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Investment Industry Regulatory Organization of Canada

An Assessment of Benefits and Costs of Self-Regulatory Organization Consolidation

July 2020

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Engagement Overview

Deloitte was engaged to conduct an assessment of benefits and costs of a potential consolidation between self-regulatory organizations in the investment industry.

Project Background

Deloitte LLP ("we", "us", etc.) was engaged by the Investment Industry Regulatory Organization of Canada (IIROC) to conduct an assessment of the benefits and costs of a potential consolidation between IIROC and the Mutual Fund Dealers Association of Canada (MFDA) (the "Consolidation Scenario").[1]

As the key input to our study, we collected information from several IIROC member firms (the "Participating Firms"), which represented a mix of entities that are regulated by IIROC and the MFDA ("dual-platform") and those that are regulated by IIROC only ("IIROC-only").[2]

Key Activities

Our method to collect information for this study was two-fold, with all information being anonymized to help ensure the objectivity and comprehensiveness of the information being received:

- *Cost Data Collection Template*: We distributed a standardized questionnaire to gather (i) general business characteristics data (e.g., total revenues), (ii) IIROC-platform and MFDA-platform expense data, and (iii) estimates as to how expenses would change under the Consolidation Scenario.
- *Stakeholder Interviews*: We conducted extensive interviews with the Participating Firms to discuss their perspectives on the key benefits and costs of the Consolidation Scenario – to investors, their firm, and the investment industry.

[1] Please note that this report does not provide recommendations regarding SRO consolidation or regulatory frameworks in the investment industry.
[2] Investment advisory firms with entities that are regulated by the MFDA but do not have entities regulated by IIROC are referred to as "MFDA-only".

The Consolidation Scenario

The Consolidation Scenario under review is defined below. The impact of this scenario was analyzed relative to the status-quo, in which the IIROC and the MFDA rules remain unchanged.

Consolidation Scenario[1]

- Consolidation of IIROC with the MFDA.
- For both IIROC dealers and MFDA dealers, the type of business and rules will continue post consolidation:
  - IIROC dealers will initially continue to operate under IIROC rules.
  - MFDA dealers will initially continue to operate under MFDA rules.
  - Over time, the rules will be harmonized, with regulation proportionate (relative to the risks to investors and/or the markets) to the business model.
  - Dual-platform dealers will have the choice to consolidate on the IIROC platform, with their mutual fund representatives exempted from the following IIROC requirements: (i) having to upgrade to unrestricted license category, (ii) IIROC minimum proficiency, continuing education and training (so long as they meet the MFDA minimums) for investment funds and exchange traded funds (ETFs), and (iii) commission redirection will continue on a grandfathered basis for mutual fund representatives.
- Consolidation applies to all provinces and territories except Quebec.
- The scenario does not consider the impacts on MFDA-only dealers of permitting introduction arrangements between MFDA dealers and IIROC dealers or, the resulting benefits to MFDA-only dealers and their clients of improved ETF distribution.

The assessment focuses on the impacts of the consolidation of the two self-regulatory frameworks on the regulated members (i.e., dual-platform investment firms) and investors. There could be additional benefits and/or costs related to the consolidation of IIROC and MFDA, as organizations, that were not considered.

[1] This Consolidation Scenario as drafted and provided by IIROC was the baseline for our analysis as communicated during phone conversations and in-person meetings with the Participating Firms.

Our Approach

A detailed cost template, and multiple stakeholder interviews, informed the assessment of self-regulatory organization consolidation in the investment industry.

Data Collection

- We prepared a detailed cost template to facilitate the collection of both firm and cost data from the Participating Firms. Specific information requested included:
  - **Business characteristics data;**
  - **IIROC platform expense data;**
  - **MFDA platform expense data; and**
  - **Estimate of cost savings under Consolidation Scenario**
- We also collected third-party economic and industry data to leverage in our final assessment.
- For more details on our approach to data collection, please see Appendix I (Pages 14-15).

Stakeholder Interviews

- We conducted consultations with the Participating Firms to capture their perspective on the benefits and costs of regulatory consolidation that would accrue to:
  - **Their individual firm;**
  - **Investors; and**
  - **The investment industry**
- We also conducted secondary research to identify the impact of regulatory consolidation in other jurisdictions.
- For a more detailed overview on our approach to the stakeholder interviews, please see Appendix I (Pages 16-19).

Assessment of Regulatory Consolidation

- We segmented the firms based on annual revenues and extrapolated the cost reduction data to arrive at an assessment of the potential impact to the investment industry of self-regulatory organization (SRO) consolidation. The guiding principles and approach underlying this analysis is adopted from guidelines published by the Financial Conduct Authority (FCA) that are recognized as a standard evaluation framework by Canadian regulatory and industry organizations.
- We also focused on five key assessment topics - with consideration given to investors, firms, and the industry - associated with SRO consolidation. Given that this analysis contemplates a consolidation of IIROC and the MFDA, and it does not consider the Autorité des marchés financiers or the Chambre de la sécurité financière, the benefits and costs were evaluated for mutual fund activities carried on outside Quebec.
- Most of the benefits outlined in this report are expected to accrue over time depending on a number of factors including the pace of transition to a single dealer and advisor platform and the timing of specific rule harmonization.

Assessment of Benefits and Costs

Key Focus Areas of Assessment

In conducting our assessment, we explored the benefits and costs associated with the Consolidation Scenario through five key focus areas. These key focus areas reflect the main themes that arose through the stakeholder interviews.

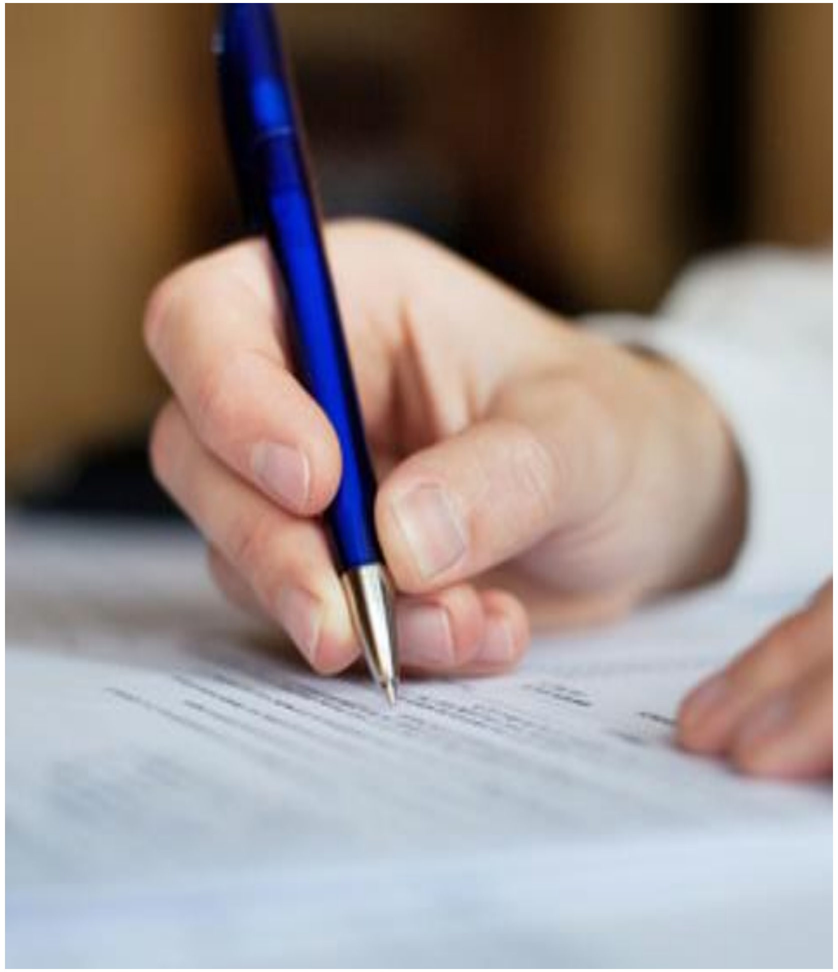
1. **Reduced Regulatory Fragmentation and Regulatory Burden**
2. **More Holistic and Flexible Investment Advice**
3. **Enhanced Opportunities for New Firm Entry and Innovation**
4. **Reduced Operating Costs**
5. **One-Time Transition Costs**

Reduced Regulatory Fragmentation and Regulatory Burden

By definition, the Consolidation Scenario will result in a single SRO, which may help to promote greater efficiency in regulatory oversight and investor protection.

The following key insights emerged from our assessment:

- Under the Consolidation Scenario, dual-platform firms have the option of transitioning to a single regulatory platform. This has potential to create efficiencies for dual-platform investment firms, such as (i) building and maintaining a single regulatory relationship, (ii) being subject to a single regulatory compliance framework and enforcement discipline, (iii) maintaining one set of policies and procedures with reference to a harmonized set of rules, interpretation and guidance, and (iv) operating a single training program.
  - Some Participating Firms suggested that the rules should be proportionate in order to not disadvantage smaller firms by forcing them to comply with extraneous IIROC requirements, which do not relate to their main product offerings or business model. The Consolidation Scenario, as proposed by IIROC, specifies that MFDA dealers will initially remain under MFDA rules and, over time, the IIROC and MFDA rules will be harmonized.
- Investors may directly benefit from a single SRO. For example, how to make a complaint may become less confusing to investors.
- Currently, IIROC and the MFDA separately review and implement rule reform and updates introduced by securities regulators, such as the Canadian Securities Administrators. Duplicated efforts by IIROC and the MFDA to update their respective policies and rules may slow the process of meaningful and consistent policy development. Through Consolidation, time that was invested in rule development and implementation across SROs may be redirected to enhancing the rules and regulations for the industry, which may also enhance regulatory oversight.



More Holistic and Flexible Investment Advice

Under the Consolidation Scenario, some investors will have access to a wider range of investment solutions and advice to better serve their needs. Furthermore, some advisors will have more flexibility to grow and expand to serve the evolving financial objectives and goals of their clients.

The following key insights emerged from our assessment:

- Under the Consolidation Scenario investors may have more choice, as they may be less restricted to investment solutions based on the registration of their advisor. Specifically, investors working with MFDA dealers will have access to a broader set of investment solutions without having to move to an IIROC dealer.
  - With a larger number of registrants permitted to offer a broader range of investment solutions, it follows that there is potential for more competition, which may also serve to benefit investors.
- Under the Consolidation Scenario, there will be less obstacles for MFDA advisors that would like to progress from a restricted license, as their clients' investment needs change and they demand different investment product offerings. For example, they would not need to move to an IIROC registered entity. This benefit has potential to strengthen the talent pool of investment advisors in Canada, as they may have greater flexibility to evolve, which, in-turn, may serve to benefit investors.
- Demand for products like ETFs is growing, and some operational challenges exist for MFDA dealers when it comes to offering ETFs to clients. A consolidation could make it easier for more clients to have access to ETFs.
- Currently there are obstacles to delivering efficient and coordinated investment service due to regulatory fragmentation. Specifically, the Participating Firms suggested that backup is sometimes difficult to secure for vacant portfolios (e.g., advisors who retire, advisors on vacation, etc.) given the need for the registration of the portfolio and adviser to match. This challenge may be mitigated under the Consolidation Scenario, in which all advisors are registered under a single SRO.

Enhanced Opportunities for New Firm Entry and Innovation

The benefits described in ‘Reduced Regulatory Fragmentation and Regulatory Burden’ and ‘Reduced Operating Costs’ may create opportunities for new market participants and innovation in Canada’s investment industry. These are conditions that, in principle, may generate productivity improvements, additional competition, and enhanced service for investors.

The following key insights emerged from our assessment:

- The Consolidation Scenario may provide scope to reduce the operating costs of investment firms. The potential savings may provide businesses with greater resources to invest in technology and other innovations to deliver better solutions and service offerings to investors.
- Canada’s investment industry is currently split between an IIROC-regulated segment and an MFDA-regulated segment. Accordingly, new entrants face the challenge of having to choose which regulator they will operate under and which part of the market they will address. A consolidation can help to mitigate this barrier, which, in-turn, would make Canada a more attractive market for new firms and support greater competition and innovation.
- The Consolidation Scenario helps to remove barriers to innovation. Time that was invested in rule harmonization between SROs may be redirected to enhancing rules and requirements for the industry. A streamlined SRO has potential to be better positioned to support new business models and a transformation towards providing services enabled by technology and other innovations.
- An operating environment that is more favourable towards new market participants and innovation has potential to support greater competition, productivity growth, and more valuable services to the investor.

Reduced Operating Costs

As an outcome of SRO consolidation, dual-platform firms will have opportunities to reduce their operating costs.

Our estimate of the net present value of the cost savings achieved by dual-platform investment firms over a 10 year time period ranges between approximately $380 million and $490 million CAD. These estimates primarily reflect savings in systems and technology, staffing costs, and corporate costs, among some other cost savings. Please see the footnote below for further details on this estimate.[1]

The following key insights emerged from our assessment:

- *Systems and Technology Costs*[2]: A large potential cost saving for dual-platform dealers is expected to come from the consolidation of dual operating system platforms. While some firms have transitioned to a single IT platform, many firms still have separate regulatory, accounting, client relationship management, and order management systems. The costs of systems and technology would be reduced upon operating a single system, instead of two parallel systems.
- *Staffing Costs*: Under the Consolidation Scenario, there may be opportunity for dual-platform firms to centralize their supervision, compliance, technology, operations, risk management, and audit groups. The extent of the savings depends on the amount of centralization already achieved.
- *Corporate Costs*: Dual-platform firms could potentially achieve cost savings as the result of combining legal entities, which may result in a single external audit, single board of directors and/or possible reduced tax filings and legal support under the Consolidation Scenario.
- *Other Costs*: Dual-platform firms may achieve some other potential cost savings. For example, there is potential to reduce marketing and communications costs under a single SRO as the result of developing and maintaining a single set of marketing and communications material.

[1] Based on the (i) cost data collected from Participating Firms, (ii) the structure of Canada's investment industry, and (iii) third-party data on compliance and regulatory costs. Given that this analysis contemplates a consolidation of IIROC and the MFDA, and it does not consider the Autorité des marchés financiers or the Chambre de la sécurité financière, this estimate is based on cost savings achieved for mutual fund activities carried on outside Quebec. Additionally, this estimate is based on the current number of dual-platform dealers, and does not contemplate future dual-platform firms or the impact on IIROC-only and MFDA-only firms. For a detailed background on our approach to computing these estimates, please see Appendix II. For disclaimers and limiting conditions, including how our estimates may be impacted by COVID-19 and the market conditions in 2020, please see Appendix III.

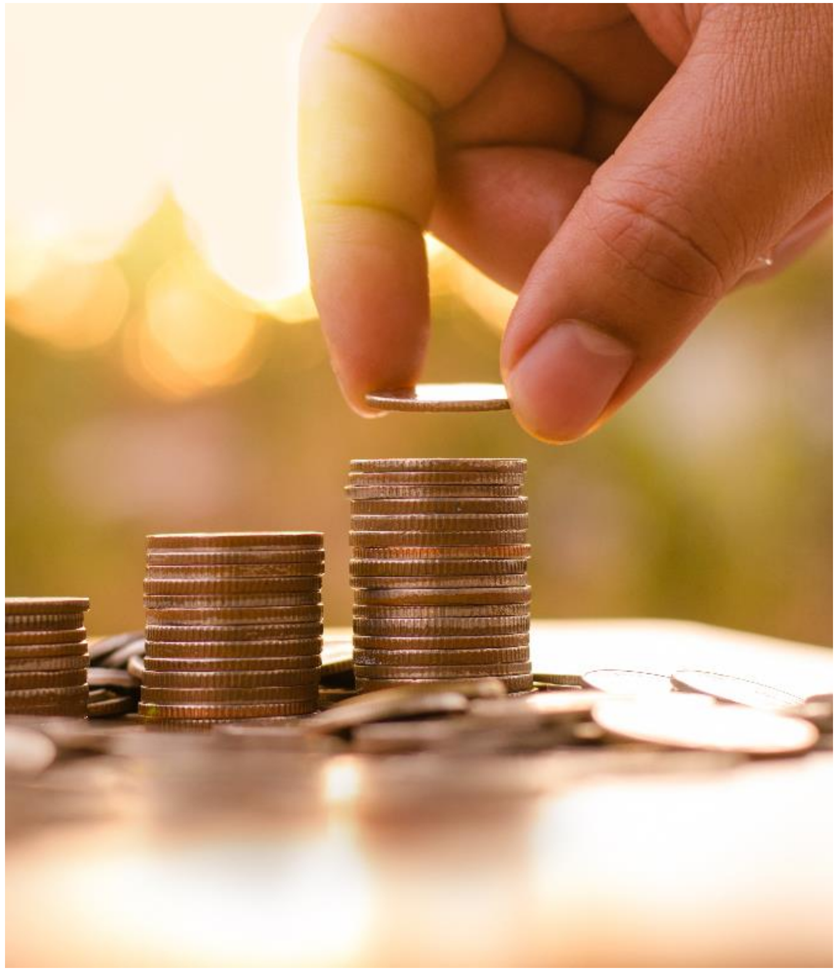
[2] Refer to Page 15 for examples of systems and technology costs.

One-Time Transition Costs

While the Consolidation Scenario is expected to generate operating cost savings over the long term, it is also likely that there will be one-time transition costs for some investment firms.[1]

The following key insights emerged from our assessment:

- The migration of client holdings to a single book of record may be a large-scale endeavour that requires changes/upgrades to IT systems, government approvals to merge separate registered plans, project management resources, and activities including internal and external communication plans, change management plans and/or staff training on changes to day-to-day operational processes.
  - The Participating Firms noted that dealers may employ varying approaches to undertaking this migration (e.g., staggered approach versus full transition of the investor base) and, therefore, the industry may benefit from flexible implementation timelines for the Consolidation Scenario.
- The Participating Firms were concerned about the cost to repaper client accounts, which may be time consuming and administratively burdensome since it would require a new set of documentation for each client.
  - The Consolidation Scenario addresses this concern, as (i) the regulatory approach avoids the need to repaper immediately and (ii) investment firms will repaper under the same schedule as the status quo requirements for repapering.
- The Participating Firms were concerned about the cost to re-register client name to nominee name, which may be time consuming and administratively burdensome.
  - The Consolidation Scenario addresses this concern, as firms will not be required to re-register client name to nominee name.



[1] Please note that the one-time transition costs herein have been explored and described qualitatively.

Appendix I

Our Approach to Information Collection

Our Approach to Data Collection

Our approach to data collection centered on distributing a detailed and standardized cost template.

We facilitated a data collection process from the Participating Firms as an initial activity of this engagement. This step involved preparing and distributing a template that collected:

- General business information; and
- Operating Cost Data

Please note that, for dual-platform businesses, there was space in the template to respond to questions as they relate to their (i) MFDA business and (ii) IIROC business separately.

The Participating Firms were asked to provide an estimate of the change in costs under the Consolidation Scenario. As we will outline in 'Our Approach to Stakeholder Interviews' (Page 16), all data provided by the Participating Firms was reviewed and validated through the consultation interviews.

Data Template

The data template requested comprehensive and standardized general business data and cost data from the Participating Firms.

The table below illustrates the data elements requested through the template.

General Business Data	Staffing Costs	Systems and Technology Costs	Corporate Costs	Other Costs
• Number of Registered Representatives (Please provide in # form) • Number of Investment Representatives (Please provide in # form) • Number of Client Accounts (Please provide in # form) • Assets under management (Please provide in $ form) • Total Revenue (Please provide in $ form) • Total Volume of Purchases and Redemptions (i.e., number of transactions ; Please provide in # form, for the 2018 period)	• Registered representatives • Compliance • Supervision • Reporting and finance • Back office and operations • Legal and risk • IT support • Administrative services (Clerical, HR, etc.) • Other (please specify)	• Accounting systems • CRM systems • Order management systems • Regulatory technology / systems • Carrying broker fees • Technology development and maintenance • Other (please specify)	• Rent / office space • Business registration fees • Regulatory fees (including investor protection fees) • External audit fees (including tax filings) • Subscription fees (clearing, research, other) • Costs to support compliance reviews • Other (please specify)	• Capital Expenditures • Marketing and communications • Office expenses (including printing and storage) • Other (please specify)

Our Approach to Stakeholder Interviews

We conducted extensive interviews with the Participating Firms to discuss their perspectives on the key benefits and costs of the Consolidation Scenario.

Following the data template exercise, the next step in our analysis was to conduct consultations with the Participating Firms to capture their perspective on the benefits and costs of the Consolidation Scenario that would accrue to: (i) their individual firm, (ii) the investment industry, and (iii) investors. All meetings with dual-platform firms were held in person and there was a consultation guide provided prior to the meeting.

At a more detailed level, the meeting was split into three segments. First, we had a discussion on the cost template to review and validate the Participating Firms' data template. Second, we had a discussion on the potential benefits associated with the Consolidation Scenario. Third, we had a discussion on the potential costs, risks, and detriments associated with the Consolidation Scenario. To ensure that we were comprehensive and standardized in our interviews, we asked each of the Participating Firms the same general set of questions for each segment (see Pages 17-19).

Overall, the agenda for each consultation session was as follows:

1. **Project Background**
2. **Consultation Objectives**
3. **Cost Data Collection Template Verification**
4. **Questions on Qualitative Benefits and Costs**

Our Data Template Interview Questions

The first segment in each interview involved a discussion on the cost template to review and validate the Participating Firms' data.

The following list reflects the general questions we asked the Participating Firms to validate their data template.

Questions on Business Characteristics Data

1. Please provide us with a general overview of your business characteristics data.
2. If applicable, how did you estimate your IIROC entity's characteristics as it relates to mutual fund ("MF") business activity?
3. Within your IIROC entity, approximately what proportion of activity involves MFs?

Questions on Operating Expenditures

1. Do your operating costs align to the categories provided in the 'Cost Data Collection Template'?
2. What analyses and assumptions did you apply to estimate your operating expenditures in completing the template?
   - This includes: If applicable, how did you estimate IIROC entity costs that relate to mutual fund ("MF") business activity?
3. What was your approach for estimating cost savings under the Consolidation Scenario?
4. Is there anything especially unique about your operating expenditures in 2018 that would render the 2018 data non-representative of a typical year?
5. What were the normal course MFDA membership fees paid in the last year?
6. What are some of the large operating expenditures your business makes? What is the lifespan of these expenditures and when will the next expenditure need to be made?

Questions on Capital Expenditures

1. What are some of the large capital expenditures your business makes? Additionally, what is the lifespan of these expenditures and when will the next expenditure need to be made?
2. What analyses and assumptions did you apply to estimate your capital expenditures in completing the template?
   - This includes: How did you define a typical year? If applicable, how did you estimate IIROC entity costs that relate to mutual fund ("MF") business activity?
3. What was your approach for estimating cost savings under the Consolidation Scenario?

Our Qualitative Benefits Interview Questions

The second segment in each interview involved a discussion on the potential benefits associated with the Consolidation Scenario.

The following list reflects the general questions we asked the Participating Firms regarding the potential benefits associated with the Consolidation Scenario.

Questions on the Operating Context

1. How have IIROC and MFDA regulatory requirements (e.g., compliance, supervision, financial reporting, operations, technology, auditing, etc.) evolved over time?
2. How have dual platform requirements impacted the way your business operates?

Questions on the Benefits to your Business

1. What business benefits do you anticipate from transitioning to a single regulatory framework?
2. What are some of the areas where potential savings from transitioning to a single regulatory framework could be reinvested into your business (e.g., consumer access and product offering, innovation, talent, competition, other areas)?

Questions on the Benefits to Canada’s Investment Industry – Businesses, Advisors, and Clients

1. What industry benefits do you anticipate from transitioning to a single regulatory framework?
   - Themes to be addressed may include:
     - Consumer access and product offering
     - Innovation,
     - Talent
     - Competition
     - Other
2. How would you like the regulator to support firms in order to achieve the benefits discussed in the previous question?

Our Qualitative Costs Interview Questions

The third segment in each interview involved a discussion on the potential costs, risks, and detriments associated with the Consolidation Scenario.

The following list reflects the general questions we asked the Participating Firms regarding the potential costs, risks, and detriments associated with the Consolidation Scenario.

Questions on General Costs to your Business and Industry

1. What are the potential detriments or risks of operating under the Consolidation Scenario to your business?
2. What are the potential detriments or risks under the Consolidation Scenario to the investment industry?

Questions on Transition Costs

1. What would be the key activities associated with transitioning from the status-quo to the Consolidation Scenario?
2. What would be the estimated costs associated with transitioning from the status-quo to the Consolidation Scenario?

Appendix II

Our Approach to Estimate Reduced Costs

Our Approach to Estimate Reduced Costs (1/5)

We conducted extensive interviews with the Participating Firms to discuss their perspectives on the key benefits and costs of the Consolidation Scenario.

Background

The guiding principles and approach underlying the estimate of reduced costs is adapted from guidelines published by the Financial Conduct Authority (FCA). In 2018, the FCA published a cost-benefit evaluation framework titled "How we analyse the costs and benefits of our policies" ("FCA's Methodology"). FCA's Methodology outlines steps required to analyze and estimate the costs and benefits of regulatory interventions, and includes guidance on the level of detail and accuracy required, evidence collection, and uncertainties in quantitative estimations.[1]

FCA's Methodology is recognized as a standard cost-benefit evaluation framework by the Ontario Securities Commission[2] and the Investment Funds Institute of Canada[3] in Canada. The Investment Funds Institute of Canada promotes the FCA's Methodology given its degree of robustness.[4]

We adapted FCA's Methodology to align with the characteristics of the regulatory change under analysis (i.e., SRO consolidation) and requirements of our assessment of benefits and costs.

High-Level Overview of Approach

Our approach involved four key steps:

1. *Identification of the Investment Firm's Affected Functions*: FCA's Methodology identified core functions that were most associated with ongoing regulatory compliance activities: compliance, human resources and training, information technology, legal, sales and marketing, and senior management. Reflected through the activities captured by the cost template, Deloitte adapted and expanded these core functions to align with those performed by dealers with respect to IIROC and MFDA compliance. Specifically, we identified the following functions as likely to be impacted by the Consolidation: sales; compliance; supervision; reporting and finance; back office and operations; legal and risk; information technology; administrative services; other ancillary functions (e.g., marketing and communications).
2. *Collection and Analysis of Sample Cost Data*: Deloitte collected cost data from the Participating Firms through the cost template (as described in detail on Pages 14-19). The cost template was shared with the Participating Firms before the 2019 calendar year end, and as such, Participating Firms were requested to provide cost data with respect to the 2018 calendar year. As our analysis estimates cost savings from 2019 to 2028, inflation adjustments were made to align the Participating Firms' cost data to 2019.[5]

1. Financial Conduct Authority, *How we analyse the costs and benefits of our policies*, July 2018.
2. Ontario Securities Commission, *Roundtable on Reducing Regulatory Burden*, March 2019.
3. Investment Funds Institute of Canada, *Regulatory Burden Reduction: OSC Staff Notice 11-784 Burden Reduction*, March 2019.
4. Ibid.
5. When applicable, inflation adjustments were made by applying inflation factors from Statistics Canada to cost data provided by Participating Firms, by cost category. Inflation factors were obtained from the following sources: (i) Statistics Canada, *Employee Wages by Industry: Table 14-10-0064-01*; (ii) Statistics Canada, *Consulting Services Price Index: Table 18-10-0178-01*; (iii) Statistics Canada, *Computer Price Index by Type of Purchaser, Table 18-10-0207-01*; (iv) Statistics Canada, *Commercial Software Price Index: Table 18-10-0061-01*.

Our Approach to Estimate Reduced Costs (2/5)

High-Level Overview of Approach (Cont'd)

3. *Extrapolation Analysis*: This step involves the extrapolation of our sample data (i.e., estimated cost savings collected from Participating Firms) to obtain estimated cost savings realized by dual-platform dealers under the Consolidation Scenario. In this step, we segmented the population of dual-platform dealers to account for economies of scale across firm sizes (in terms of revenues). The population of dual-platform dealers was segmented into three groups based on firm revenues: (i) large-sized firms, (ii) medium-sized firms, and (iii) small-sized firms. At a high level, the ratio of estimated cost savings to revenues for each firm in our sample set was applied to the population of firm revenues within each group. The one exception is for the small-sized segment, in which we leveraged a mix of the Participating Firm data and third-party data to estimate the ratio of estimated cost savings to revenues.[1] The reason we undertook this step is because none of the small-sized firms that participated were dual-platform dealers. Ultimately, the sum of the operations undertaken in this step provided an estimation of cost savings realized by dual-platform dealers under the Consolidation Scenario for a single year.

4. *Scaling Analysis*: This step involved scaling the estimated cost savings obtained from Step 3 to estimate annual cost savings realized by dual-platform dealers under the Consolidation Scenario over a 10 year time horizon. We based our scaling analysis on market estimates of growth in assets under administration associated with dealers in the investment industry. At a high level, the ratio of estimated cost savings to revenues for each group was applied to our estimates of firm revenues, on a year-by-year basis. The sum of these operations provided an estimation of cost savings realized by dual-platform dealers under the Consolidation Scenario over a 10 year time horizon.

Further Details on the Extrapolation Analysis

Several studies have compared compliance costs across a sample of financial institutions that vary by size.[2] These studies find that economies of scale exist for financial institutions in fulfilling compliance obligations – e.g., smaller firms (in terms of assets under administration, which are strongly correlated with firm revenues)[3] incur higher costs than larger firms in pursuit of the same compliance standards. This observation is intuitive given that larger firms are more likely to have established large systems and dedicated teams for compliance, leading to higher efficiencies in compliance activities. Therefore, the investment industry may be segmented by size (in terms of firm revenues) in light of the empirical relationship between firm size and compliance costs. Firms within each segment of the investment industry are expected to exhibit similar ratios of revenues to compliance costs.

1. Specifically, we used third-party data to adjust for the economies of scale realized by small-sized firms relative to medium-sized firms. The two key studies that formed the basis of this adjustment are: (i) Federal Reserve Bank of St. Louis, *Compliance Costs, Economies of Scale and Compliance Performance*, 2018 and (ii) Berger et al., *What Explains Differences in the Efficiencies of Financial Institutions?*, Journal of Banking and Finance, 1997.
2. For example: (i) Federal Reserve Bank of St. Louis, *Compliance Costs, Economies of Scale and Compliance Performance*, April 2018, (ii) Drew Dahl et al., *Scale Matters: Community Banks and Compliance Costs*, July 2016.
3. Financial Conduct Authority, *Asset Management Market Study*, November 2016.

Our Approach to Estimate Reduced Costs (3/5)

Further Details on the Extrapolation Analysis (cont'd)

We extrapolated the sample data collected from Participating Firms (i.e., cost savings under the Consolidation Scenario) to estimate cost savings realized by dual-platform dealers under the Consolidation Scenario.

As a first step, we segmented the population of dual-platform dealers by revenues to account for the presence of economies of scale in fulfilling compliance obligations. Based on data provided by IIROC, there were 25 dual-platform dealers active as at January 2020. The IIROC entities of dual-platform dealers vary significantly by annual revenues – ranging from $3 million to $7,351 million (based on the most recent fiscal year as at December 31, 2019). We analyzed the distribution of dual-platform dealers by the annual revenues realized by their IIROC entities to develop an approach for segmenting the investment industry. This enabled the segmentation of all dual-platform dealers into three groups: (i) large-sized firms, (ii) medium-sized firms, and (iii) small-sized firms.

Table 1: Segmentation of Dual-Platform Firms, by Revenues
All $ values presented in CAD

Segment	**Definition** (Based on annual revenues generated by the IIROC entities of dual-platform dealers)	**Number of IIROC Entities of Dual-Platform Dealers** (January 2020)	**Revenues Generated by the IIROC Entities of Dual-Platform Dealers** (For the most recent fiscal year as at December 31, 2019)
Large-sized firms	More than $2.5 billion	8	$24.3 billion
Medium-sized firm	Between $200 million and $2.5 billion	6	$2.2 billion
Small-sized firms	Less than $200 million	11	$0.5 billion

Source: IIROC. Deloitte Analysis. **Notes**: The revenues presented refer to annual revenues realized by the IIROC entities of dual-platform dealers. Due to data limitations, we could not ascertain the annual revenues realized by both IIROC and MFDA entities of dual-platform dealers. As such, our approach assumes that the revenues generated by the IIROC and MFDA entities of dual-platform dealers within each segment follow a similar distribution to the corresponding Participating Firm within each segment (i.e., the ratio of IIROC entity revenue to MFDA entity revenue for each Participating Firm is similar to the other dual-platform dealers in its associated segment).

Our Approach to Estimate Reduced Costs (4/5)

Further Details on the Extrapolation Analysis (cont'd)

As described above, several studies have found a relationship between compliance costs and firm size (defined by revenues in our study) for financial institutions.[1] This observation implies that both compliance costs before and after a regulatory intervention (e.g., SRO consolidation) can be viewed as a function of firm revenues. Intuitively, the difference between compliance costs before and after a regulatory intervention (i.e., cost savings under the Consolidation Scenario) can be viewed as a function of firm revenues.

As a second step, based on the aforementioned guiding principle, we calculated the ratios of estimated cost savings to revenues associated with the Participating Firms in our sample set. The ratios were applied to the population of firm revenues within the group associated with each Participating Firm. The sum of these operations provided an estimation of a single year of cost savings realized by dual-platform dealers under the Consolidation Scenario.

Further Details on the Scaling Analysis

In 2017, Canada's investment industry managed total assets of $4,277 billion through seven key distribution channels.[2] Across these key distribution channels, it is estimated that the investment industry in Canada will manage total assets of $7,041 billion by 2026 (compound annual growth rate [CAGR] of 5.7% between 2017 and 2026).[3] As described earlier, there is a strong correlation between assets under administration and firm revenues within the investment industry.[4] For the purposes of our scaling analysis, we assumed assets under administration and firm revenues are correlated.

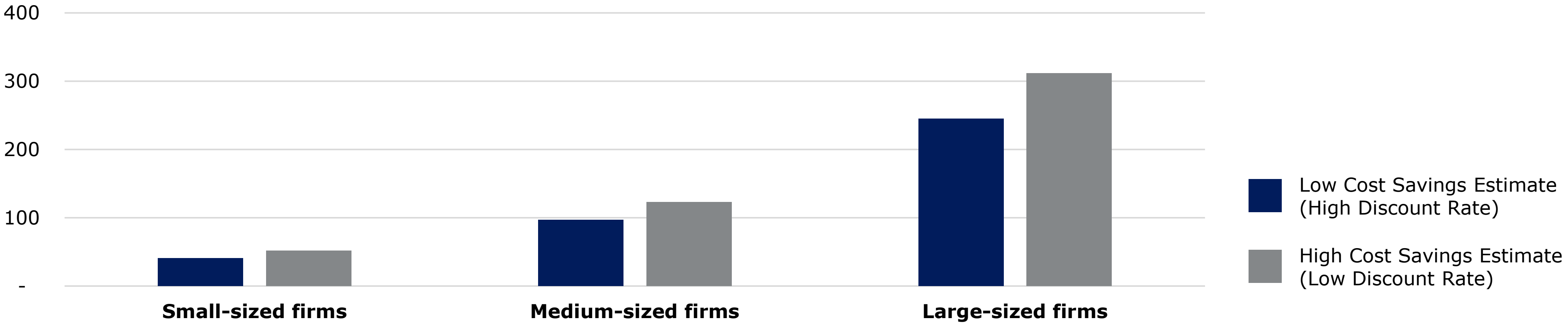
1. Please see Page 22.
2. The seven key distribution channels are: (i) full-service brokerage, (ii) branch direct, (iii) branch advice, (iv) financial advisor, (v) private wealth, (vi) online brokerage, and (vii) direct seller or robo-advice.
3. Strategic Insights, *Canadian Investment Funds Industry: Recent Developments and Outlook*, 2019.
4. Please see Page 22.

Our Approach to Estimate Reduced Costs (5/5)

Further Details on the Scaling Analysis (cont'd)

We scaled the annual revenues generated by dual-platform dealers on a year-by-year basis from 2019 to 2028. The CAGR of 5.7% was employed as a basis for scaling annual revenues. Thereafter, the ratio of estimated cost savings to revenues computed for each group was applied to the population of firm revenues within each group, on a year-by-year basis. The sum of these operations provided an estimation of cost savings realized by dual-platform dealers under the Consolidation Scenario from 2019 to 2028. This study presents estimated cost savings for this time horizon in terms of net present value (discount rates are based on the weighted average cost of capital [WACC] values associated with the parent companies of dual-platform dealers).[1]

Chart 1: Net Present Values of Estimated Cost Savings Realized by Dual-Platform Dealers, 2019 – 2028
All values presented in $ millions CAD.



Source: Deloitte Analysis. **Note**: Given that the Consolidation Scenario is based on SRO consolidation, and it does not consider the Autorité des Marchés Financiers or the Chambre de la sécurité financière, the benefits and costs were evaluated as they relate to mutual fund activities carried on outside Quebec.

Potential Opportunities for Further Research

Given that we worked with a limited sample, engaging a broader sample of dual-platform dealers would serve to strengthen our estimation of reduced costs. Specifically, this step would enable us to account for differences in cost structures between firms.

1. We estimated WACCs associated with the parent companies of dual-platform dealers (public companies only) based on financial information for the most recent year as at December 31, 2019 to develop a range of discount rates for the purposes of our net present value calculations. The minimum value (3.3%) and maximum value (7.9%) from our estimations were leveraged to develop a range of discount rates for the net present value calculations in this analysis.

Appendix III

Disclaimers and Limiting Conditions

Disclaimers and Limiting Conditions

This report has been provided for the purpose of providing the Investment Industry Regulatory Organization of Canada (IIROC) with an assessment of benefits and costs of regulatory consolidation in the investment industry.

Deloitte's role is limited to providing the independent analysis described in this report. In presenting our results, Deloitte takes no view or cannot undertake any role that could be fairly interpreted as public policy advocacy, lobbying, or otherwise be perceived as impairing our independence and the firm's work is not intended to be used as such or in that context.

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The analysis is provided as of March 20, 2020, and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting this analysis, which may come or be brought to our attention after the date hereof. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the analysis after the date hereof, we reserve the right to change, modify or withdraw the analysis.

The outbreak of COVID-19 will have a significant impact on the economic outlook. The analysis presented in this report was based on the economic situation prior to the COVID-19 outbreak and does not include any consideration of the likely impact of either of these events or the related fiscal stimulus measures. As a result, readers should carefully consider the relevance of the views and findings contained in this report as the basis for any decisions made in the current economic climate against the backdrop of heightened uncertainty.

We do not provide assurance on the achievability of any forecasted results contained herein because events and circumstances frequently do not occur as expected, differences between actual and expected results may be material, and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.

If prospective financial information provided by the client or its representatives has been used in this analysis, we have not examined or compiled the prospective financial information and, therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.

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