

Member Regulation Policy

Canadian Investment Regulatory Organization

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Re: Non-tailored Advice in the Order Execution Only Channel

Ladies and Gentlemen,

Morningstar welcomes the opportunity to comment on the Canadian Investment Regulatory Organization's consultation paper on "Non-tailored Advice in the Order Execution Only (OEO) Channel." As a leading provider of independent investment research, our mission is to create products that empower investor success and help them reach their financial goals. Serving individual investors, financial advisors, and institutional clients on a global scale, we have a multifaceted perspective on the impact of the proposed guidance and its possible effect on the advice that investors receive. Moreover, our experience in providing solutions addressing the global shifts in regulation toward a best interest standard offers a unique opinion on developments on OEO, robo-advice, hybrid, and full-service advice channels.

General Comments

We commend CIO for addressing the evolving needs of Canadian investors and recognizing the significant growth in the do-it-yourself investor segment. Our review of industry surveys over the recent past echo many of the same findings and sentiment in CIO's own investor survey. (1) Investors are opening DIY investing accounts at younger ages and are likely to seek information from nontraditional sources¹, and (2) investors who choose to use an OEO service tend not to trust advisors, yet some believe information on OEO platforms is considered advice².

Though we agree with Canadian regulators' concerns of young investors getting "advice" from unscrupulous sources, we ask CIO to also consider the advice gap that exists for investors who don't have the means or motivations to access regulated advice but are able to open a trading account. Allowing for a broader set of capabilities and information sets to be allowable directly on the platform and encouraging their use would greatly aid in closing this gap. Moreover, broader capabilities within this segment will foster competition and innovation in the Canadian retail investor market, ultimately bettering financial outcomes for investors. Morningstar's own survey-based research study (2022 US survey, n=1500) points to the fact that retail investors "welcome features on digital trading platforms that encourage them to educate themselves and to make financial decisions in their best interests like saving money for the future. They welcome use of personal and financial data only for personal improvement or personalized investment recommendations."³ The findings of this study are attached to

¹ Finra Investor Education Foundation & CFA Institute. 2023. "Gen Z and investing: Social media, crypto, FOMO, and family." <https://www.finrafoundation.org>

² https://faircanada.ca/wp-content/uploads/2024/09/2024_10_01_FAIR_Understanding-DIY-Account-Holders_Eng_ver0.pdf

³ Morningstar: "No Bells No Whistles No Problems: What Investors Want From Their Online Trading Platforms." See Appendix

this consultation response as an appendix.

As a local supplier of data and research to Canadian OEO dealers, we take note of the fact that many OEO firms are hesitant to offer services to their clients that border on a recommendation. We believe this cautious approach is a consequence of existing guidance⁴. The appeasement of this cautious approach via updated guidance would help close the advice gap.

Related to this topic is the matter of sustainable investing, which is itself facing an advice gap not just in the OEO channel, but across all parts of the retail advice continuum in Canada. Morningstar's data shows that assets in retail sustainable-investment funds and exchange-traded funds (identified by a clear investment objective) totaled CAD 56 billion at the end of 2024, a small fraction of the CAD 2.5 trillion-plus fund and ETF market⁵. Yet, investor surveys continually point to most investors (especially those who are younger) wanting to invest sustainably⁶. The Ontario Securities Commission's guidance in sustainable-fund disclosures alongside the federal government's Bill C-59 antigreenwashing bill are a testament to the advancement of sustainable investing in Canada. Given that the growth in DIY investing accounts also tilts toward a younger demographic, these same investors would benefit greatly from additional information, tools, and research as it relates to sustainable investments. This is not limited to tools that help narrow the choice of investments but includes tools that allow an investor to measure and understand their own preferences while investing in line with personal values. Encouraging tool sets that encompass elements of sustainable investing would serve to close the advice gap in this area and would promote the flow of capital into sustainable projects.

We note that the number of Canada-listed ETFs has grown substantially from 308 at the end of 2014 to over 1,540 at the end of 2024⁷, arguably mirroring or exceeding the number of liquid Canada-listed equities. Given this context, the following are direct responses to the questions posed in the consultation and largely reference investment funds made available via OEO dealers.

Question #1 – Notifications and alerts

(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?

Financial instruments that by their nature might introduce large swings of volatility in an investor's portfolio would warrant proactive communication at the point of purchase. From the perspective of managed investment funds available through OEO dealers (exchange-traded funds and some mutual funds), examples include leveraged or inverse leveraged products, and funds classified in alternative categories (like those that invest in cryptocurrencies or those that employ long-short approaches). We note importantly that the context of the communication should be related to the instrument being purchased as opposed to a blanket warning, which would be less effective.

⁴ <https://www.ciro.ca/news-room/publications/guidance-order-execution-only-services-and-activities#toc-3-1-meaning-of-recommendation->

⁵ <https://www.morningstar.com/en-ca/lp/sustainable-investing-landscape>

⁶ https://www.riacanada.ca/content/uploads/2024/02/2023-RIA-Investor-Opinion-Survey_Final-Report.pdf

⁷ Source: Morningstar Direct Data as of November 6, 2024

Investors should also be warned around potential liquidity issues at the security and at the wrapper level. Investments that have lock-in periods or investments that are known to be thinly traded (marked by wide bid-ask spreads) warrant a proactive message at the point of sale.

When investors are considering entering positions that have the potential to result in a loss larger than the amount invested, they should be warned. This would include margin trading situations (particularly if combined with a leveraged product or investment), short-selling, and uncovered/naked call options.

Generally, proactive information regarding tax effects on an individual are of value to investors. Though there is much education around sheltered accounts and account selection, information about tax implications on higher volume trading would warrant a consideration. Though this may not appear as an alert for every trade, higher frequency traders should be reminded as appropriate. To this end, Morningstar also highlights that disclosures are more effective when presented clearly and “just in time,” as such disclosures provide easy-to-understand information right when an investor needs it most. Further detail around our viewpoints are found in our Comments to FINRA Regulatory Notice 24-13 regarding day trading⁸.

Finally, we note that over the past two decades, the meaning and implications of the ETF wrapper have evolved significantly. Initially, ETFs were predominantly broad-based, offering diversified exposure to entire markets or large segments thereof. However, the proliferation of sector-specific and single-stock ETFs are of concern. These concentrated investments carry risks that may not be immediately apparent to the average investor, particularly when compared with broad market-based ETFs. Given this evolution, we advocate for the introduction of warning labels on sector-specific and single-stock ETFs. These labels should clearly communicate the heightened concentration risk associated with these products, ensuring that investors are adequately informed before making investment decisions.

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

CIRO may consider tying proactive alerts to the types of risks that are commonly disclosed in a prospectus document (market risk, credit risk, liquidity risk, derivatives risk, currency risk, as examples) and the associated criteria that measure these types of risk. Ideally, a concise layman’s explanation of the risk, how that risk might affect the value of the investment, and how it is measured would be included in communications to investors at the point of sale.

It is of vital importance that the warnings displayed are contextual and ideally include some consideration of the investor’s other portfolio positions. For example, an investor who is interested in buying a risky investment that has low correlations to the rest of their portfolio may not warrant as strong of a warning as compared with an investor whose first investment is a fund that tracks a cryptocurrency. Warnings should consider the nature of the investment and what it represents as part of the investor’s broader asset allocation.

Question #2 – Self-help tools

⁸ <https://www.finra.org/sites/default/files/NoticeComment/Morningstar%20-%20FINRA%20Day%20Trading%20Letter.pdf>

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

CIRO has well-defined guidance in the full-service advice space through know-your-client know-your-product and suitability determination requirements to adhere to National Instrument 31-103. Morningstar believes that DIY investors should be given the opportunity to conduct similar elements of a suitability determination within their OEO platform. Though it can be argued that a savvy investor might conduct this type of analysis off-platform, encouraging on-platform analysis would give the dealer, CIRO, and the Canadian Securities Administrators more visibility into investors' behavior.

Self-risk assessment tools like risk-tolerance questionnaires are an important part of a suitability determination for CIRO-registered advisors, and we believe these should not just be made available but also encouraged by the OEO dealer upon opening an account. The CSA's research points to some overconfidence in Canadians' own financial knowledge⁹, and we believe that self-profiling tools are an effective way to further educate investors and help mitigate this risk. The implementation of risk-tolerance questionnaires should provide functionality that mirrors an advisor's duty to clients. They should include clear-cut questions, offer clarification if needed, and provide an ability to double-back if answers are not as expected.

A self-applied risk-assessment tool is only useful if it is used in conjunction with appropriate measures of portfolio risk. We believe CIRO should encourage measures of risk that span beyond today's standard — which is either a very generic asset allocation (that is, "low" risk = 20/80 stock/bond portfolio), or a very generic measure of risk (such as the 10-year standard deviation of returns or "risk level" displayed on Fund Facts and ETF Facts documents). Risk measures should be applied at the portfolio level and should be clearly displayed and described. OEO dealers should provide an option to help investors understand whether their portfolio's risk is in line with their risk profile, without forcing a recommendation.

As it relates to managed investment products, OEO dealers should provide peer group information to ensure investors are indeed comparing the performance of a product with its industry-defined peers. The Canadian Investment Funds Standards Committee has a long track record of providing standardized fund categories to the Canadian market and is referenced on fund profiles. Investors would be well served to have peer group averages available to them when screening for managed investments and when gauging fund performance and other important characteristics like fees. The CIFSC has also developed a Responsible Investment Identification Framework,¹⁰ which helps find managed investments that use well-recognized sustainable-investing approaches. This framework is in line with the OSC's recent guidance (CSA Staff Notice 81-334) around sustainable-fund naming and the CFA Institute's recent publication that defines sustainable-investing approaches¹¹. Having both traditional fund classifications and sustainable-fund identifications available to DIY investors as screening/searching criteria would add great value to retail investors without a heavy cost to OEO dealers. This might also help address the gap between retail investors' intent to invest sustainably and the lack for retail assets in sustainable-investment funds.

⁹ <https://www.advisor.ca/industry-news/industry/diy-investors-the-most-financially-literate-finds-osc-study/>

¹⁰ <https://www.cifsc.org/responsible-investment-identification-framework/>

¹¹ <https://rpc.cfainstitute.org/research/reports/2023/definitions-for-responsible-investment-approaches>

OEO Dealer firms should also be encouraged to provide basic portfolio analytics to their users. For example, asset allocations, geographic/regional exposure, and sector exposures are useful sets of information to inform decision-making and ongoing portfolio monitoring. Additionally, investment exposure to controversial areas (like animal testing, weapons, fossil fuels, and so on) and climate-related metrics would allow for investors to better align with their nonfinancial preferences.

Finally, Morningstar notes that generative artificial intelligence is quickly becoming a valuable technology across the financial-services industry in Canada. We clearly recognize the risks of using this technology for investment advice and for trade execution. However, when used to educate investors on investment concepts, clarify workflows, and retrieve relevant data or documents, generative AI technology can greatly reduce the technological friction associated with traditional financial data technology—a particularly relevant hurdle for DIY investors who might lack the experience and skill set to navigate traditional systems. Hence, we believe the use of generative AI in the above context should be allowed on OEO dealer platforms, provided that the OEO dealer appropriately points the AI model to a fenced-in corpus that contains relevant information from verified/trusted sources. Explicitly, this would exclude social-media platforms and online investment forums (or other known sources of questionable advice) but include professional research databases and credible news sources. This would help ensure the answers produced are of higher quality and would safeguard against misuse of data. When accessed through a prompt window or chatbot, explicit warnings should be presented to users each time the technology is accessed and should warn investors that it cannot provide investment advice. Responses should include links to source information and encourage users to read the source documents themselves.

(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?

Yes, we would recommend allowing model portfolios that reference specific securities, provided no recommendation is made by the OEO dealer based on client information. A motivated investor might otherwise seek such information from nonregulated sources. Allowing visibility into these models would enable some level of oversight by either the dealer or the self-regulatory organization.

Furthermore, this approach could foster competition and increase access to professionally managed model portfolios. The vertically integrated nature of Canada’s financial markets has led to proprietary models being offered in various wrappers, such as separately managed accounts, which are often exclusive to a single distribution network and require high minimum investments. Providers are understandably motivated to keep these models proprietary and exclusive, making it challenging for investors to compare models across firms in terms of performance and holdings, and limiting their ability to invest according to the model.

Permitting DIY investors to follow a professionally managed model could accelerate competition, similar to the trajectory observed in the US market, where robust public model marketplaces exist, greatly enhancing the range of choices available to investors. From the perspective of vertically integrated OEO

dealers, who offer a full spectrum of advice, this could also help reduce risk by providing oversight of existing model portfolios.

(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?

Yes, Morningstar would support the addition of self-assessment tools. More context is available in our response regarding self-help tools, above.

(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)?

No, we would not impose limits on how filtering tools are implemented. The complexity of screening functionality varies across available platforms today but for the most part pales in comparison to similar tools made available to professional investors. As filters are a primary tool for the DIY investor (and likely to be conducted off-platform), encouraging screening within OEO dealer platforms will give the operators line of sight into what types of parameters are being used and will enhance the user experience. Filtering across a greater set of parameters is of low incremental cost to implement and provides a great deal of information to an investor. CIRO should not limit the amount of information that is available but leave to the dealer/the market to decide what is relevant to investors.

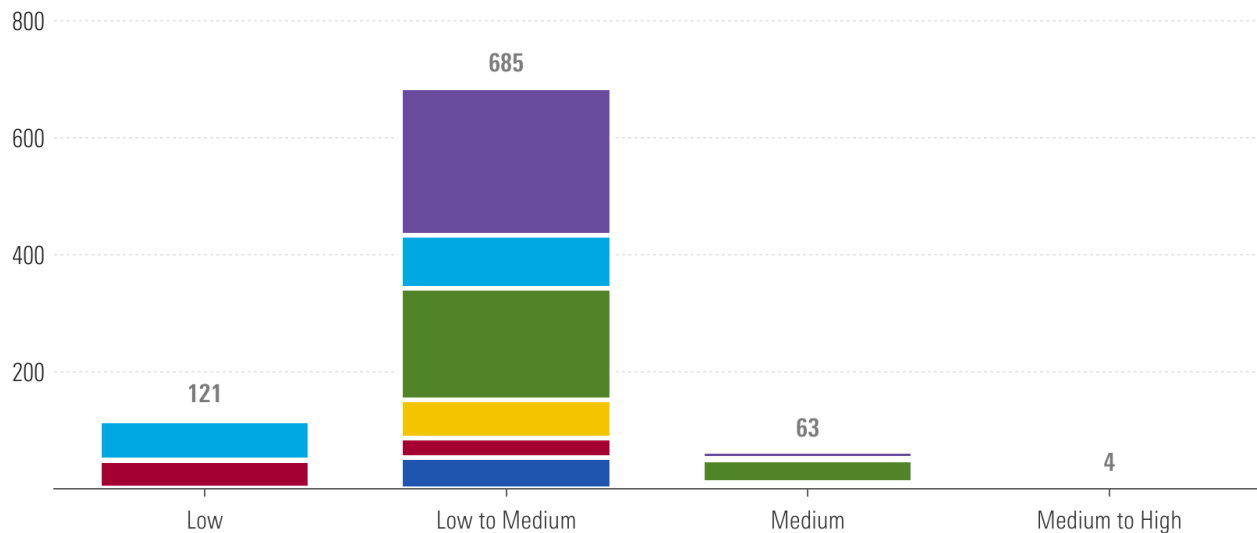
This said, risk ratings, maximum drawdowns, performance ranks, ratings, and other related information should be made available when screening/searching for investments and should be prominently displayed to help users find appropriate investments.

Morningstar encourages risk measures that span beyond what appears on Fund Facts or ETF Facts documents, given this measure no longer considers performance during the global financial crisis (a critical litmus test to understand performance during large market corrections), nor does the measure consider changes in underlying positions of an investment fund. Moreover, lack of granularity of the CSA-defined risk level limits the utility for investors who wish to receive a precise measure of portfolio risk. The distribution of risk levels across Canada-domiciled target allocation funds illustrates this well (Exhibit 1), showing that most balanced funds display a “low to medium” risk rating, despite these products spanning all six target allocation categories representing a wide swath of asset mixes. A motivated long-term investor using a DIY platform with intentions to match a self-completed risk profile with an appropriate target allocation product would find the risk level of limited utility by itself.

Exhibit 1: Distribution of Risk Level Across Canada-Domiciled Target Allocation Funds

An overwhelming majority of balanced funds have displayed "Low to Medium" risk levels on their Fund Facts or ETF Facts documentation.

■ Canadian Equity Balanced ■ Canadian Fixed Income Balanced ■ Canadian Neutral Balanced ■ Global Equity Balanced ■ Global Fixed Income Balanced ■ Global Neutral Balanced



Includes oldest share class of Canada-domiciled Mutual Funds and ETFs categorized across the six target allocation categories.

Source: Morningstar Direct | Data as of Feb. 13, 2025. | n= 873

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This said, there is no single agreeable measure of risk. OEO dealers should be encouraged to provide many measures of risk to allow for the DIY investor to make their own informed judgment.

(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)?

The combination of various tools such as self-assessment, asset allocation, securities filter, and rebalancing tools is fundamentally essential for the optimal functioning of a DIY investor. Stifling the availability of these tools would constitute a significant disservice to investors. It is imperative to recognize that DIY investors, by definition, seek to manage their investments independently. The provision of these tools by OEO platforms is crucial as it not only facilitates informed decision-making but also provides valuable insights into investor activities through user data. This visibility is instrumental in understanding investor behavior and preferences, which can further refine the tools and services offered.

An OEO dealer who offers a broad tool set is inarguably going to serve investors better than a dealer who offers limited tools. It is vital to ensure that OEO platforms are enabled to provide these tools, thereby fostering a more informed and self-reliant investor community.

(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?

In the stated example, it may seem that a nudge to invest cash positions might be beneficial to end investors. However, depending on timing of the market cycle, it is possible that the nudge occurs at exactly the wrong time, souring the investor's initial experience and introducing short-term losses. Geopolitical and economic uncertainty and historically high market valuations introduce an increased probability of a market cycle downturn. Pointing to broad educational articles as opposed to those that encourage investing at a specific point in time would better serve end investors. In the provided example, the material should be unbiased and represent both the pros and cons of investing from cash.

OEO dealers should recognize the critical distinction between scenarios in which an investor initiates the interaction with the intent of seeking information from the OEO platform and instances where the platform initiates the interaction with the investor. In the first scenario, the investor is seeking out information and providing insight into their needs and interests. The OEO dealer may use this information to supplement their existing knowledge and expertise when providing information to an investor. This situation is different from when the dealer firm initiates an interaction, where there is a greater chance that a firm will use prompts or marketing to "nudge" investors to take a particular investment-related action. Nudging may be even more apparent when a dealer is initiating a sale; however, providing information sought out by investors is completely different. This information can be used for financial education rather than for a sale or to nudge a particular buy/sell/hold transaction, and we agree that nudges that tend to inspire such transactions could be viewed in some cases as a recommendation and may cross the boundary between information and advice.

Question #3 – Finfluencers

(a) 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).

No Response.

(b) 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?

No Response.

Question #4 – Copy trading

(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?

While the democratization of portfolio strategies through copy trading functionality may appear beneficial to investors, it is imperative to recognize the significant risks involved. Retail investors may lack the requisite sophistication to fully grasp the intricacies of active trading strategies, especially those that employ leverage, short-selling, or involve high turnover. Moreover, the absence of stringent regulatory oversight on the activities of “other investors” whose trades are being replicated exacerbates these risks. These “other investors” are not necessarily subject to the same rigorous standards and scrutiny as professional fund managers, which can lead to irresponsible or excessively risky trading behaviors. This poses a substantial threat to the financial well-being of retail investors, who may unwittingly follow high-risk strategies without adequate understanding or protection.

If the intent of CIRO’s updated guidance is to distinctly separate OEO dealers from the rest of the advice continuum, enabling copy trading functionality would cross the line between “information” and “advice,” especially if offered via the OEO dealer platform.

However, an exception could be considered if the “other investor” is registered as a licensed portfolio manager in Canada and is subject to fiduciary duty. In such cases, the portfolio manager would need to be aware that the copy trade functionality is being utilized, thereby placing the onus on the portfolio manager to ensure proper oversight and adherence to regulatory standards. This would provide an additional layer of protection for retail investors, ensuring that the copied trades are managed responsibly and in the best interests of the clients.

Nevertheless, it is strongly recommended that retail investors seek exposure to complex trading strategies through professionally managed investment funds. These funds offer a more controlled and regulated environment, ensuring that the associated risks are managed by experienced professionals, thereby safeguarding the interests of retail investors.

(b) What measures can be implemented to ensure that copy trading is used in a way that is beneficial to investors?

Should CIRO pursue the allowance of copy trading (outside of the above-mentioned situation where

strategies are being managed by a fiduciary), it would be prudent to implement a requirement for each individual trade to be reviewed by the investor prior to execution. This review process should include the presentation of any warning flags or risk warnings associated with the trade. Given the impracticality of conducting thorough due diligence on each available strategy, monitoring the overall effectiveness and safety of copy trading becomes challenging. Consequently, the potential benefits for the average investor are limited, while the associated risks remain substantial.

Question #5 – Delivery of tools and information

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?

No Response.

Conclusions

We believe that revising the OEO Guidance to clarify the scope of non-tailored advice and the tools that OEO Dealers can provide will significantly empower retail investors. By refreshing current guidance and incorporating feedback from stakeholders to reflect the realities of today's DIY investor demographic, CIRO will create a more robust framework that fosters the financial success of retail investors in Canada.

We appreciate the opportunity to provide our input and look forward to the continued development of policies that support Canadian retail investors.

Sincerely,

Ian Tam, CFA Director of Investment Research Morningstar Research Inc.	Scott Mackenzie President and CEO Morningstar Research Inc.	Danielle LeClair, M.Fin. Director of Manager Research Morningstar Research Inc.
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Appendix: No Bells, No Whistles, No Problem: What Investors Want From Their Digital Trading Platforms
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