do so and hence reduce the implicit liabilities of order execution only platforms.

Research carried out in the UK[2] suggests that investors understand the responsibilities of the domain and I would suggest similarly so for Canadian investors, based on the limited anecdotal feedback I have seen.

There is of course an intersect here with those who should not be managing their own assets, and clearly online service sites should demarcate the fork in the road between a) manage your own with the help of tools and recommendations (clearly a regulated activity, b) manage your own with the tools but without the recommendations (quite probably not a regulated activity in terms of providing security recommendations, but regulated in the sense that constructs have to be appropriate and able to stand on their own) and c) have your assets managed remotely but with investor access for investment planning interaction and what ifs etc.

The transaction module, which is what the OEO is essentially, is likely to be appended to more advanced wealth management service options in future and may no longer be the first point of entry, or branch on the decision tree, for online investors.

It is time to look at the evolution of wealth management services in a technologically innovative world as the barriers to the provision of lower cost/sophisticated wealth management services come down.

A better understanding of the investment process and the roots of responsibility for its governing processes and structures is a necessary condition for defining its regulation.

There are of course conflicts that need to be resolved between the face to face model and the online model, between the nature of investor responsibility for those with the intent and the tools to manage their own and those without.

One key conflict is that between a retail advisory model (in Canada) with high costs, suitability issues and imbalances in regulation of responsibility for decisions and process, and the development of the online medium which offers many investors a way out via better, if simplified, structure and lower costs.

The development of the online medium needs to be carefully managed and concerns over the impact of push on investors using these sites warrants serious attention, but the dimensions we are dealing with are more nuanced and wider than the push/pull of the traditional brokerage model, a model from which the discount brokerage rose from.

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[2] http://www.cassknowledge.com/sites/default/files/article-attachments/bny-mellon-rdr-cass-knowledge.pdf

IIROC's consultation seeks only to close down the options for DIY investors and makes no real attempt to look at the ways in which these sites can be developed to aid investors use tools and models safely and without undue influence, to help them better manage their portfolios.

Globally the issue of model portfolios and Robo advisers and the impact of such on the traditional advice led model are being given serious consideration. But in international jurisdictions the backdrop is also of a different order: best interest standards and the removal of embedded compensation have opened up the market place to more professional and higher standards of advice.

Yours sincerely,

Andrew Teasdale, CFA