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Member Regulation Policy

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Non- tailored Advice in the Order Execution Only Channel Consultation

<https://www.ciro.ca/news-room/publications/non-tailored-advice-order-execution-only-channel>

Kenmar appreciate the opportunity to comment on the regulation of Discount brokers providing Non- tailored Advice to retail clients. We commend CIRO for creating the opportunity to have this conversation so discount brokerages can optimize the benefits available to DIY investors' in the information age.

Kenmar Associates is an Ontario-based privately-funded organization focused on investor education via articles hosted at www.canadianfundwatch.com Kenmar also publishes the Fund OBSERVER on a monthly basis discussing consumer protection issues primarily for retail investors. Kenmar is actively engaged with regulatory affairs. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused consumers and/or their counsel in filing investor complaints and restitution claims.

Introduction

Millions of retail investors are denied access to personalized financial advice due to high minimum account sizes ,high advice costs, limited service and/or lack of trust in full service Firms. This scenario is often referred to as the "advice gap".

The last few years have seen tremendous growth in discount brokerage accounts. According to research firm Investor Economics, there were 10.6M accounts as of June 2022. A recent Conference Board of Canada report found that [almost half \(45 %\) of investors had self-directed investments, and about one-third had opened those accounts in the past two years](#). Today, 61 per cent of investors are working with an advisor, [down from 69 per cent in 2020](#). Younger Tech-savvy investors eager to learn about investing have been attracted to discount brokerages.

Basic investment advice is being commoditized/made increasingly cost-effective and improved via digitalization, AI and the internet which also expands the reach of advice. Online models and tools will continue to proliferate outside of the regulated frame even if their development is hindered within it. It's time to recognize the spread of this evolutionary trend, embrace innovation and discard regulatory structures that favour an imperfect product-based advice delivery

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structure. Development of low-cost simplified, but regulated, non-tailored advisory options offers a viable option and a safe channel for DIY investors.

Discount brokers have matured in step with technology advancement and continue to do so. Artificial intelligence (AI) /machine learning is evolving at a fast clip in the fintech sphere- it is to trading what fire was to the cavemen. This DIY investing shift is expected to keep growing as artificial intelligence significantly ramps up the digital tools for investors making it easier and even better to use.

According to the J.D. Power *2024 Canada Self-Directed Investor Satisfaction Study*, overall satisfaction with self-directed brokerages rose to 631 (on a 1,000-point scale), a significant 33 points higher than in 2023). The study measures satisfaction in seven factors (in order of importance): trust; digital channels; ability to manage wealth how and when I want; products and services; value for fees; people; and problem resolution.

We are not aware of any client complaints related to discount brokers tools or subscribed notifications .The complaints we hear about relate to customer service, online service outages and poor account statements.

The rise of actively-managed ETFs

According to Morningstar's latest data, 287 unique investment funds were launched in Canada this year. A whopping 137 (47.7%) of them were launched as exchange traded funds (ETFs) and a [growing number of them are also actively-managed](#). Over half the 1500+ ETFs listed in Canada are actively managed. As noted by Morningstar, "*...active ETFs **offer a formidable alternative to the traditional mutual fund structure given they come without embedded advice costs, granting investors who choose to forgo a relationship with an advisor access to professional money managers..***".
Source *15 new Canadian funds worthy of attention* - The Globe and Mail
<https://www.theglobeandmail.com/investing/investment-ideas/number-cruncher/article-15-new-canadian-funds-worthy-of-attention/>

A number of online brokerages offer free ETF trading, cutting transaction costs to the bone.

Actively-managed ETF's tie in perfectly with CIRO's initiative to open up the so-called Order Execution Only platform to non-tailored investment advice.

Response to Questions

The modern discount broker provides online access to investment research reports, model portfolios, trading tools, educational materials, self-assessment tools, predictive tools, calculators, hyperlinks to other sites etc.

Question #1 – Notifications and alerts

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There are certain products like leveraged /reverse ETFs whose complexity may not be understood by retail investors. An Alert could state that the product is complex and suggest the investor read the applicable ETF Facts before investing. Similarly, if the OSC approves a risky illiquid mutual fund for sale online, we think there should be a warning to read the risk section of the prospectus before investing.

If an investor wants to make a trade out of character with historical transactions, an Alert could pop up informing the client of that fact. If an investor wants to sign up for IPO notifications, she/ he could be informed of new opportunities.

Alerts can be applied when a target price has been achieved, if a stock drops more than x% in a single day or if the portfolio asset allocation becomes unbalanced.

Any product that is sold on the basis of chargebacks, has a defined holding period or involves exit fees would merit an Alert.

Smart discount brokers can provide educational materials and also link to regulator websites such as those of the FCAC, CSA, AMF, BCSC or CIRO. If discount brokerages do not provide educational data and tools, investors may rely on inaccurate information from unreliable sources in order to make investment decisions. Of course, investors already can and do obtain free information and tools via reliable, albeit unregistered, sources such as BNN, Morningstar, Yahoo Finance, the Globe and Mail, established bloggers and other entities not regulated by CIRO or any other securities regulator.

Question #2 – Self-help tools

Tools means, charts and other visual aids, dashboards, feeds and filters.

We support full utilization of validated questionnaires and self-assessment tools including CIRO's own self-assessment tool.

The OSC mutual fund fee impact calculator can be a real eye opener for mutual fund investors. There are many calculators that can assist investors in making more informed investment decisions.

Filtering should be enabled for investor use. We cannot rationalize any justification for constraints.

Model portfolios allow small investors to make inferences on the basis of evidence and their own personal circumstance and reasoning. Are available model portfolios personalized "advice"? That may not be personalized advice but it could present conflicts-of-interest if the portfolio is stacked with products of an affiliate. In order to be unconflicted information, it must not be permitted for a brokerage to nudge a

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client to consider any particular security. Information must be consistent and available for a broad range of securities of the same class.

There are generally understood interpretations of technical and fundamental analysis that provide possible indications of price movements or other valuation outcomes. Notwithstanding the fact that technical and fundamental analysis informative tools may qualify a situation as “bullish”, “undervalued” or “bearish” or “overbought” or “oversold”, and notwithstanding the fact that calculations may include levels to assist with the client’s own planning for future objectives, such as target prices for entry or exit decisions, we see no reason such quantitative tools should be kept from DIYs. We don’t believe these analyses constitute personalized advice- it is generic technical/fundamental analysis.

We are of the firm conviction that when an investor seeks out Dealer research reports on a listed Company, it is just part of information gathering and not understood to be a personalized buy or sell recommendation.

Limited client-specific information could be useful. For example, notification when a RRIF withdrawal is coming due.

Trading tools such as those provided by Vector Vest (®) (www.vectorvest.ca) are widely promoted on TV, are not regulated by CIRO and can be readily accessed by retail investors for a subscription fee. The tool tells clients when to buy, what to buy and when to sell to maximize profits. Why not let discount brokers provide such a similar service to Main Street, perhaps as part of a premium service package? It could be offered as a distinct billable service so it is clear that it is a separate service not linked to a KYC. Strong disclaimers would apply.

Question #3 – Finfluencers

We are extremely critical of Finfluencer referral agreements. Such agreements appear to be contrary to CFR intent. A discount broker should not become a casino.

Some discount brokers now utilize a variety of digital engagement practices (DEPs), to connect with a broader array of retail investors, particularly younger investors who grew up with similar design features in other online apps and games on their devices. The concern we have as investor advocates is that some DEPs, using sophisticated algorithms, and game-like features, may blur the line between solicited and unsolicited transactions. A business model of online brokerages, which is paid for order flow, means that the platform is designed around incentivizing clients to trade, trade more frequently, trade in larger amounts, trade in riskier products and open margin accounts for leverage even when not appearing to recommend a specific security (“gamification”). Do behavioral nudges take on attributes similar enough to advice or recommendations such that regulatory intervention is needed?

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The Ontario Securities Commission recently released a study *Gamification Revisited: New Experimental Findings in Retail Investing* <https://www.osc.ca/en/investors/gamification-revisited-new-experimental-findings-retail-investing> that examined the influence of gamification and other behavioural techniques on retail investor behaviour. Since gamification tends to make DIY investors make worse decisions when platforms 'gamify' trading, we encourage regulators to consider the recommendations made in the study.

Question #4 – Copy trading

We have not picked up on this type of activity in our engagement with retail investors.

Question #5 – Delivery of tools and information

We support information and tools provided to be those on the online brokers website or a direct link to a broker authenticated website. We would be cautious linking to social media or Apps. Some investing Apps use features similar to video games like gaming notifications and ranking leaderboards to encourage more trading. These game like features can encourage risky behaviour and impulse trading which is not good for long term financial success.

Discount brokers need to be monitored

Although discount brokers have provided DIY investors a great platform to effect low cost trading, they are not angels. For years, these brokerages collected hundreds of millions of dollars in trailing commissions from mutual fund companies embedded in the price to provide personalized advice, knowing that they were not permitted to provide such advice. In 2022, regulators banned the payment of such commission payments for Dealers that do not provide personalized advice.

There are examples where certain products are kept off the platform if they compete with products of the firm affiliated with the discount broker.

Securities regulators need to monitor Discount brokers to detect when they cross the line into personalized advice or play other tricks like gamification.

As an aside, regulators also need to examine the point at which service levels and interrupted access to accounts mutate to a material investor protection issue given the incidence of significant service interruptions experienced by discount brokerage clients. Cybersecurity is especially critical for online brokerages.

Investor Protection

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The following provisions are required in our opinion:

1. Clear disclaimers should be employed that state that any services used are to aid investors in decision making but are not personalized recommendations.
2. Discount brokers should not bar a security from inclusion on the platform without just cause and good reason.
3. Trailing commissions of any kind are not acceptable.
4. Model portfolios should be generic and not include specific securities.
5. All tools and calculators should be tested and validated before authorized for use on the platform. Any assumptions or limitations of the tools/ calculators should be disclosed.
6. Any complaints about client supporting services should be resolved in accordance with CIRO complaint handling rules and be subject to OBSI independent review. Systemic issues should be brought to the attention of senior management.
7. Identified conflicts-of-interest shall be addressed and resolved in the best interests of clients.
8. Cybersecurity should be of the highest order to protect client information.
9. The use of AI should be in compliance with applicable CIRO, CSA and national standards.
10. Unusual or invalid transactions shall prompt an alert to the client prior to order processing.
11. The platform shall at all times conduct itself in such a manner as to earn respect for Canadian capital markets.

Bottom line

While the “initiative aims to ensure that such advice does not diminish the value of established, robust advisory channels, thereby preventing any potential confusion between the two”, once DIY investors see the power of enhanced OEO services coupled with AI , such assurance will prove elusive. Numerous studies have highlighted the limited scope of regulated investment advice , the conflicts-of-interest , abusive complaint handling, the rise of low-cost actively-managed ETF’s and more recently the shrinking of product shelves , established advisory channels will have to up their game or face the consequences .

Historically, there was a very “bright line” for retail investors when they decided to go on a trading platform knowing it was “unadvised territory”. But that line is really fuzzy now. The reality is that the traditional investment industry is not particularly capable of delivering personalized investment advice to smaller accounts. Discount brokerages allow investors of modest means to participate in the market. As their needs and investable assets grow, they can consider the cost-benefit of paying for professional financial planning, tax optimization, estate planning and personalized investment advice.

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Information tools are in the “best interest” of clients who are seeking more data for their investments and will look elsewhere if online brokers won’t provide it

By modernizing rules and approach to regulation, regulators can help reduce the risks associated with innovation and make it easier for discount brokers to deliver the low-cost, quality services and products that Canadians desperately need to satisfy their financial objectives.

Online discount brokers play a vital role in promoting Canadian financial literacy and empowering investors to make informed investment decisions. This enhancement in smart discount brokerage capabilities will also assist in meeting government goals of enhancing competition in capital markets.

A key question needs to be asked: Is it in the Public interest for a divide to open up in Canada whereby only regulated investment representatives can have access to the tools and models needed by investors to make informed investment decisions? The regulation of discount brokers is a socio-economic issue that, when resolved, will give many ordinary Main Street investors an opportunity to control their own financial destiny at an affordable price.

We hope the information provided proves useful to CSA decision making.

Please feel free to contact us if there are any questions regarding our commentary.

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REFERENCES

Canadian discount brokerages at-a-glance: Moneysense
<https://www.moneysense.ca/canadian-discount-brokerages-at-a-glance/>

Choosing a discount broker | Morningstar
Since first setting up shop in Canada in the mid-1980s, discount brokers have significantly improved the investment experience for do-it-yourself investors. Online trades are cheaper and easier to execute, more educational and research resources are available, and financial-planning tools have been added.
<https://www.morningstar.ca/ca/news/185974/choosing-a-discount-broker.aspx>

Artificial Intelligence and Retail Investing: Use Cases and Experimental Research | OSC
<https://www.osc.ca/en/investors/investor-research-and-reports/artificial-intelligence-and-retail-investing>

The report identified a benefit of AI as “More **sophisticated and properly regulated AI systems can provide increased access to financial advice**”

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for retail investors, particularly those that cannot access advice through traditional channels.” This early data suggest that AI and smart discount brokers should be capable of empowering DIY investors in meeting their basic investment needs. As asset levels increase such investors may engage with other advisors for tax, financial and estate planning. These activities are not “registerable activities “under CIRO registration.

CSA investor index 2024

<https://www.securities-administrators.ca/wp-content/uploads/2024/06/CSA-2024-Investor-Index-Executive-Summary-ENG.pdf>
<https://search.app/chthNkPAfnCMgV2X9>

Funding the Future: The Economic Impact of Canada’s Investment Funds Industry: CBOC https://www.conferenceboard.ca/wp-content/uploads/2022/10/funding-the-future_2024.pdf

Report Insights: DIY Investors in Canada on the Rise: NCFAC
<https://ncfacanada.org/report-insights-diy-investors-in-canada-on-the-rise/>

Retail Investors May Soon Rely on Gen AI Tools for Financial Advice

Generative AI’s ability to compete with financial advisers will likely reshape investment industry distribution strategies. According to the Deloitte analysis, individual investor use of financial advisers will drop to 31% in 2028 from 35% in 2023. This decline may be concentrated among advisers who provide more limited advice, such as representatives who are licensed to offer mutual funds and variable annuities but not exchange-traded funds or common stock.

<https://deloitte.wsj.com/cio/retail-investors-may-soon-rely-on-gen-ai-tools-for-financial-advice-ea6e0e4f>

Discount brokers will attract more clients: RRs will have to be registered beyond trading and investment advice. Tax planning, estate planning, financial planning .or face headwinds.

Opportunities and Risks of Artificial Intelligence in Investment

Markets: Consumer Federation of America

<https://consumerfed.org/wp-content/uploads/2024/10/Opportunities-and-Risks-of-Artificial-Intelligence-in-Investment-Markets-Formatted-Final.pdf>