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Delivered by email to: memberpolicymailbox@ciro.ca

Member Regulation Policy

Canadian Regulatory Organization of Canada
40 Temperance Street, Suite 2600
Toronto, Ontario, M5H 0B4

Re: Response to request for comments on Non-tailored Advice in the Order Execution Only Channel

The Ombudsman for Banking Services and Investments (OBSI) is pleased to provide our comments to the Canadian Investment Regulatory Organization (CIRO) in response to its recent consultation, *Non-tailored Advice in the Order Execution Only Channel*.

OBSI is a national, independent, and not-for-profit organization that helps resolve and reduce disputes between consumers and nearly 1500 financial services firms from across Canada in both official languages. We provide services to federally regulated financial institutions, provincially regulated securities firms and credit unions from across the country. We have been providing these services for over 28 years. As such, we are uniquely positioned to share our views and insights on this important consultation.

As long-time advocates for accessible dispute resolution services as an essential component of a fair, effective and trusted financial services sector, we support CIRO's overarching goal of enabling greater access to advice for Canadian investors.

Overview of comments

OBSI supports CIRO's initiative to enhance investor protection by ensuring access to high-quality information from verified sources and allowing the use of tools designed to help investors make better investment decisions. Our comments emphasize the importance of providing investors with timely, relevant, and accurate information to improve their decision-making and overall investing experience. Our key points include:

- OEO dealers should issue alerts and information related to high-risk and complex services
- Alert criteria should be connected to an investor's investment knowledge, trading experience and behaviour
- Pop-up windows, e-alerts and skill testing questions can provide timely and relevant information
- Model portfolios that reference specific securities introduce risks for investors that should be minimized. If allowed, conflict of interest controls, transparency, and regular updates and rebalancing should be required.
- Self-assessment tools help investors better understand their investment knowledge and risk tolerance and high-quality tools should be encouraged
- Filtering tools can help investors find suitable investments and should be paired with knowledge tools

- Combining tools with self-assessments and alerts could enhance investors' decision-making and align their risk profiles and goals
- Personalized educational content could improve investment outcomes by promoting alignment of investment decisions with goals and prompting appropriate adjustments
- Semi-tailored advice and warnings can mitigate copy trading risks
- Using all communication channels ensures better accessibility, engagement, and timely updates

Question 1 (a): Are there particular products or services in respect of which you think OEO Dealers should be encouraged to issue alerts or other proactive information?

OEO DEALERS SHOULD ISSUE ALERTS AND INFORMATION RELATED TO HIGH-RISK AND COMPLEX PRODUCTS AND SERVICES

OBSI supports encouraging OEO dealers to issue alerts and other proactive information related to high-risk and complex products and services.

Such alerts and proactive information should be issued for

products and services with inherent risks and complexities, including:

- Derivative investment products, including options of all types
- Leveraged products
- Fixed income products, including structured bonds
- Purchasing on margin
- Potential overcontribution to registered accounts

When developing these alerts related to products and services, the tools should also be constructed to trigger when high-risk behavior or activities are being pursued, such as trading on margin, investing in volatile securities (including cannabis, crypto assets and meme stocks), or engaging in trades around major corporate events such as stock splits or mergers. A warning or flagging system would help to ensure investors are aware of the risks they are taking, create the opportunity for more informed decisions, and potentially avoid unnecessary losses.

Question 1 (b): What consistent criteria could OEO Dealers use in choosing to issue alerts or other proactive information?

ALERT CRITERIA SHOULD BE CONNECTED TO AN INVESTOR'S INVESTMENT KNOWLEDGE, TRADING EXPERIENCE AND BEHAVIOUR

OEO dealers should consider a number of criteria to determine when to use alerts. In general, we believe these should be connected to an investor's investment knowledge, trading experience, and behaviour. Alerts should:

- Prioritize investor protection broadly
- Focus on educational content to help investors make informed decisions rather than on information oriented towards investment opportunities or encouraging trading behaviour

- Target vulnerable investors, such as new investors, young investors, those with lower amounts of assets, seniors, and those with a history of investment losses
- Tailor information to investors with varying levels of experience
- Respond to patterns of behavior associated with negative outcomes, including:
 - frequent trading
 - a focus on volatile stocks, such as cannabis, crypto assets, or meme stocks
 - inactivity in an account, such as failing to act when holding derivative positions or failing to rebalance positions over an extended period of time
 - trading on margin
 - engaging in trades around major corporate events, like stock splits or mergers (consumers frequently misunderstand the nature and timing of these events and experience losses as a result)
- Refrain from focusing on price changes, unless consumers opt in to receive such alerts

It is also important to avoid overwhelming investors with too many alerts, as this can lead to alert fatigue, causing investors to ignore important notifications. Effective targeting is essential to ensure that alerts are relevant and timely. While investors should be allowed to opt out of receiving alerts, when they have opted out they should be presented with reminders to consider opting in on a regular basis.

It should be clear to investors that alerts are not recommendations but rather general advice or information designed to help them make informed decisions. This distinction is essential to ensure that OEO dealers can offer valuable information while managing consumer expectations about the nature of the information presented.

Because some of these recommendations may negatively impact firm revenue, CIRO should consider establishing minimum standards for all OEO dealers.

Example 1 – Alerts and proactive information could have helped consumer avoid losses

Mr. B had a margin account at an OEO dealer. The total value of the investments and margin in his account was approximately \$10,000. Late in the trading day on a Friday afternoon, he purchased call options to buy a popular and expensive tech stock. The options cost only a few hundred dollars. That day, the stock price fluctuated and the closing price of the stock was higher than the strike price of the options. The options were now in-the-money and they were automatically exercised for approximately \$1.4 million. Mr. B had set a limit order to sell the options that day, which did not get executed because the limit price was never reached.

On the next trading day, which was a Monday, to cover the cash call on the margin account, the OEO dealer sold the tech stock shares at market price, resulting in a \$22,000 loss.

Mr. B did not think the options should have been exercised given the available funds and margin in his account. Mr. B argued that the exercise of the options by the firm was financially imprudent and ignored standard risk assessment practices. He did not understand the terms of the options he had purchased or acknowledge that his error led to his losses. Given the circumstances, he was fortunate to have lost only \$22,000.

Question 2 (a): Specific tools. Are there any specific tools or services you believe should be included or excluded from the list of non-tailored advice?

POP-UP WINDOWS, E-ALERTS AND SKILL TESTING QUESTIONS CAN PROVIDE TIMELY AND RELEVANT INFORMATION

There are several tools that are worth considering, such as warning pop-up windows, e-alerts and skill testing questions that can provide timely and relevant information to investors.

Pop-up windows and e-alerts serve as immediate prompts, ensuring that investors have the opportunity to learn of potential risks or important considerations before proceeding with a transaction.

Knowledge and skill testing questions are useful as these questions can assess an investor's understanding of complex financial instruments or strategies, prompting them to consider whether they have the necessary knowledge to make informed decisions. For example, before allowing an investor to purchase a derivative product, a pop-up could ask, "Do you understand that the maximum potential loss from this position is \$X? Click here for more information." This approach would help to educate investors and encourage them to improve their understanding of the products they are dealing with before making decisions.

Question 2 (b): Model portfolios. The current guidance contemplates model portfolio tools that are "limited to class of investor, asset class, industry sector and/or time horizon." Model portfolios that reference specific securities are not contemplated. Would you support allowing model portfolios that do reference specific securities, providing no recommendation is made by the OEO dealer based on client information?

MODEL PORTFOLIOS THAT REFERENCE SPECIFIC SECURITIES INTRODUCE RISKS FOR INVESTORS THAT SHOULD BE MINIMIZED. IF ALLOWED, CONFLICT OF INTEREST CONTROLS, TRANSPARENCY, AND REGULAR UPDATES AND REBALANCING SHOULD BE REQUIRED

We have concerns about allowing model portfolios that reference specific securities. The main challenges we see with model portfolios referencing specific securities relate to managing conflicts of interest and ensuring investors have all the relevant information they need before selecting a specific set of investments and while holding these investments. We are also concerned

that any portfolio of investments requires regular attention and rebalancing so consumers who have selected a model portfolio should be regularly prompted with information relevant to rebalancing. To limit volatility and the complexity of rebalancing, model portfolios should be limited to portfolios of investment funds. We would not support model portfolios that identify specific equities.

Regular updates and adjustments to any model portfolio are necessary to ensure that it remains aligned with its original goals. Any investor who has selected a model portfolio that is subsequently changed should be alerted to the changes made and the reasons for the changes.

Regulators should also consider requiring that any securities included in a model portfolio are presented as part of a range of choices for consideration, identifying the features of each option and the lowest-cost option. For example, if an active fund option is offered, it should be matched with a passive fund option

with an explanation of the difference. Similarly, if a growth-oriented option is offered, a value-oriented option should also be offered with an explanation of the difference. Care must be taken in designing the presentation of any model portfolio to avoid implicit suggestions of preference for one security over another. It must be clear to investors that they are not receiving personalized investment recommendations and that they are responsible for their own investment decisions.

Transparency related to costs is also important should this option be considered. Investors need to be fully aware of the costs associated with the securities in the model portfolios to ensure they are making informed decisions and avoid potential misunderstandings.

Question 2 (c): Self-assessment tools. The current guidance does not contemplate OEO dealers providing tools that help clients determine what class of investor they are. Would you support allowing OEO dealers to provide self-assessment tools?

SELF-ASSESSMENT TOOLS HELP INVESTORS BETTER UNDERSTAND THEIR INVESTMENT KNOWLEDGE AND RISK TOLERANCE AND HIGH-QUALITY TOOLS SHOULD BE ENCOURAGED

OBSI supports the inclusion of self-assessment tools. These tools can help investors gain a better understanding of their own investment knowledge, experience, and risk tolerance. We have seen many examples of consumers who have overestimated their investment knowledge and suffered significant financial harms as a result. Self-assessment tools can help mitigate

investor overconfidence by providing a more realistic picture of an investor's actual capabilities and limitations.

There are significant benefits to offering self-assessment tools before an investor's first trading activity or even making self-assessment mandatory. This would ensure that all new investors have a baseline understanding of their knowledge and abilities, as well as their risk profile, before they begin trading. By requiring this initial assessment, firms could reduce the risk of investors making uninformed or overly risky trades.

Care must be taken, however, to ensure that a consumer understands the limitation of such tools and that they do not represent investing advice. The importance of accurate and thoughtful input should also be emphasized. We have seen many cases where investors have provided inaccurate or incomplete information during the KYC process because they failed to appreciate the implications of the information that they provided.

While self-assessment tools can be beneficial to many investors, there are some investors whose experience and capabilities are not sufficient to allow them to appropriately manage their investments through an OEO platform. Any self-assessment questionnaire should recognize this possibility and provide information to any consumer with inadequate knowledge and skills about alternative investment options such as robo advice or in person advisory channels that may be available to them.

Example 2 – Knowledge assessment tools could have helped consumer avoid losses

Mr. A had been using his bank's OEO service to trade stocks online for a few years. He was confident in his understanding of market operations and how the OEO service executed orders. He believed that once he selected "buy" or "sell" for a security, the price displayed on his computer screen was locked in.

In March, Mr. A placed a market order to buy shares in a penny stock and placed a market sell order in May for a few cents more. However, when he reviewed his statement, he noticed that the purchase price was higher than he expected, and the selling price was lower than what he thought he had sold the stock for. These prices did not match the screen images he had taken. He believed that the dealer had sold the shares at a lower price, and two days late.

Mr. A did not understand the nature of the market orders that he had placed or that the trade date and the settlement date could be different. He claimed that the OEO dealer executed his orders at incorrect prices and delayed the sale of his shares inappropriately. He remained confident and adamant in his views throughout the complaint process and did not understand the limitations of his investment knowledge.

Question 2 (d): Filters. OEO Dealers provide their clients with tools for filtering the investments available on their platforms (e.g., large cap Canadian equities or TSX 60 index tracking ETFs). Would you impose limits on how specific such tools can be made (e.g., narrowing down large sets of investments such as those in the example above by price, performance or other criteria)?

FILTERING TOOLS CAN HELP INVESTORS FIND SUITABLE INVESTMENTS AND SHOULD BE PAIRED WITH KNOWLEDGE TOOLS

In general, we support the use of filtering tools because they can help investors better focus their choices and find investments that match their risk profile and investment objectives.

Providing more information to investors is beneficial provided that it is not overwhelming. The objective should be to balance offering sufficiently detailed information while ensuring it remains manageable for the investor.

If a tool allows for filtering by performance, appropriate warnings about past performance not being indicative of future results should be included to help manage investor expectations and remind them of this important fact and that performance can vary over time.

Question 2 (e): Combining tools. What is your opinion on the potential effects of combining tools of various kinds (e.g., if a client uses each of the following in succession: a self-assessment tool, an asset allocation tool, a securities filter and a rebalancing tool)?

COMBINING TOOLS WITH SELF-ASSESSMENTS AND ALERTS COULD ENHANCE INVESTORS' DECISION-MAKING AND ALIGN THEIR RISK PROFILES AND GOALS

We support providing more information to investors by combining tools where feasible. Equipping investors with comprehensive tools can enhance their decision-making process and overall investment experience.

We would encourage CRO to consider carefully the quality of any risk self-

assessment tool. We have observed several cases where consumers have failed to accurately or reasonably assess their own risk tolerance or participate meaningfully in a risk tolerance assessment process. We would also caution policymakers to remember that risk tolerance is only one component of an overall suitability assessment. A willingness to accept risks is not the sole indicator that higher risk investments are appropriate for an investor. Rather, other factors, such as the consumer's ability to withstand loss, investment time horizon, and financial goals are also relevant to that determination. To ensure that investors are equipped with appropriate information, self-assessment tools and any follow-up information that is based on the results should be carefully vetted for accuracy.

We would also recommend that if multiple tools are offered, there should be cross-referencing between the tools based on the responses to each. For instance, if an investor establishes a certain risk profile in the self-assessment tool but then selects investments that conflict with this risk profile, the system should flag this inconsistency. This would help ensure that an investor's activity remains aligned with their established investment goals and preferences.

Any self-assessment tools should be offered alongside the warnings and alerts discussed above. For example, even where a consumer has indicated a high level of investment knowledge and risk tolerance, it may still be appropriate to alert them to high-risk transactions that they are considering.

Example 3 - Alerts and knowledge tools could have prevented significant losses and over-contributions

Mr. G had a tax-free savings account (TFSA) with his bank's OEO dealer for several years. Wanting to increase his investments in the stock market, he applied online to open a non-registered OEO account. Right after opening this new account, he transferred \$100,000 from his line of credit into it.

The next morning, Mr. G used the transferred funds to buy a security at market price, influenced by a company news release. Later that day, a representative from the OEO dealer contacted him to request additional information that they needed to finalize the opening of his non-registered account.

During this conversation, Mr. G inquired about the status of his purchase order, which he now regretted and wished to cancel. The representative informed him that the purchase order had been filled from his TFSA. Mr. G then realized that his new account had not been created. He not only made the trade from the wrong account, he also overcontributed to his TFSA. To make matters worse, the stock he purchased based on positive news from the company had already dropped in value.

Question 2 (f): Limited client-specific information. Should there be greater allowance for the use of limited client-specific information that does not include a recommendation and is not based on KYC information? For example, in situations where a new client has funded their account but has not made any investments after a certain period, would it be appropriate to reach out with educational information about the benefits of investing some or all of their cash holdings?

PERSONALIZED EDUCATIONAL CONTENT
COULD IMPROVE INVESTMENT OUTCOMES BY
PROMOTING ALIGNMENT OF INVESTMENT
DECISIONS WITH GOALS AND PROMPTING
APPROPRIATE ADJUSTMENTS

Providing timely and relevant educational content can help lead to better investment outcomes. To advance this important goal, there should be an allowance for the use of limited client-specific information. The information provided should be personalized based on the circumstances of the consumer's account and tailored to the

consumer's potential needs. For example, it would be appropriate to reach out with educational information if:

- The investments in an OEO account do not match the client's previously recorded KYC information, to prompt a review and ensure alignment with their current investment goals
- The asset allocation in a portfolio is no longer aligned with the original allocation, to provide guidance on rebalancing
- There is inactivity in trading that could negatively impact the client's portfolio performance, to encourage them to review and adjust their investments as needed. This is especially important for securities and derivatives that are normally held for short periods of time

Question 3: Some CIRO OEO Dealers have entered into referral arrangements with Finfluencers and in certain cases have integrated their trading platform with the third-party platform, (e.g. "Trade Now" functionality that provides the ability to trade directly through the third-party platform). What are your views on this practice and to what level of initial due diligence and ongoing monitoring should be required on the part of the OEO Dealer?

We have not seen related cases at OBSI. However, we have concerns that any trading activity that results from such arrangements may not appropriately reflect the needs of the investor.

Question 4 (a) and (b): (a) Should OEO Dealers be allowed to provide their clients with "copy trading" functionality that provides the ability to automatically replicate the trades of other investors? (b) What measures can be implemented to ensure that copy trading is used in a way that is beneficial to investors?

SEMI-TAILORED ADVICE AND WARNINGS
COULD MITIGATE COPY TRADING RISKS

We have not seen investor complaints related to copy trading. We would observe, however, that this is a modern way to facilitate a traditional approach to investing. If OEO platforms facilitate copy trading,

however, it introduces numerous risks based on the ease and speed of trading. The most notable risks are that the resulting investments may not be appropriate for the investor's specific needs, and those who

copy trade risk making all of their investments on a momentum basis, potentially amplifying market movements and potential losses.

Potential conflicts of interest for the original trader and timing lags of the copy trading from the original trading are also risk factors that should be considered. If copy trading is allowed, to mitigate these risks, semi-tailored advice could be beneficial. Providing warnings and outlining risks can help inform investors about the potential downsides and encourage them to proceed with caution.

Question 5: Should the guidance distinguish information and tools provided directly on OEO Dealer websites or by email or made available through apps or social media sources?

USING ALL COMMUNICATION CHANNELS
ENSURES BETTER ACCESSIBILITY,
ENGAGEMENT, AND TIMELY UPDATES

We believe all communication methods have value. Providing information and tools directly on OEO dealer websites ensures that investors have a centralized and reliable source of information, while delivering information and tools via email, apps, and

social media likely would enhance accessibility and engagement. In each of these instances, these channels would allow investors to receive timely updates and alerts, which are useful for staying informed about market changes and investment opportunities.

Thank you for providing us with the opportunity to participate in this important consultation. We would be pleased to provide further feedback to CIRO at any time.

Sincerely,

Sarah P. Bradley
Ombudsman & CEO