Regulating Robo-advisers in Canada

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1. INTRODUCTION

Robo-advisory has gained a significant amount of popularity and attention from regulators in the last few years, in Canada and globally. Their fast-paced emergence has demonstrated that they present key advantages for investors, especially for those with average incomes. However, the current regulatory approach adopted by Canadian securities regulators towards robo-advisers somewhat stifles these potential benefits. Before proceeding in more detail, the following introduction aims to bring some clarity surrounding the very nature of robo-advisers and to dispel popular misconceptions about them.

The biggest myth surrounding robo-advisers is that they operate as robots, or independent machines, as the name suggests. Many media articles, columns and even financial commentators reinforce this by portraying robo-advisers as operating without any involvement of humans.[1] However, this paper demonstrates that humans currently play, and will continue to play, a crucial role in the operations of robo-advisers.

A more nuanced understanding demonstrates that robo-advisers are, in fact, not robots. "Robo-advisers" rather refer to firms — ie. legal entities — that use algorithms to generate financial advice, and operate through online platforms, rather than through traditional channels, to streamline their services.[2] This service is called "robo-advisory". Their algorithms are programmed using various economic assumptions,[3] and asset allocation models.[4] Generally, robo-advisers gather information about their clients through online questionnaires,

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1 See e.g. Investopedia, which defines a robo-adviser as "an online wealth management service that provides automated, algorithm-based portfolio management advice without the use of human financial planners. (. . .)", online: <http://www.investopedia.com/terms/r/roboadvisor-roboadviser.asp>.

2 See *IOSCO Research Report on Financial Technologies (Fintech)*, International Organization of Securities Commissions (ISOCO) Report, (2017) at 25 [*IOSCO FinTech Report*]; see also *Regulation Guide 255: Providing digital financial product advice to retail clients* Australian Securities and Investment Commissions (ASIC) Regulation Guide (2016) at para 255.10 [*ASIC RG 255*].

3 See Financial Industry Regulatory Authority (FINRA), *Report on Digital Investment Advice*, (2016), at 3 [*FINRA Digital Investment Report*].

4 See *IOSCO FinTech Report*, *supra* note 2 at 25; Melanie L. Fein, "Robo-Advisers Aren't All They're Cracked Up to Be", *American Banker* (9 August 2015) at 1 [Fein, "Cracked"]; *FINRA Digital Investment Report*, *supra* note 3.

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notably regarding their financial goals, circumstances and risk tolerance. With this information, algorithms then recommend investment portfolios, and manage them for clients.[5] Australia's main financial regulator, the Australian Securities and Investment Commission (ASIC), describes robo-advisory as involving some kind of an automated opinion or recommendation generated by an algorithm, meant to influence the client's financial decision.[6]

A second common misconception is that robo-advisers will entirely disrupt the traditional financial advisory market by replacing human advisers. Admittedly, robo-advisers will likely disrupt this market to a certain extent. However, a more thorough analysis demonstrates that robo-advisers instead fill current gaps in existing advisory services. They do so by providing quality and cost-efficient financial advice to segments of the population that are generally underserved by traditional advisers. Namely, they provide accessible services to average-income persons. Often enough, the cost of traditional advisory renders it inaccessible for average-income investors, whether because of high minimal investment amounts required, or ongoing costs and fees schemes that are disadvantageous when investing small sums.

Of course, there are several robo-adviser business models that exist across different jurisdictions. The degree of human involvement of the different models varies on two scales: 1) the supervision of the algorithm-generated advice by financial professionals; and 2) direct communication that investors may have with these professionals. Some models rely solely on digital interactions, while others offer direct access to human advisers.[7]

In Canada, securities regulators do not yet allow for fully-automated robo-advisers as they exist in other countries, like the United States, the United-Kingdom and Australia.[8] Under the current regulatory regime, Canada rather has a hybrid model of "online advisers". Canadian online advisers use online platforms and algorithms to provide financial advice services, making them more efficient and streamlined, but human advisers have to review each financial recommendation generated by the algorithms. Ultimately, these human advisers, along with the firm, bear legal and regulatory responsibility for the advice rendered.[9] Since regulation is supposedly "technology neutral", Canadian online advisers are subject to the same regulatory obligations and requirements as traditional advisers.[10] One of the main goals of this paper is to explore how these

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5 See *IOSCO FinTech Report*, *supra* note 2 at 25; *Investor Bulletin: Robo-Advisers,* S.E.C. Investor Bulletin, (2017) at 1 [*SEC Investor Bulletin 2017*].

6 *ASIC RG 255*, *supra* note 2 at 1, 37.

7 See *SEC Investor Bulletin 2017*, *supra* note 5 at 1-2; *FINRA Digital Investment Report*, *supra* note 3 at 3.

8 *CSA Staff Notice 31-342 — Guidance for Portfolio Managers Regarding Online Advice*, O.S.C. CSA Notice, (2015) 38 O.S.C.B. 8197 [*CSA Staff Notice 31-342*].

9 *Ibid.*

10 *Ibid.*

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regulatory obligations apply to these online advisers, and how they could eventually be adapted to apply to fully-automated robo-advisers.

This paper is further organized as follows. **Section 2** sets the context by examining the emergence of robo-advisory, and providing a general overview of Canadian online advisers. **Section 3** explains how and where online advisers fit in the current Canadian regulatory framework, and analyses how the obligations of registration and suitability apply to them. **Section 4** discusses the manner in which regulators globally have dealt with the rapid emergence of Financial Technologies (FinTechs) like robo-advisers. Finally, **Section 5** proposes an adapted regulatory framework to allow full automation of robo-advisers in Canada.

2. CONTEXT OF ROBO-ADVISORY AND OVERVIEW OF CANADIAN ONLINE ADVISERS

(a) Socio-historical Context of Robo-advisory

Apart from the recent technology advancements, the emergence of robo-advisers, along with many other finance technologies called "FinTechs", stems from the global financial crisis (GFC) in 2008. Since then, the financial industry has had to face slow economic growth and rising compliance-related costs, as different regulating bodies have imposed a wide range of new regulatory requirements. The industry has thus faced higher costs and lower profitability.[11] Traditional financial institutions have increasingly turned to technology to improve efficiency and enhance delivery of financial services. This transformation, or evolution, proved nonetheless to be both costly and complex. Moreover, it presented some risks for these incumbents, who are notoriously risk-averse.[12] These changes in the industry then led to the outbreak of new stakeholders aiming to democratize financial services by the use of technology.[13]

Enter robo-advisers and other FinTechs. These different emerging platforms have used technological innovation to create new business models and redesign financial services.[14] The most common new FinTech platforms are robo-advisers, market and peer-to-peer lending, and crowdfunding. The use of cryptocurrencies, initial coin offerings (or ICOs), and other blockchain-based platforms is also on the rise.[15] In the United States, where robo-advisory is most

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[11] Greg Bauer & Robard Williams, "Technological Innovation in Financial Services" (2016) Int'l. Fin. L. Rev. [Bauer & Williams].

[12] *Ibid.*

[13] See SEC Commissioner Kara M. Stein for herself, "Surfing the Wave: Technology, Innovation, and Competition" (Remarks at Harvard Law School's Fidelity Guest Lecture Series, 9 November 2015, unpublished) [Stein].

[14] *Ibid.*

[15] See *Highlights Potential Securities Law Requirements for Businesses Using Distributed*

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prominent, it was predicted that robo-advisers would reach $285 billion in assets under management (AUM) by 2017,[16] which still constitute a small fraction of the $20 trillion in retail investors' total investable assets.[17]Another study demonstrated that by 2020, robo-advisers would have over $2 trillion dollars in AUM in the United States, constituting around 5.5% of American investment assets.[18] In Canada, the largest robo-advisers — Wealthsimple — is reaching $2 billion in AUM.[19]

Contrary to popular belief, FinTechs do not necessarily constitute direct competition to traditional financial firms. Instead, they are often complementary to the traditional financial industry by filling gaps in existing services. In the case of robo-advisers for example, one of their main advantages is that they render quality and cost-efficient financial services to average-income investors, who are typically underserved by traditional advisers. In Canada, these investors are least likely to invest. Conversely, they are also the segment that is least sought out by traditional advisers. To give the reader an idea, a recent consultation by Canadian Securities Administrators (CSA) Staff considered "mass-market" (i.e. an expression often used for "average-income") households to be those with $100,000 or less of investable assets. These households constituted 67% of Canadian households.[20]

Nonetheless, these new technology-based business models are pressuring the financial industry to become more transparent, cost-efficient, technologically innovative and consumer-friendly. As a consequence, traditional financial institutions all around the world are either purchasing or developing some robo-adviser platforms of their own.[21] In Canada for instance, Bank of Montreal now provides its own robo-advisory service, SmartFolio, to its clients. Financial institutions can thus use robo-advisers as tools to provide better services at lower rates, and to assist their human advisers in assessing risk tolerance, portfolio determination, or even to provide a better interface.[22]

Whether or not they constitute direct competition to traditional advisory, robo-advisors fulfil a market need. While the target clientele of robo-advisers has

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Ledger Technologies, O.S.C. News Release (8 March 2017); *Distributed Ledger Technology: Implications of Blockchain for the Securities Industry*, F.I.N.R.A. Report (January 2017).

16 Tara Siegel Bernard, "The Pros and Cons of Using a Robot as an Investment Adviser", *The New York Times* (29 April 2016) [Bernard].

17 Tara Siegel Bernard, "Robo-Advisers for Investors Are Not One-Size-Fits-All", *The New York Times* (22 January 2016).

18 Stein, *supra* note 13.

19 See Clare O'Hara, "Power Financial adds investment in robo-adviser Wealthsimple", *The Globe and Mail* (February 21 2018).

20 *Consultation Paper 81-408 — Consultation on the option of discontinuing embedded commissions*, O.S.C. CSA Consultation Paper (2017) [*CSA Consultation Paper 81-408*].

21 See *IOSCO FinTech Report*, *supra* note 2 at 25-26.

22 See *FINRA Digital Investment Report*, *supra* note 3 at 3.

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typically been millennials, robo-advisers are now also attracting investors from other market segments. Millenials are generally overlooked by the traditional advice industry, as they have few assets to invest; they are also known for showing little interest in traditional institutions. Moreover, they are usually comfortable with technology. Generations that are comfortable with technology like Siri are likely to be just as comfortable with robo-advisors.[23] Since many investors use various financial advisers, millennials are likely to also eventually seek human advice for more complex investment projects.[24] In this sense, the exposure to robo-advisory services by millennials acts as a gateway to financial education and financial advice at large.

(b) Disruptive Technologies, Financial Services and Regulatory Framework

Across the financial industry, regulators are confronted with these technology-driven innovations that are challenging traditional regulatory frameworks. They are faced with the difficult task of balancing innovative growth and investor protection. The latter should always remain a primary guiding regulatory principle.[25] Further, one of the main challenges for both regulators and robo-advisers will be to ensure that the algorithms and technology underpinning financial advice can adequately react to unexpected and sudden changes in the financial markets and global economy.[26]

FinTechs, in and of themselves, are not a new phenomenon.[27] The new phenomenon is rather the *disruptiveness* of FinTechs currently emerging. The use of technology to deliver services more efficiently has been common for at least thirty years. ATMs and online banking are examples of FinTechs that were not disruptive;[28] rather, these technologies emerged gradually, which gave regulators time to adapt. Current FinTechs are rather emerging at an accelerated pace, all the while bringing forth technologies of which regulators do not possess in-depth knowledge,[29] making it challenging for them to respond.

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[23] Frank J. Cavaliere, ‘‘Web-Wise Lawyer: Finances on the web: robo-advisors”, *The Practical Lawyer (American Law Institute-American Bar Association Committee On Continuing Professional Education)* (November 2016) (Lexis) [Cavaliere].

[24] ‘‘Robo-Advisers: The Gateway to Millennials”, (2015) *Journal of Financial Planning* at 12.

[25] See Stein, *supra* note 13.

[26] *Ibid.*

[27] Robert Scavone et al., ‘‘Fintech at the crossroads: regulating the revolution” (2016) 35:5 Nat’l Banking L. Rev. 61 [Scavone et al.].

[28] *Ibid.*

[29] See Alena Thouin, ‘‘Regulation of Financial technology: Bracing the New Frontier”, (2016) 35:4 Nat’l Banking L. Rev. 53 [Thouin].

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(c) General Overview of Canadian Online Advisers

(i) Types of services

Currently, Canadian online advisers mainly provide portfolio building and management services. They also typically provide portfolio rebalancing. For example, Wealthsimple rebalances a portfolio when the account holdings are deviating from target allocation by over twenty percent.[30] If the weight target for an asset is set at 10% in the portfolio, the algorithm will trigger a rebalancing if the weight goes above 12% or under 8%.[31] Although more rarely, some online advisers may offer services like dividend reinvestment, trade execution, and tax efficiency services. Generally, Canadian online advisers expressly state that they are not financial planners. However, most will provide advice on choosing types of accounts (e.g. Tax-Free Saving Accounts (TFSAs), Registered Retirement Saving Plan (RRSPs), etc), which might constitute a form of financial planning. Typically, Canadian online advisers offer a range of model portfolios. Each of these portfolios holds different asset allocation models, according to which the client's assets are invested through the algorithms. Some do offer customized portfolios, tailored to every client.[32]

(ii) Types of investment

While Canadian online advisers use a variety of investment vehicles, they utilize mostly exchanged-traded funds (ETFs).[33] Generally, ETFs are fit for most types of investment strategies.[34] A typical ETF portfolio will include both bonds and stocks (Canadian, American and foreign). They will sometimes include other kinds of assets like real estate, investment trusts, funds from emerging markets and high-yield bonds.[35] Canadian online advisers also use low-cost mutual funds, and other redeemable investment funds and cash.[36] Finally, online advisers use passive management strategies and their model portfolio are built accordingly.

(iii) Accounts

The assets invested with Canadian online advisers are kept in various types of accounts. Typically, the online adviser will make recommendations on which

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[30] See Rob Carrick, "The 2016 robo-adviser guide: Find out which firms deserve your business", The Globe and Mail (25 November 2016) [Carrick].

[31] *Ibid.*

[32] See e.g. NestWealth Management Agreement, online: <https://s3.amazonaws.com/nw-public-documents/Nest_Wealth_Investment_Management_Agreement_20150901.pdf> [*NestWealth Management Agreement*].

[33] See Carrick, *supra* note 30; see also *IOSCO FinTech Report*, *supra* note 2 at 25.

[34] See Stein, *supra* note 13.

[35] See David Aston, "Les robots s'invitent dans vos finances", *L'actualité* (29 September 2016).

[36] *CSA Staff Notice 31-342*, *supra* note 8.

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type of account the client should select for the portfolio. The types of accounts include non-registered accounts, TFSAs, RRSPs, Registered Retirement Investment Funds (RRIFs), and other types of specialized accounts like Registered Education Saving Plan (RESPs).[37]

Canadian online advisers generally hold discretionary accounts, which are called "managed accounts" under Canadian securities regulation.[38] With these types of accounts, online advisers are not required to seek clients' express consent for each transaction they make. Online advisers may exercise discretion and refuse to proceed with a transaction if it is unsuitable or undesirable for the client's portfolio. By way of contrast, for a non-discretionary account, types of accounts usually held by dealers, firms and representatives must get client consent for every transaction.[39] Here is an example of a Canadian online adviser agreement clause by which the client appoints the adviser as investment manager of her accounts:

> full power to supervise and direct the investment of the assets of the [a]ccounts in its *sole discretion* as set forth herein. The [a]dvisor may make all investments for the [a]ccounts without consulting the [c]lient or any other person or obtaining the [c]lient's or any other person's consent or instructions. The [c]lient acknowledges that all actions taken by the [a]visor hereunder shall be *binding* upon the [c]lient and as binding upon the [c]lient's legal representatives as upon the [c]lient.[40] [emphasis added]

This discretion, or power over the assets, is subject to the investment goals associated with the portfolio. As detailed below, this is relevant because it entails more stringent obligations of online advisers towards their clients.

Generally, online advisers manage their clients' invested assets through accounts held at third-party dealers. This is called the "back office". These registered dealers, typically called "custodians", hold account assets for online advisers. They thereby have the actual "physical possession" of those assets.[41] These dealers are required to be members of the Canadian Investor Protection Fund (CIPF), which means that the account assets are covered up to $1,000,000 in case of insolvency of the dealer.[42] Accordingly, online advisers have to require clients, through the agreements, to grant them full authority over the

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[37] See Carrick, *supra* note 30.

[38] *Registration Requirements, Exemptions and Ongoing Registrant Obligations,* A.M.F. NI 31-103 (15 July 2016) [*NI 31-103*].

[39] See *CSA Consultation Paper 33-403 — The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, O.S.C. CSA Consultation Paper, (2012) 35 O.S.C.B. 9558 [*CSA Consultation Paper 33-403*].

[40] See e.g. *NestWealth Management Agreement*, *supra* note 32.

[41] See *CSA Staff Notice 31-347 Guidance for Portfolio Managers for Service Arrangements with IIROC Dealer Members for more details about custody service arrangements*, O.S.C. CSA Notice, (2016) 39 O.S.C.B. 9365.

[42] See *CSA Notice of Commission Approval of MOU between the CSA and the CIPF and*

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management of the accounts assets held by the third-party dealer. This includes security purchase, sale and delivery, receipt and disbursement of cash, and the exercise of voting rights attached to held securities.[43] Further, this means that the assets held in client account are not included in the online adviser's balance sheet — in other words, they are not in possession of client assets. One Canadian online adviser, Wealthsimple, did acquire its own dealer.[44] Consequently, it has complete control over the whole investment experience — advice, portfolio building, trade execution and custody.

(iv) Fees

Canadian online advisers are generally low-cost,[45] and cost-efficient even when investors have little assets to invest. They do not typically require a minimal investment (or require one that is fairly low). Robo-advisers fees, often called "advice fees" in agreements, are either percentage-based or a flat fee. Depending on the business model, some may charge trading commissions, but these are usually included in their advice fees. Fees associated with funds — either ETFs or mutual funds — are simply deducted directly from the assets help within the fund, as they are within traditional advisory. Most Canadian online advisers fees are percentage-based. The percentage may vary depending on the amount of invested assets, and will range anywhere between 0.3% to 0.6%.[46] Some rather have "flat percentages", meaning that the percentage rate stays the same regardless of the amount invested — the online advisers that choose this paying method are usually the ones that impose a minimum investment. Flat fees will typically also vary depending on the amount invested (for example, $20 per month for less than $75,000 managed, and $40 per month for amounts invested in the range of $75,000 to $150,000.)[47]

3. CURRENT SECURITIES FRAMEWORK APPLIED TO CANADIAN ONLINE ADVISERS

This section examines how Canadian online advisers are in compliance with regulation. It discusses the manner in which the obligation of registration applies to them. It will then accordingly examine the manner in which the Know Your Client (KYC) and suitability obligations apply, as these duties are at the core of sound financial advisory. It will also go over the applicable standard of care, the pertaining upcoming reforms of Canadian securities regulation and the potential

Notice of Commission Approval of By-law No. 1 of the CIPF, O.S.C. CSA Notice, (2008) 31 O.S.C.B. 7556.

43 See e.g. *Nest Wealth Management Agreement*, *supra* note 32.

44 Wealthsimple, online: <https://www.wealthsimple.com/en-ca/legal/terms>.

45 See Carrick, *supra* note 30; see also *IOSCO Fintech Report*, *supra* note 2 at 25.

46 See Carrick, *supra* note 30.

47 *Ibid.*

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impacts on online and robo-advisory. In order to understand the logic behind these obligations, this section starts with a presentation of the underlying philosophy of the Canadian regulatory framework.

The underlying philosophy of the framework is twofold. It aims to ensure both the efficiency of capital markets and the protection of the public.[48] Financial markets are key to economic growth. They are meant to facilitate transfers between agents that will try to transform capital into productive investments. These markets are divided into main activities: production of financial products, and their distribution.[49] Robo-advisory belongs to the latter. Part of protecting the public means ensuring that intermediaries in distribution activities (e.g. performing securities trades and providing investment advice, as robo-advisers) act honestly and maintain a good reputation. The securities regulatory framework aims to ensure that Canadian investors trust capital markets. In turn, this will encourage more persons to make investments, which is assumed to have beneficial impacts on the economy.[50] Generally, both Canadian and other international securities markets are heavily regulated.[51] Accordingly, Canadian securities law includes an important corpus of legislation, regulation, rules, norms, policies, notices, instructions, as well as guiding principles, forms and bulletins of regulators and self-regulatory organizations.[52] In Canada, securities law is mostly rule-based,[53] rather than principle-based, like Australian securities law for instance.[54] Typically, the former tends to be more rigid, whereas the latter can be more adaptable to new situations. Finally, provincial securities commissions are entrusted with the application of securities law;[55] they

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48 See Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Canadian Securities Law: Sources of Securities Law; Securities Legislation" at HSC-2 "Purposes".

49 See Mélanie Viguié-Bilodeau, "Notions fondamentales sur la réglementation du marché des valeurs mobilières", in *Jurisclasseur Québec, Droit des valeurs mobilières*, Collection Droit des affaires (dir. Stéphane Rousseau), Fascicule 1 (Montréal: LexisNexis, 2015) at para. 37 [Viguié-Bilodeau].

50 See CED (Ont 4th), vol 47, title 140 at § 2-3.

51 See Viguié-Bilodeau, *supra* note 49 at para. 2; see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Canadian Securities Law: Sources of Securities Law; Securities Legislation" at HSC-2 "Rules and regulations".

52 See Viguié-Bilodeau, *supra* note 49 at para. 1.1; see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Canadian Securities Law: Sources of Securities Law: Securities Legislation" at HSC-2 "Securities Legislation, Rules and regulations".

53 *Ibid.* at para 1.1.

54 ASIC RG 255, *supra* note 2 at para. 255.11.

55 See Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Canadian Securities Law: Constitutional Jurisdiction over Securities Regulation" at HSC-1 "Constitutional Jurisdiction", "Canadian Securities Law: Securities Regulatory Authority", HSC-7 "Commissions". However, seven provinces have decided to unite and form a single securities regulator called Capital Markets Regulatory Authority, due to be implemented before June 30 2018, see *Memorandum of Agreement Regarding the Cooperative Capital Markets Regulatory system* (July-August 2016), at para 10.3, online:

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have both regulation and enforcement powers. They have the duty to monitor the investment products that are offered to investors, to administrate registration of the intermediaries distributing these products, and to monitor their conduct to prevent harm to consumers.[56]

(a) Registration

(i) Overview of registration

As a basic principle, *CSA National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103")[57] provides that all firms and individuals acting as financial intermediaries must fit and register in one of the categories established by securities legislation. The three main categories established in provincial Securities Acts are: dealers (trading), advisers (advising and portfolio management), and fund managers (investment funds management).[58] In Quebec, financial planning is also a category established by legislation.[59] The scope of a firm's or an individual's activities often encompasses more than one registerable activity. Accordingly, they must be registered in every category of which they exercise the activities. For example, a firm that both advises clients on investments strategies and trades securities for them must be registered both as an adviser (portfolio managers) and a dealer. Unless under specific regulatory exemption,[60] that firm must also fulfill the regulatory requirements and obligations of each categories of its registration.[61]

< http://ccmr-ocrmc.ca/wp-content/uploads/moa-23092016-en.pdf. Moreover, the Canadian Securities Administrators (CSA) is the umbrella organization that was created to allow the provincial securities regulator to coordinate their regulatory and policy activities. For instance, there is a "passport system", under which intermediaries may register once with their provincial regulator, where their head office are located, and thereby become registered throughout Canada. However, this collaboration has its limits, and some regulatory elements differ from one province to another, see Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Canadian Securities Law: Harmonization and Co-ordination of Securities Regulation: Introduction" at HSC-8 "Harmonization and Co-ordination", "Passport System", at HSC-9 "Passport System".

[56] CED (Ont 4th), vol 47, title 140 at § 14.

[57] *NI 31-103*, *supra* note 38; see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration Requirements" at HSC-246 "Introduction".

[58] See e.g. *Securities Act*, R.S.O. 1990, c. S-5 [OSA]; *Securities Act*, R.S.Q. c. V-1.1 [QSA].

[59] An Act Respecting the Distribution of Financial Products and Services, R.S.Q. c. D-9.2, s. 1 [*Financial Products and Services*].

[60] Julie-Martine Loranger et al, "Régime d'inscription", in *Jurisclasseur Québec, Droit des valeurs mobilières*, Collection Droit des affaires (dir. Stéphane Rousseau), Fascicule 11 (Montréal: LexisNexis, 2015) at para 18.

[61] *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, O.S.C. CP 31-103, at 1.3 (Fundamental concepts, Multiple categories) [*CP 31-103*].

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The registration obligation is thus business triggered, as it is based on the activities that a firm or individual performs.[62] In other words, what matters is what a firm does, not what it says it does. If a firm is performing a registrable activity, a mere clause stipulating that it is not does not perform said activity, in the agreement signed by clients, is not sufficient to exempt the firm or individual from registration and from complying with the applicable obligations.[63] The main goal of registration is therefore to ensure that firms and persons providing Canadian investors with financial advice are qualified to do so.[64] When reviewing applications for registration, securities regulators act as gatekeepers by ensuring that applicants are suitable before granting or renewing such registration. In Quebec, the applicable test is whether an applicant's directors have the adequate competence and integrity to ensure that investors are protected from harm, and that it has sufficient financial resources to ensure the firm's viability.[65] Ultimately, securities regulators have a high level of discretion in the decision to grant registration, as registration is considered a privilege, not a right. In certain cases, they will impose additional conditions on the applicant in order to grant registration[66] when the circumstances warrant those conditions in order to ensure adequate protection of the public. However, if in a given case granting registration would be fundamentally inappropriate, registration will simply not be granted, even with special conditions.[67] Finally, NI 31-103 requires separate registrations for individuals and firms. This entails that both the firm and the individual acting as representatives for that firm must be registered separately.

The first step to apply the Canadian framework to online advisers is to determine whether or not they fit in one of the categories and need to register as such. To do so, the next section discusses the relevant traditional categories of securities intermediaries.

(ii) Traditional security intermediaries

The three categories that are relevant to online advisory, and which will be discussed in turn, are: advising, dealing, and financial planning. To be clear, advising and dealing are activities that are registrable for both individual and firms; the following thus applies to both individual and firms that perform those

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62 See *CP 31-103*, *supra* note 61, s. 1.3; Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration Requirements" at HSC-246 "Business purpose test"; Loranger et al., *supra* note 60, at para 9.

63 Loranger et al., *supra* note 60 at para 55.1.

64 *Ibid.* at para 17.

65 See also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration process" at HSC-248 "Granting of registration".

66 See Loranger et al., *supra* note 60 at para. 19.1; Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration process" at HSC-248 "Restrictions on registration".

67 Loranger et al., *supra* note 60 at para. 19.1.

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activities. The legislative definition of "adviser" slightly varies from one Canadian jurisdiction to another. In the Ontario *Securities Act* (OSA), an adviser is defined as a "person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to the investing in or the buying or selling of securities".[68] Simply put, advisers give financial advice. They advise investors on securities investment strategies, and how to invest their assets.[69] The registration requirement for advisers is triggered if the firm or the individual gives "specific advice"; i.e. advice tailored to the client's needs and circumstances. For instance, recommending a security to a client, or potential client, is specific advice.[70] Advisers typically hold discretionary accounts, i.e. they may make transactions in the clients' account without their permission, subject to the investment goals established in the client's portfolio.[71] This is highly relevant as registrants that hold discretionary accounts, as most Canadian online advisers do, have higher and more stringent obligations towards their clients. This heightened standard is logical as they are entrusted with important power vis-à-vis their client's assets. The category of registration for advisers is called "portfolio manager". "Full portfolio managers" may advise on any security.[72] "Restricted portfolio" managers may only advise on the type or group of securities established in their registration.[73]

The definition of "dealer" also varies in different Canadian jurisdictions. In the OSA, a dealer is defined as "a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in securities as principal or agent".[74] Dealers buy and sell securities. They typically hold non-discretionary accounts, i.e. they will make transactions only following client's instructions, although some do hold discretionary accounts. They must be registered in the "dealer" registration category. There are also dealer sub-categories.[75] There are investment dealers, which may trade any type of security.[76] They provide a wide range of services to clients on all types of

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68 OSA, *supra* note 58, s. 1; QSA has the same definition, but it adds: "or the business of managing a securities portfolio", QSA, *supra* note 58, s. 5; see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration Requirements" at HSC-246 "Adviser".

69 Viguié-Bilodeau, *supra* note 49 at para 93.

70 *CP 31-103 supra* note 61, s. 7.2.

71 See e.g. *Vipond v. AGF Private Investment Management*, 2012 ONSC 7068, 2012 CarswellOnt 15991 (Ont. S.C.J.), at paras. 176-177.

72 *NI 31-103*, *supra* note 32, s. 7.2 (1)(2).

73 *Ibid.*; see Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration Requirements" at HSC-247 "Adviser categories".

74 OSA, *supra* note 58, s. 1; see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Registration Requirements" at HSC-246 "Dealer".

75 *CP 31-103*, *supra* note 61, s. 7.1(1); see also Halsbury's Laws of Canada (online), *Securities (2013 Reissue)*, "Registration: Categories of registration" at HSC-247 "Dealers categories".

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investment products, like stock market titles, options, and investment funds, as well as investing, research and title analysis.[77] They must be members of the Investment Industry Regulatory Organisation of Canada (IIROC) to act as such.[78] There are also mutual fund dealers, which may trade securities of mutual funds or of investment funds that are labour-sponsored.[79] In Quebec, individuals acting as mutual fund dealers must be members of Chambre de la sécurité financière,[80] and in the rest of Canada, both individual and firms acting as such, of the Mutual Fund Dealers Association (MFDA).[81] Scholarship plan dealer may only act as a dealer with respect to a scholarship plan.[82] Finally, exempt market dealers may trade securities that are distributed under a prospectus exemption, and restricted dealers may trade on the type or group of securities established in their registration.[83] Because of modern changes to financial markets, dealers increasingly also act as advisers. They are accordingly registered in a second category, as portfolio managers.

Moreover, in Quebec, there is a specific category of registration for financial planners, to which are attached proficiency requirements, and deontological regulatory obligations. In other Canadian provinces, there is no framework for financial planners. In Ontario, an independent expert committee appointed by the Ontario Minister of Finance recently issued a report recommending that a regulatory framework be implemented in Ontario for financial planners and advisers.[84] The MFDA is also calling for comments on the possibility of imposing minimum proficiency requirements for member firms and individuals using the title of 'financial planner',[85] as is currently done by the Chambre de la sécurité financière in Quebec. It is generally accepted law that financial planning involves advice on the planning of clients' financial situations, with respect to the following fields: legal, estate, insurance and risk management, finance, tax, investments and retirement.[86] It does not include offering advice or recommendation on buying and selling title, performing transactions or selling financial products. Consequently, financial planners are often registered in

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76 *CP 31-103*, *supra* note 61, s. 7.1(2)(a).

77 Viguié-Bilodeau, *supra* note 49 at para. 87.

78 *NI 31-103, supra* note 32, ss. 3.15(1), 9.1.

79 *CP 31-103*, *supra* note 61, s. 7.1(2)(b).

80 *Financial Products and Services*, *supra* note 59, ss. 385 at para. 5; 289 at para. 1.

81 *NI 31-103*, *supra* note 32, ss. 3.15(2), 9.2.

82 *Ibid.,* s. 7.1(2)(c).

83 *Ibid.,* s. 7.1(2)(d)(e).

84 *Final Report of the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives*, Independent Expert Committee (1 November 2016), online: <http://www.fin.gov.on.ca/en/consultations/fpfa/fpfa-final-report.pdf>.

85 *Proposed Amendments to MFDA Rule 1.2.5 (Misleading Business Titles Prohibited),* MFDA Bulletin #0702-P (27 October 2016).

86 Viguié-Bilodeau, *supra* note 49 at para. 96

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another category, for instances as mutual fund dealers or life insurance representatives.[87]

(iii) Canadian online advisers perform registrable activities

Given the description of Canadian online advisers given in Section 2(c), it appears that they perform advising activities, as well as dealing activities in some cases. Accordingly, most Canadian online advisers are in fact registered as portfolio managers (i.e. the registration category for advisers). Some are also registered as restricted dealers, or exempt market dealers. As for financial planning, most agreements for Canadian online advisers that were examined explicitly exclude advice on tax, legal or accounting matters from their activities. However, as illustrated in Section 2(c), it appears that some do engage in some form of financial planning, for instance by giving guidance on selecting between TSFAs or RRSPs. As explained, a clause in the online adviser's agreement stipulating that it does not engage in financial planning is not sufficient to exempt the firm from registration, if it is in fact providing such services.[88] Apart from Quebec, however, there are no explicit categories for financial planning, subject to potential changes coming in Ontario and for MFDA members. This paper mainly focuses on portfolio managing, as it is typically the type of service most rendered by online and robo-advisers. Finally, there is a "general advice" exemption. General advice is advice that "does not purport to be tailored to the needs of the person receiving the advice".[89] An online adviser that provides general advice through an online platform does not need to register.

(iv) In other jurisdictions, robo-advisory generally triggers registration obligations

In its recent FinTech Report, the International Organization of Securities Commissions (IOSCO) noticed that securities regulators generally require that robo-advisers be registered or licensed to render financial services to investors.[90] In Australia for instance, robo-advisers are registered under the same title as a traditional advice provider. Robo-advisers must therefore hold a valid Australian Financial Services (AFS) license, under *Australia's Corporations Act 2001 (Cth)*.[91] They must be registered as such or as an authorized representative of an AFS licensee.[92] Consequently, a registered robo-adviser must comply with all the same obligations and requirements as any other AFS licensee (ASIC has however issued a regulatory guide for robo-advisers, examined in detail below).[93]

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87 *Ibid.*

88 Loranger et al., *supra* note 60 at para. 55.1.

89 *NI 31-103*, *supra* note 32, s. 8.25(a).

90 *IOSCO FinTech Report*, *supra* note 2 at 31.

91 *ASIC RG 255*, *supra* note 2 at 8 (Key points), para. 255.18.

92 *ASIC RG 255*, *supra* note 2 at para. 255.18; see also ASIC, *Regulatory Guide 36: Licensing: Financial product advice and dealing* (2016) at para. 36.13.

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According to ASIC, this is because the law is "technology neutral".[94] Regulators across several jurisdictions use the expression "technological neutrality" to convey that their regulation, rules and policies apply regardless of whether technology is used to perform the regulated activities. Furthermore, similarly as in Canada, neither robo-advisers nor traditional advisers in Australia need to register and obtain an AFS license to provide *factual* information about financial matters,[95] although it is good practice to clearly disclose that the information given constitutes facts and not advice.[96] The registration requirement is triggered only if a robo-adviser provides financial product *advice*.[97]

In the United States, robo-advisers typically act as intermediaries called "investment advisers", and are thus required to be registered as such; they are also subject to the same regulatory regime. The *Investment Advisers Act of 1940* defines investment advisers as: "anyone who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." [98]

In a keynote address, then-SEC Chair Mary Jo White explained that, while digital financial advice (i.e. "robo-advice") is different than traditional advice, the SEC's assessment of robo-advisory is the same as for human-advisory.[99]

As robo-advisory usually triggers registration, the IOSCO FinTech Report raises an important point concerning private international law: if robo-advisers offer cross-border services, other licensing or registration requirements of jurisdictions where client investors are based might be triggered,[100] apart from their own jurisdictions.

(v) Canadian online advisers registration: due diligence and other specificities

Following the rapid growth of Canadian online advisers, CSA Staff issued a notice regarding online advisory.[101] As ASIC, CSA Staff claim that Canadian securities regulation is technology neutral,[102] and consequently the same

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93 *ASIC RG 255*, *supra* note 2 at para. 255.18; see also ASIC, *Regulatory Guide 104: Licensing: Meeting the general obligations* (2015); ASIC, *Regulatory Guide 175 Licensing: Financial product adviser — Conduct and disclosure* (2017).

94 *ASIC RG 255*, *supra* note 2 at para. 255.6, 255.87.

95 This compares to the 'general advice' exception under Canada regulation, see Section 3(a)(iii), above.

96 *ASIC RG 255*, *supra* note 2 at para. 255.20-255.21.

97 *ASIC RG 255*, *supra* note 2 at para. 255.23-255.29; see also Australia's *Corporations Act 2001* (Cth), s. 766B.

98 *Investment adviser Act of 1940*, s. 202(a)(11), 15 U.S.C. §80b-2(a)(11).

99 Chair Mary Jo White, Address (Keynote Address delivered to the SEC-Rock Center on Corporate Governance Silicon Valley Initiative, 31 March 2016, unpublished) [White].

100 *IOSCO FinTech Report, supra* note 2 at 31.

101 *CSA Staff Notice 31-342*, *supra* note 8.

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obligations apply to online advisers. However, CSA Staff also recognized that the *application* of these obligations might differ and thus warrant some additional guidance. CSA Staff Notice 31-342 provides more detailed explanations on how Canadian online advisers that operate as portfolio managers are to comply with the applicable existing securities regulation.

With respect to registration, there is no special application process for online advisers. When applying for registration, they are required to provide the same documents and information as traditional applicants, notably a business plan and other information about business activities they intend to conduct.[103] However, CSA Staff specifies that, in the case of an online adviser, the information provided should also include: "[a] proposed online KYC questionnaire, investor profiles, model portfolios and details of related processes."[104] Securities regulators will gather this information to perform due diligence and assess if registration may be granted. Traditional firms that want to add an online platform service to their current business model are also required to file the applicable modification form.[105]

In its due diligence, the securities regulator will pay particular attention to the manner in which online advisers intend to meet KYC and suitability requirement (Section 3(b) below discusses these matters in more detail). As traditional firms, online advisers are responsible for gathering their own KYC information and making their own suitability determination. Accordingly, their online KYC questionnaires must "amount to a meaningful discussion between the firm and the client or prospective client."[106] This means that the questionnaire cannot just be a "tick the box exercise".[107] Securities regulators will also pay attention to the "composition of the different investor profiles and model portfolios" that online advisers intend to use to provide advice to clients.[108] So far, securities regulators have only registered online advisers with relatively simple business models and model portfolios, built with simple ETFs and mutual funds with "uncomplicated asset allocation". These types of models and products are easier to understand by investors with average financial literacy. Moreover, suitability determination is a more straight-forward exercise within those types of uncomplicated investment strategies. If confronted with applications of online advisers that include more complex business models, algorithms and investment products, securities regulators will ensure, before granting registration, that these online advisers will be able to comply with all

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[102] *Ibid.*

[103] *Ibid.*; see *Firm Registration (F6) filing*, O.S.C. Form 33-109F6.

[104] *CSA Staff Notice 31-342*, *supra* note 8.

[105] *CSA Staff Notice 31-342*, *supra* note 8; see also *Change of Registration Information*, O.S.C. Form 31-109F5.

[106] *CSA Staff Notice 31-342*, *supra* note 8.

[107] *Ibid.*

[108] *Ibid.*

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regulatory requirements and obligations.[109] Namely, they will assess whether additional regulatory conditions might be warranted for new business models as they develop.[110]

Upon due diligence, the securities regulator will also ensure that clients have the possibility to interact with a human adviser representative either "by telephone, video link, email or internet chat".[111] Online advisers may choose the manner in which they comply with this requirement. Various models have developed in Canada.[112] First, there is the "always call" model, where a human adviser will systematically contact clients during the on-boarding process. Second, there is the "call occasionally" model, where a human adviser contacts clients in instances where there are concerns regarding the on-boarding process, as prompted by the firm's software. Finally, there is the "no call" model where the human contact will only be initiated if asked for by the client, as needed. If an applicant does not intend on systematically calling every client during the on-boarding process, it will need to demonstrate to the regulator that it has established a system that identifies inconsistencies or other triggers, and prompts a human adviser to contact the on-boarding client.[113]

(b) KYC and Suitability Obligations

The KYC and suitability obligations are at the forefront of regulatory compliance of financial advisory, whether traditional or online. They are strongly inter-connected, in that an online adviser must "know his client" before providing financial advice, in order to ensure that that advice is *suitable* for that client.[114] Under NI 31-103, KYC information that advisers must collect includes clients' investment needs and objectives, financial circumstances and risk tolerance.[115] The precise *extent* of the KYC information that an adviser must gather to make adequate suitability determinations will depend on the client's circumstances, the type of security, the relationship with the client and the firm's business model.[116] Because of the fact that they typically hold discretionary accounts, Canadian online advisers will need to gather extensive KYC information. Both traditional and online advisers that hold discretionary accounts have more extensive KYC obligations, because they are entrusted with significant powers over their clients' assets. Canadian online advisers should, in order to adequately comply with these heightened KYC and suitability

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109 *Ibid.*

110 *Ibid*; see Section 3(a)(i) above.

111 *CSA Staff Notice 31-342*, *supra* note 8.

112 *Ibid.*

113 *Ibid.*

114 *NI 31-103*, *supra* note 32, ss. 13.2(2)(c), 13.3(1).

115 *Ibid.*, s. 13.2(2)(c).

116 *CP 31-103*, *supra* note 61, s. 13.3 (KYC information for suitability depends on circumstances).

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obligations, "have a comprehensive understanding" of the client's "investment needs and objectives".[117] This includes knowing the client's time horizon for their investments, the client's "overall financial circumstances, including net worth, income, current investment holdings and employment status", as well as the client's "risk tolerance for various types of securities and investment portfolios, taking into account the client's investment knowledge".[118] By way of contrast, other circumstances, not applicable to online advisory, may warrant reduced KYC and suitability obligations, for example when the dealings between an adviser or dealer and its client are non-discretionary, occasional and the investment amounts are small when considered against the overall financial circumstances of that client.[119]

Suitability also encompasses a Know-Your-Product (KYP) obligation. Firms like online advisers must possess an "in-depth knowledge of all securities" that they recommend to clients. They should have sufficient knowledge of each security to understand and explain to clients' the associated risks, features, costs and fees. Simply disclosing the risks associated to a security or a transaction is not sufficient to meet the KYP and suitability obligation.[120]

Both online and traditional advisers must assess and determine suitability for each recommendation made to every client,[121] and may not delegate the responsibility to do so.[122] Finally, both online and traditional advisers must also take reasonable steps to ensure that KYC information is current.[123] It has to be "sufficiently up-to-date to support a suitability determination". As they hold discretionary accounts, online advisers have the duty to *frequently* update clients' KYC information.[124]

Dealers, even if they execute trades as requested by clients, are also subject to a suitability duty which would apply equally to an online dealer platform.[125] If a client instructs the dealer to "buy, sell or hold" a security, and, according to the dealer's reasonable opinion, "following instructions would not be suitable for the client", the dealer must inform the client. The dealer must then only proceed with the transaction if the client decides and instructs the dealer to proceed regardless of its unsuitability.[126]

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[117] *Ibid.,* s. 13.3 (KYC information for suitability depends on circumstances).

[118] *Ibid.*

[119] *Ibid.*

[120] *Ibid.,* s. 13.3 (Suitability obligation cannot be delegated).

[121] *Ibid.*

[122] *Ibid.*

[123] *NI 31-103*, *supra* note 32, s. 13.2(4).

[124] *CP 31-103*, *supra* note 61, s. 13.2 (Keeping KYC information current).

[125] *CSA Staff Notice 31-342*, *supra* note 8.

[126] *NI 31-103*, *supra* note 32, s. 13.3(2).

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(i) The specificities of KYC and suitability for Canadian online advisers

Within the Canadian hybrid model of online advisers, human representatives must review every advice generated to ensure its suitability.[127] Canadian online advisers typically use an "interactive website" to interact with prospective clients and clients. They then use software "to make a preliminary determination" of the client's investor profile, as well as the model portfolio that is suitable for that profile.[128] In other words, an algorithm generates the financial advice. Under current regime, a human adviser then reviews the advice to ensure that the investor profile generated by the algorithm corresponds to the KYC information that was gathered. Second, she or he has to ensure that the model portfolio recommended by the algorithm is suitable for the investor; i.e. that the asset allocation according to which the assets were invested is suitable for the investor profile. Ultimately, human representatives bear the responsibility to fulfil the KYC and suitability obligations.

Online advisers must accordingly have a robust process for collecting KYC information. It must be well-designed, and include behavioural questions to determine the risk tolerance of new clients and gather accurate KYC information. An adequate process will also prevent a client from going forward if she has not answered all the questions or if there are inconsistencies in the KYC information, as it might lead to an insufficient suitability determination. For instance, if answers point to both low tolerance to risk and aggressive high "growth objectives", an appropriate system design will prompt the online adviser to inquire more about the profile before allowing the client to complete the on-boarding process. The system should also be designed to provide clients and prospective clients with proper education about "terms and concepts involved" at relevant moments of the process.[129] For the reader that is less familiar with financial advice, note that what is described in this section is not foreign to traditional advice models. It is rather the manner in which the online advisers complies with all these requirements that is slightly different.

Additionally, online advisers' systems should adequately capture pertinent changes occurring either in the client's circumstances or in the market. Namely an adequate system should "prompt clients to update their personal information online at least annually".[130] It should also prompt clients to update their information if there has been a material change in their financial circumstances (e.g. marriage, divorce, and change in employment). Concretely, this means that the software should re-determine suitability of the portfolio, as the material change in circumstances may warrant a portfolio change. As with the initial advice, an adviser representative has to review the new advice generated by the algorithm.[131] As their clientele grows, online advisers must hire a sufficient

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[127] *CSA Staff Notice 31-342*, *supra* note 8.

[128] *Ibid.*

[129] *Ibid.*

[130] *Ibid.*

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number of adviser representatives to provide adequate services to all clients, and comply with all the regulatory requirements, including the review of each financial advice.[132]

As with traditional advisers, online advisers rely on the accuracy of the information given by the investor. Most Canadian online advisers include in their agreements that the client, by signing, certifies the accuracy of the information provided. Further, the agreements expressly state that online advisers rely on the accuracy of the information when assessing the suitability of recommendations and trades made in the client's account. Most online advisers also include a clause by which clients commit to notifying the occurrence of any material change in their financial circumstances.[133]

Moreover, online advisers must ensure that the asset allocation in the client's account remains consistent with the parameters of the model portfolio recommended and assigned to that client. Online advisers consequently rebalance a client's portfolio "to its target asset allocation mix at appropriate intervals".[134] To do so, online advisers have clients give them full discretionary power to manage their account, usually held at a third-party dealer, the custodian.[135] Through this power, algorithms will instruct custodians to make certain trades and transactions in the account, in order to maintain asset allocation and investment goals.

Finally, in their agreements, Canadian online advisers usually disclose that investment goals are only *goals*. Online advisers will recommend investments that are *suitable* for these goals, but do not guarantee any result of any investment. As a result, online advisers cannot be held responsible if the goals are not met.[136] These parameters and limits of responsibility are typically the same in traditional advice. It is also generally accepted that in some circumstances, both traditional and online advisers may give investment advice that are suitable without being in the best interest of clients.[137] This will remain valid and enforceable as long as the financial advice rendered is suitable, and the adviser respects the agreement and the applicable standard of care.

(c) Standard of Care

(i) Applicable standard of care

Currently, intermediaries, including online advisers, have the duty to deal fairly, honestly and in good faith with their clients. In Quebec however, civil law

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[131] *Ibid.*

[132] *Ibid.*

[133] See e.g. *Nest Wealth Management Agreement*, *supra* note 32.

[134] *CSA Staff Notice 31-342*, *supra* note 8.

[135] *Ibid.*

[136] See e.g. *NestWealth Management Agreement*, *supra* note 32.

[137] *CSA Consultation Paper 33-403*, *supra* note 39 at 9568.

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imposes a heightened standard, sometimes called the "best interest" standard. The *Quebec Securities Act* (QSA) expressly imposes the duty to "deal fairly, honestly, *loyally* and in good faith with their clients" (emphasis added).[138] Moreover, intermediaries are "required to act with all the care that may be expected of a knowledgeable professional acting in the same circumstances."[139] Second, Quebec contract law also imposes the duty of loyalty through sets of contractual rules that apply to the intermediary-investor contractual relationships, namely the (1) administration of the property of others, (2) contract for services, and (3) mandate.[140] Although this is not unanimous, some authors argue that the duty of loyalty is akin to that of fiduciaries at common law.[141] The scope and intensity of these obligations imposed by the *Civil Code of Quebec* will vary according to the precise nature of the advisory relationship, for instance on the degree of trust, dependence and vulnerability of the client.[142] Online advisers that have operations in Quebec are thus subject to this more stringent standard in their dealings with clients.

Moreover, some provinces have imposed a "best interest standard" through regulation when advisers or dealers have discretionary powers over their client's accounts.[143] This standard would thus apply to Canadian online advisers that hold discretionary accounts. This regulatory standard is also consistent with what has been found by common law courts: fiduciary duties or a heightened standard of care will arise almost every time advisers have discretion over a client's assets.[144]

On top of their legal and regulatory duties, some Canadian online advisers also undertake a contractual best interest standard under the agreements they have with investors.[145] They also commit to exercising the "degree of care, diligence and skill that a reasonably prudent advisor would exercise in the circumstances".[146] These contractual standards of care and duties apply only to the content and execution of their agreements. In other words, they apply to violations of these agreements.[147] Accordingly, investor losses due to force majeure are usually explicitly excluded from the adviser's contractual liability.

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138 QSA, *supra* note 58, s. 160.

139 *Ibid.,* s. 160.1.

140 See *CSA Consultation Paper 33-403*, *supra* note 39.

141 *Ibid.* at 9564.

142 *Ibid.* at 9564.

143 Alberta, Manitoba, Newfoundland and Labrador, and New Brunswick: see *CSA Consultation Paper 33-403*, *supra* note 39 at 7 n. 29.

144 *Ibid.* at 7.

145 See e.g. *NestWealth Management Agreement*, *supra* note 32.

146 *Ibid.*

147 *Ibid.*

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(ii) Upcoming Canadian securities reform: enhancing intermediaries' obligations toward clients

Canadian securities regulators are currently in the process of reviewing and potentially reforming securities regulation to enhance intermediaries' obligations towards clients.[148] If enacted, the proposed reforms are likely to have significant impacts on online advisory in Canada. Namely, it might entail a surge of robo-advisers on the market. This is because the heightened standards of said reform will likely lead to increased compliance costs, especially for traditional advisory. As seen in the United Kingdom and Australia following similar reforms (further discussed in Section 3(c)(iii)), this could in turn lead to increased demand for cheaper advisory services, and thus to the expansion of online or robo-advisory in Canada.

Specifically, CSA Staff are conducting two parallel consultations, which both strive to enhance, or heighten the obligations that intermediaries have toward their clients.[149] One of the key issues raised is that "[m]ost investors incorrectly assume that their registrants must always provide advice that is in their best interest" (i.e. expectations gap).[150] CSA Staff are conducting a targeted reform on a set of regulatory amendments that aim to improve consumer outcomes, better define the nature of the relationship between a registrant and its clients and to better align the interests of registrants with those of their clients.[151]

Simultaneously, CSA Staff (except BCSC) are conducting a second consultation regarding the introduction of a regulatory best interest standard "that would form both an over-arching standard and the governing principle against which all other client-related obligations would be interpreted".[152] If enacted, both reforms would apply to all advisers and dealers, and thus to online advisers, as well as their representatives, including members of Self-Regulatory Organizations (SRO).[153] Unintended outcomes of both reforms could include increased compliance cost and service cost linked to providing advice to clients, which in turn could harm accessibility and affordability of these advice services.[154] Additionally, CSA Staff is conducting a consultation on the possibility of banning embedded commissions in Canadian mutual funds, and switch to direct modes of remuneration.[155] Broadly, this measure aims to reduce

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[148] See *Consultation Paper 33-404 — Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients*, O.S.C. CSA Consultation Paper, 39 O.S.C.B. 3947 (2016) [*CSA Consultation Paper 33-404*]; see also *CSA Consultation Paper 81-408, supra* note 20.

[149] *CSA Consultation Paper 33-404, supra* note 148 at 3947.

[150] *Ibid.* at 3956.

[151] *Ibid.* at 3947.

[152] *CSA Consultation Paper 33-404*, *supra* note 148 at 3948.

[153] *Ibid.*

[154] *Ibid.* at 3971-3973.

[155] See *CSA Consultation Paper 81-408*, *supra* note 20.

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conflicts of interest in intermediaries' remuneration and improve fee transparency. Such a ban could also lead to an increase in the cost of financial advice, and impact accessibility and affordability of financial advisory in Canada,[156] as further discussed below in Section 3(c)(iii).

One of the issues raised in the first proposed targeted reform is that current regulation, mainly NI 31-103, lacks *explicit* obligations and requirements with respect to intermediaries' dealings with client. Consequently, CSA Staff seek to introduce more express rules. Applying the analysis in Sections 3(a), (b), and 3(c)(i), these enhanced obligations would equally apply to online advisers in Canada.[157] With respect to KYC, for instance, the reform would introduce an explicit requirement[158] that firms and their representatives gather more KYC information and ensure that the overall KYC process provide a thorough understanding of client's profile. It would also expressly require that firms and representatives take reasonable steps to update KYC information once every twelve months, or upon material change affecting clients' portfolios.[159] With regard to KYP, the reform would add an explicit requirement for firms and their representatives to "have the information and ability to comply with their KYP obligation", through "policies and procedures, training tools, guides or other methods".[160] The reform thus aims to enhance overall suitability determination. It would further introduce a rule[161] to require that firms and their representatives assess and identify whether other "basic financial strategies" are "more likely to achieve the client's investment needs and objectives than a transaction in securities"; for example, "paying down a high interest debt".[162] As for "investment strategy suitability" and "product selection suitability", the recommendations would have to be the "most likely to achieve the client's investment needs and objectives".[163] It would also introduce an explicit obligation to re-assess suitability of their clients' portfolios at least once every twelve months and upon material change, significant markets, material change in risk profile of issuer of which clients hold securities. Further, it would explicitly require that if an unsuitable investment were detected in a client's account, firms and representatives be obligated to take appropriate steps to give additional advice. The reform would also add a specific requirement that firms and their representatives disclose the "actual nature of the client-registrant relationship in

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156 *Ibid.*

157 Section 3(b) above; they would also equally apply to fully-automated robo-advisers if they were to be allowed by Canadian securities regulation, see discussion in Section 5, below.

158 By way of amendment of NI 31-103, *supra* note 32, s. 13.2.

159 *CSA Consultation Paper 33-404*, *supra* note 148 at 3957-3958.

160 *Ibid.* at 3958.

161 By way of amendment of NI 31-103, *supra* note 32, s. 13.2.

162 *CSA Consultation Paper 33-404*, *supra* note 148 at 3960.

163 *Ibid.* at 3960.

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easy-to-understand terms".[164] Finally, the reform would amend securities legislation of most provinces and territories to impose a statutory fiduciary duty on registrants when clients grant them discretionary powers over their assets.[165]

As for the second reform for the introduction of a regulatory best interest standard, it would basically impose upon registrants the duty to "deal fairly, honestly and in good faith with its clients and *act in its clients' best interests*" (emphasis added).[166] To meet this new standard of care, registrants and their representative would be expected to have the conduct of a prudent and unbiased firm or representative acting reasonably. The guiding principles to always act in the client's best interest would serve as general principal from which all the other rules would be interpreted.[167]

(iii) United Kingdom: similar reforms led to a surge of robo-advisers

In the United Kingdom, similar reforms in recent years have led to a surge of robo-advisers. This was due to a phenomenon called "advice gap", defined as "situations in which consumers are unable to get advice and guidance on a need they have at a price they are willing to pay".[168] It is that advice gap that has in turn led to a surge of robo-advisers, and other FinTechs in the United Kingdom. There is a general consensus that FinTechs like robo-advisers can help *fill* this advice gap.[169]

The two major reforms of the financial service industry that resemble the ones currently contemplated by Canadian regulators took place in 2007 and 2013. In 2007, the Financial Conduct Authority (FCA, then FSA) introduced a duty to "act honestly, fairly and professionally, and in the *client's best interest"* (emphasis added).[170] The "Retail Distribution Review" (RDR) in 2012 further enhanced obligations of firms and representatives towards their client; for instance, by implementing a code of ethics on all intermediaries, and by imposing higher proficiency requirements.[171] The FCA also banned embedded

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[164] *Ibid*. at 3961.

[165] *Ibid*. at 3964.

[166] *Ibid*. at 3965.

[167] *Ibid*.

[168] See Financial Conduct Authority (FCA) & HM Treasury, *Financial Advice Market Review — Final Report* (2016) [*FAMR Final Report 2016*]; a similar phenomenon has been noted in Australia following the FoFA reform, see ASIC, *Report 407: Review of the financial advice industry's implementation of the FOFA reforms* (2014).

[169] *FAMR Final Report 2016*, *supra* note 168.

[170] See *Financial Conduct Authority Handbook, Conduct of Business Sourcebook* (2013) at s. 2.1.1 (The client's best interests rule).

[171] See Financial Conduct Authority (FCA), *Post-implementation review of the Retail Distribution Review — Phase 1* (December 2014); see also Financial Service Authority (FSA), *Distribution of retail investments: Delivering the RDR — professionalism*, Policy Statement 11/1 (January 2011) (Feedback to CP10/14 and CP10/22 and final rules).

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commissions in order to eliminate conflicts of interests in financial advice caused by commission-driven business models.

Although the impacts of such reforms would likely not be identical in Canada, the case study of the United Kingdom can help shed some light on potential unintentional ancillary consequences of such reforms in Canada. Both the U.K. reforms amounted to a significant increase in the cost of financial advice for retail investors, especially for those with few assets to invest (ie. average-income investors), thus contributing the advice gap. Moreover, the increased cost of compliance related to traditional advisory entailed a shift of traditional financial institutions toward more profitable, high net-worth investors. Comments submitted to the FCA in recent years showed that many stakeholders believe that robo-advisers can increase access for average-income investors to high-quality financial advice.[172] As robo-advisers present many new regulatory challenges, the FCA is engaging with these emerging advice platforms in order to promote and support innovative business models. In Australia, the main regulator ASIC also took the same types of initiatives following similar reforms that resulted in the advice gap phenomenon. The next section of this paper exposes how the FCA and ASIC have opened a dialogue with robo-advisers (and other types of FinTechs) in order to promote and support innovative growth in the financial service industry.

4. REGULATING ROBO-ADVISERS: MOVING FORWARD

(a) Initiatives in Other Jurisdictions in Reaction to the Emergence of Robo-advisers

In other jurisdictions, regulators have reacted in different ways to the emergence of robo-advisory and other FinTechs. This section examines some of the initiatives they have taken, and then uses this analysis to determine the potential ways to move forward in Canada.

(i) United States

A. Investors' alerts on robo-advisory

In the United States, where robo-advisers have the most AUM worldwide, securities regulators have taken a somewhat ambiguous stance regarding robo-advisory. They have not restrained their activities as was done by regulators in Canada. They have also issued warnings about robo-advisers, pressing investors to be cautious when using their services. Yet, they do not provide concrete guidance on how robo-advisers are regulated and how they monitor and ensure their regulatory compliance.

In May 2015, the national securities regulator, the Securities and Exchange Commission (SEC), and the main SRO, the Financial Industry Regulatory

[172] *FAMR Final Report 2016*, *supra* note 168.

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Authority (FINRA), jointly issued an Investor's Alert on robo-advisers. The SEC and FINRA recognize the advantages of robo-advisers, like low cost and broad accessibility. They also recognize that, in some cases, robo-advisers merely make tools already being used for a while by many financial professionals become "client-facing". They however state that investors should be "wary" of robo-advisers that "promise better portfolio performance".[173] They encourage investors to understand robo-advisers' terms and conditions; they also warn them that the automated advice directly depends on the information gathered and that the advice might not be optimal for the investor's goals and circumstances.[174] These tips and advice are not inaccurate, but they equally apply to traditional human advisers. The SEC an FINRA also stress that key assumptions utilized to generate advice could be incorrect. The algorithms might use economic assumptions that may not adequately react to a market shift. If the market takes an unforeseeable course, the advice produced by the algorithm might then deviate from the intended goal and be unfit.[175] This statement too equally applies to traditional advice. Regardless, this issue is pertinent in any financial advice context, including robo-advisory. This paper will further discuss ways to address this in Section 5. Moreover, as things currently stand, this issue is generally mitigated by the simplicity of current models and products currently offered by robo-advisers.

In a keynote address in March 2016, then SEC Chair Mary Jo White briefly discussed robo-advisers and took a more nuanced stance. She stated that the SEC had deployed efforts to monitor their activity.[176] She also explained that, just as KYC information collected by human advisers, there might be varying degrees of the robustness in the gathering process. SEC Staff is examining the operations of robo-advisers, with the goal of both deepening knowledge about the underlying technologies and ensuring that the services provided to investors comply with applicable normative framework.[177]

The 2017 SEC Bulletin regarding robo-advisers is also more nuanced. It offers advice to investors on how to manage their dealings with robo-advisers. For instance, it provides information on the level of human interaction and the fact that it may vary from one robo-adviser to another. It encourages investors to ask themselves what level of interaction they need and want with their adviser. Although the Bulletin warns that the burden to update the information may fall on investors, it adds that this is also the case with traditional advisers. It further suggests to clients to inquire about robo-advisers' investment strategies, as they differ from one to another. Regarding costs and fees, the SEC states that while robo-advisers do offer low-costs services, investors should inquire about their

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[173] SEC & FINRA, *Investor Alert: Automated Investment Tools* (8 May 2015).

[174] *Ibid.*

[175] *Ibid.*

[176] White, *supra* note 99.

[177] *Ibid.*

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total fees and costs. The SEC explains that if a robo-adviser uses investment products that have high costs, the total costs paid by investors can still be high. High investment products costs are often embedded in management and other fees, and thus are not directly visible to investors. This advice, while relevant, also equally applies to traditional advisers. To that matter, as explained above in Section 3(c)(ii), there have been significant regulatory actions and proposed reforms targeting fee disclosure and prohibition of certain commissions in Canada, because investors were not aware of the high remuneration and commissions paid to their traditional advisers.[178] The conflicts relating to remuneration and commissions will be further discussed in Section 5(c)(ii). Although useful to investors that may seek guidance with the SEC about using robo-advisers, neither this Bulletin nor the other actions by SEC provide concrete guidance on how the normative framework applies to robo-advisory.

B. The office of the comptroller of currency: adapted regulation

At the federal level, the Office of the Comptroller of Currency (OCC) is currently studying the possibility of creating a new special purpose charter for FinTech companies.[179] Although the OCC does not oversee securities — it rather regulates banking matters and thus not robo-advisers — this type initiative can provide great guidance on how to approach emerging FinTechs in general. First, the OCC has established an office dedicated exclusively to "responsible innovation".[180] The office's main mission is the implementation of a framework that will help the OCC "identify, understand, and respond" to innovations, and emerging trends that may impact the federal banking system and financial service industry.[181] The new office is also establishing technical assistance outreach, conducting awareness activities and promoting interagency collaboration.[182] Contrary to the FCA and ASIC, the OCC does not support

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[178] As stated in section 3(c)(ii), CSA is notably looking at the option of discontinuing embedded commissions connected to mutual funds in Canada; see CSA Consultation Paper 81-408, *supra* note 20. There also has been a long on-going regulatory reform regarding fee and remuneration disclosure (commonly known as CRM and CRM2); see *CSA Staff Notice 31-345 — Cost Disclosure, Performance Reporting and Client Statements — Frequently Asked Questions and Additional Guidance*, O.S.C. CSA Notice, (2016) 39 O.S.C.B. 3569; *CSA Notice and Request for comments — Proposed Amendments to NI 31-103 and its Policy, NI 33-109 and OSC Rule 33-506 (including related forms)*, O.S.C. CSA Notice 2016-39 (7 July 2016).

[179] At the time of publication, the OCC had just started receiving its first applications for the special purpose charter — see Ana Badour, "US Federal Banking Regulator Announces Decision to Accept Applications for National Fintech Banking Charters", *Lexology* (7 August 2018), online: Lexology <https://www.lexology.com>.

[180] Office of the Comptroller of the Currency (OCC), *Recommendations and Decisions for Implementing a Responsible Innovation Framework*, (Washington D.C., 2016) [*Responsible Innovation Framework*]; OCC, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective* (Washington D.C., 2016).

[181] *Responsible Innovation Framework*, *supra* note 180.

[182] *Ibid.*

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creating regulatory sandboxes. Sandboxes typically waive consumer protection requirements to allow businesses to test their new products in a regulation-free environment (these will be defined and discussed further in Sections 4(a)(ii) and 4(a)(iii)).[183]

In December 2016, the OCC announced that it was seeking to create a new license category called "Special Purpose National Bank Charters for FinTech Companies".[184] This proposed Charter has been challenged in court twice by state associations, the Conference of State Bank Supervisors (CSBS), representing the interests of regulators from all 50 states, as well as the New York Department of Financial Services (NYDFS). Both claims were rejected and deemed not "ripe for determination" on account of the plaintiffs not demonstrating any injury, as the OCC had yet to issued its first FinTech Charter.[185] Regardless of the result of future judicial challenges, the very idea of adapted regulation approach[186] constitutes an efficient initiative to foster innovative growth. This paper further argues that the optimal approach to robo-advisory and new technology-based financial services is one that utilizes both adapted regulation, and dynamic regulation (e.g. regulatory sandboxes), further discussed in the following sub-section.[187]

(ii) Australia

A. ASIC's progressive stance

In Australia, ASIC has taken a progressive stance toward robo-advisers and, more largely, toward FinTechs, and is trying to lead a general culture shift in Australian financial services. Robo-advisory has gained significant popularity there, partly as robo-advisers helped bridge the financial literacy and advice gap in the population following significant regulatory reforms as explained in Section

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183 Thomas J. Curry, Comptroller of the Currency, "The Banking Revolution: Innovation, Regulation & Consumer Choice" (Remarks, delivered at the Before Chatham House 'City Series' Conference, 3 November 2016, unpublished).

184 OCC, *Exploring Special Purpose National Bank Charters for Fintech Companies* (Washington D.C., 2016); see also Thomas J. Curry, Comptroller of the Currency, Address (Remarks regarding Special Purpose National Bank Charters for Fintech Companies delivered at the Georgetown University Law Center, 2 December 2016) [unpublished].

185 See Stephen C. Piepgrass, Timothy Butler & Chelsea Lamb, "Federal Court Dismisses Challenge to OCC Fintech Charter Proposal" *Lexology* (13 December 2017), online: Lexology <https://www.lexology.com>; and Eamonn K. Moran, "Federal Court Dismisses Second Lawsuit Challenging OCC Special Purpose National Bank Charter Proposal for Fintech Companies" *Lexology*, (7 May 2018), online: Lexology <https://www.lexology.com>.

186 In this paper, "adapted regulation" means a certain degree of adaptation, by a given regulator, of its current regulation, to the particularities of technology-based financial services, without changing regulatory requirements altogether.

187 Dynamic regulation will be discussed in following sections; see also *infra* note 189.

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3(c)(iii). Since said reforms, ASIC has adopted a regulatory guide specifically targeting robo-advisers (ie. adapted regulation). It has also created an Innovation Hub, as well as a Regulatory Sandbox (ie. dynamic regulation).[188] In August 2016, Greg Tanzer, then-ASIC Commissioner, spoke on "The Future of Wealth Technology" and how innovation is currently challenging traditional financial industry *culture*. Culture, he explained, greatly affects an industry and its stakeholders. Culture defines the underlying mind-set and establishes the unwritten rules. Culture silently shapes opinions, decisions and behaviour of individuals within the industry.[189] New platforms like robo-advisers are disrupting the current culture. This creates uncertainty on how regulatory requirements and obligations apply to them. That is why ASIC is proactively engaging with FinTechs like robo-advisers.[190]

Moreover, ASIC has entered into international agreements with other securities regulators to better encourage the growth of emerging FinTechs, notably with the Monetary Authority of Singapore (MAS), the Capital Markets Authority of Kenya (CMA), the FCA and the OSC. The main aim is to support innovative businesses attempting to penetrate the two respective markets. It allows these businesses to receive licensing and regulatory compliance advice in both jurisdictions,[191] once they qualify under certain established criteria. The regulators also commit through these agreements to sharing information on different emerging trends and effects on normative framework.[192]

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[188] Dynamic regulation can be broadly described as discretionary powers entrusted to regulators to exempt persons of regulatory requirements, in given circumstances and in order to achieve a predefined goal. Globally, financial regulators have turned to dynamic regulation to manage new and innovative financial technologies. Author Wulf A. Kaal describes dynamic regulation as a "regulatory supplement" to an existing framework. For Kaal, it can "... address the evolving disconnect between regulation and innovation, including the so-called 'pacing problem' between innovation and regulation, e.g., innovation develops faster than applicable regulation". Wulf A. Kaal, *Dynamic Regulation for Innovation: Perspectives in Law, Business & Innovation*, ed. by Mark Fenwick et al. (New York Springer: U of St. Thomas (Minnesota) Legal Studies Research Paper, 2016) [Kaal].

[189] Greg Tanzer, "The Future of Wealth Management Technology" (Speech delivered in Sydney, 4 August 2016) [unpublished].

[190] *Ibid.*

[191] See ASIC, Media Release, 16-194MR, "Singaporean and Australian regulators sign agreement to support innovative businesses" (16 June 2016); ASIC, Media Release, 16-359MR, "Kenyan and Australian regulators sign agreement to support fintech innovation" (21 October 2016); ASIC, Media Release, 16-088MR, "British and Australian financial regulators sign agreement to support innovative businesses" (23 March 2016); ASIC, Media Release, 16-371MR, "ASIC and Ontario Securities Commission sign agreement to support innovative businesses" (3 November 2016).

[192] *Ibid.*

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B. The innovation hub and the regulatory sandbox

ASIC introduced a Regulatory Sandbox in February 2017.[193] A Regulatory Sandbox is a type of regulatory safe harbour, or "safe space". When in a regulatory sandbox, new innovative technology-based businesses may test their models and services in a live environment with real clients, all the while being exempted from licensing requirements and some of the regulatory obligations that would normally apply. ASIC had also introduced an Innovation Hub in 2015. The Hub mainly assists emerging FinTechs with regulatory questions and issues.[194] In June 2016, after a year of existence, the Hub had provided informal guidance to 67 businesses and worked with a total 90 businesses;[195] 14 of these businesses had received licenses to operate through its assistance.[196]

Even with the Hub, however, ASIC still believed that there were significant barriers to innovation in the financial service industry.[197] It identified one of the major issues as the "speed to market" problem,[198] which stems from the time and cost associated with marketing and licensing new technology-driven businesses. A new robo-adviser, for instance, has to obtain an AFS licence prior to any actual testing of viability of its business model and underlying products in a live environment. If, after obtaining the licence and testing their models, the platform and algorithms, for example, require some modifications, the business may have to delay the start of its operations, thus incurring more expenses without income for an additional period of time.[199]

As a response to the speed to market issue, ASIC established a Regulatory Sandbox. The Sandbox includes three parts: (1) exemptions that already exist under Australia's *Corporation Act 2001*, (2) the FinTech licensing exemption, and (3) individual "tailored" exemptions.[200] The framework of the FinTech licensing exemption is rather unique. Like any other Sandbox, it consists of a conditional, industry-wide exemption to some regulatory requirements.[201]

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193 *Regulatory Guide 257: Testing fintech products and services without holding an AFS or credit licence*, A.S.I.C. RG 257 (23 August 2017) [*ASIC RG 257*].

194 *Ibid.*; *Consultation Paper 260: Further measures to facilitate innovation in financial services*, A.S.I.C. CP 260 (8 June 2016) at para. 2 [*ASIC CP 260*].

195 *Ibid.* at paras 2, 16-17.

196 See ASIC, Media Release, 16-129MR, "Innovation Hub: Regulatory sandbox proposal" (4 May 2016).

197 See *ASIC RG 257*, *supra* note 193 at para. 257.13; *ASIC CP 260*, *supra* note 194 at para. 18.

198 *Ibid.* ASIC also identified organisational competence and access to capital as the other two interconnected issues linked to innovation barriers.

199 *ASIC RG 257*, *supra* note 193 at paras. 257.14-257.15; *ASIC CP 260*, *supra* note 194 at paras. 18-19.

200 *ASIC RG 257*, *supra* note 193 at para. 257.22.

201 *ASIC CP 260*, *supra* note 194 at paras. 12-15. As discussed earlier in this section, this kind of power given to regulators is sometimes called dynamic regulation; see Kaal, *supra* note 187. "No-action letters" are another example of dynamic regulation, by which ASIC

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Businesses can thus validate both the concept and viability of their models[202] without incurring excessive compliance costs. The uniqueness of the Australian FinTech exemption rather lies in the fact that businesses do not need to apply for it.[203] If they meet all the eligibility requirements, they can use the exemption by simply giving notice to ASIC.[204] During the exemption period, exempted businesses have to thoroughly comply with the regulatory requirements set out in *ASIC Corporations (Concept Validation Licensing Exemption) Instrument 2016/1175*.[205] These requirements mainly concern retail investor protection. The exemption, and, more generally, the Sandbox, targets business that are in "early-stage testing", or the "concept validation" phase.[206] Through dialogue with stakeholders, ASIC found that the most problematic issues of development arose during that proof-of-concept phase.[207] Accordingly, existing AFS licenses that are developing innovative models are not eligible for the FinTech licensing exemption, as they are unlikely to face the same speed to market challenges.[208] ASIC also restricts the types of businesses that are eligible to the FinTech licensing exemption. The eligible categories include: providing financial advice relating to Australian securities, simple managed investment schemes, deposit products and credit arrangements. Robo-advisers are thus specifically eligible for the FInTech exemption. ASIC excluded businesses offering more complex financial products (e.g. derivatives), or products with long-term focus (e.g. superannuation, a type of pension plan, and life insurance) from the FinTech licencing exemption.[209] This ensures that consumer protection remains adequate.[210]

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commits not to take action against a violation of legislation or regulation (*Regulatory Guide 108: No-action letters*, A.S.I.C. RG 108 (18 December 2009). See also *ASIC RG 257*, *supra* note 193 at paras. 257.39 and 257.49; and *ASIC Corporations (Concept Validation Licensing Exemption) Instrument 2016/1175*, A.S.I.C. (12 April 2018), s. 5(1) [*ASIC Instrument 2016/1175*].

[202] *ASIC RG 257*, *supra* note 193 at para. 257.49.

[203] *ASIC RG 257*, *supra* note 193 at para. 257.41.

[204] *ASIC Instrument 2016/1175*, *supra* note 201, s. 6; see *ASIC RG 257*, *supra* note 193 at paras. 257.42, 257.109-257.115.

[205] *ASIC Instrument 2016/1175*, *supra* note 201, s. 6; *ASIC RG 257*, *supra* note 193 at para. 257.41.

[206] *Ibid.* at para. 257.46; *ASIC CP 260*, *supra* note 194 at 23 C1 (b).

[207] *Ibid.* at paras. 62-63.

[208] *ASIC Instrument 2016/1175*, *supra* note 201, s. 4 (eligible person); see *ASIC RG 257*, *supra* note 193 at para. 257.51; *ASIC CP 260*, *supra* note 194 at paras. 69-70. Foreign companies may be eligible if registered under Pt 5B.2 of the *Corporations Act 2001* (Cth.) [*Corporations Act*]. Finally, persons banned from providing financial services are logically not eligible.

[209] See *ASIC RG 257*, *supra* note 193 at para. 257.68; *ASIC CP 260*, *supra* note 194 at para. 65. *Contra*, see eligible products in *ASIC Instrument 2016/1175*, *supra* note 201, s. 4, and *ASIC RG 257*, *supra* note 193 at para. 257.58.

[210] *ASIC CP 260*, *supra* note 194 at para. 66.

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To operate under the FinTech licensing exemption, businesses must comply with all the requirements and obligations set out by ASIC, which are fairly strict. Namely, they have to be serving less than one hundred retail clients.[211] Additionally, those retail clients must have limited loss exposure of a maximum of $10,000.[212] This limits the risk associated with poor technology; for instance, a glitch in communicational tools or faulty algorithms leading to important losses for a large number of clients.[213] FinTechs must also have also require internal dispute resolution schemes, be members of an approved external dispute resolution schemes and have sufficient compensation arrangements.[214] These requirements will ensure proper indemnification in the event of bad consumer outcome or harm.[215] Additionally, ASIC requires that businesses "clearly and prominently" disclose to the clients that the service is provided through a testing environment, that it does not hold an AFS licence and that, accordingly, some of the usual protections pertaining to financial services may not apply.[216] Finally, businesses operating under the FinTech exemption must comply with the best interest duties normally owed to retail customers by ASP licensees.[217] Businesses that are ineligible for the Fintech licensing exemption, for example existing AFS licensees, may still obtain regulatory relief by applying for individual tailored exemptions.

ASIC believes that a Regulatory Sandbox will encourage the growth of technological innovation in the financial industry for three main reasons. First, it helps new promising businesses attract investment prior to obtaining licensing (and thus prior to incurring related costs).[218] Second, it accelerates development of innovation by solving the speed to market issue.[219] Third, it will generally enable easier entry to the financial industry. This in turn fosters healthy competition, which AISC believes ultimately benefits Australian consumers.[220]

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211 *ASIC Instrument 2016/1175*, *supra* note 201, s. 6(1)(b)(i); *ASIC RG 257*, *supra* note 193 at para. 257.81.

212 *ASIC Instrument 2016/1175*, *supra* note 201, s. 6(3)(b).

213 See *ASIC RG 257*, *supra* note 193 at para. 257.84; *ASIC CP 260*, *supra* note 194 at paras. 72-74.

214 *ASIC Instrument 2016/1175*, *supra* note 201, s. 7(3)(4); see *ASIC RG 257*, *supra* note 193 at paras. 257.94-257.108.

215 See *ASIC RG 257*, *supra* note 193 at paras. 257.96, 257.103; *ASIC CP 260*, *supra* note 194 at paras. 78-81.

216 *ASIC Instrument 2016/1175*, *supra* note 201, s. 7(2).

217 *ASIC Instrument 2016/1175*, *supra* note 201, s. 7(5); see *Corporations Act*, *supra* note 208, part 7.7A, Division 2.

218 *ASIC RG 257*, *supra* note 193 at para. 257.20.

219 *Ibid.*

220 *ASIC CP 260*, *supra* note 194 at paras. 56-57.

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C. ASIC's regulatory guide for robo-advisers

As stated above, ASIC has adopted a regulatory *guide* specifically targeting robo-advisers ("ASIC RG 255"). This approach is highly useful, as it gives much needed clarity and guidance on how regulation is met by robo-advisers and monitored by ASIC. Further, it legitimizes robo-advisers.[221] In proposing ASIC RG 255, ASIC seeks to promote the access to "high-quality low-cost digital advice" and the growth of "healthy and vibrant digital advice industry in Australia". As a preliminary remark, ASIC reports that approximately 20% of Australians seek personal advice.[222] Robo-advisory, according to ASIC, has the potential to reach more retail clients by providing low cost and convenient advice options to persons that would not normally seek personal advice.[223] The guide is also meant to provide a level playing field in the financial industry.[224] It does not introduce new regulatory content. It simply provides guidelines for robo-advisers on how to comply with current regulation.[225] As Australia's securities framework is principle-based, rather than rule-based, ASIC does not usually provide licensees with the required steps to comply with regulation as it does in RG 255.[226] Section 5 of this paper uses ASIC RG 255 to propose an adapted Canadian regulatory framework and will thus go over it in more detail.

(iii) United Kingdom

A. Project innovate: innovation hub, advice unit, and regulatory sandbox

Globally, the FCA was a leader in terms of dynamic regulation initiatives. Its initiative, "Project Innovate", was first launched in 2014 with an Innovation Hub. Project Innovate is now threefold: the Innovation Hub is meant to lead initiatives to foster innovation; the Advice Unit to provide advice to new entrants on regulatory compliance; and the Regulatory Sandbox to provide new FinTechs with a regulatory "safe space". Much like the Australia Sandbox, the FCA Sandbox allows innovative businesses like robo-advisers to test their products and services in a live environment without being subject to some of the applicable regulation. However, unlike in Australia, businesses have to apply and receive

[221] Furthermore, Australia's *Corporations Act 2001*, (Cth.), s. 961(6), states that personal advice may be provided through "computer programs". It states: "A person who offers personal advice through a computer program is taken to be the person who is to provide the advice, and is the *provider* for the purposes of this Division" [emphasis added].

[222] *Corporations Act*, *supra* note 208, s. 766B(3) defines personal advice as: "financial product advice given or directed to a person (including by electronic means) in circumstances where. . .the provider of the advice has considered one or more of the client's objectives, financial situation and needs. . .; or. . .a reasonable person might expect the provider to have considered one or more of these matters".

[223] *ASIC RG 255*, *supra* note 2 at para. 255.3.

[224] *Ibid.* at para. 255.5.

[225] *ASIC RG 255*, *supra* note 2 at paras. 255.6-255.8.

[226] *Ibid.* at para. 255.11.

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approval from the FCA to be part of the sandbox. Another difference with Australia is that firms that already hold a licence and that are testing new technologically-based services are also eligible. During live testing periods (ie. on actual clients), the FCA closely monitors the businesses, and impose additional safeguards to mitigate risks and protect consumers from harm. In the case of robo-advisory, for example, the FCA has imposed secondary reviews of the financial advice automatically generated through algorithms by qualified financial advisers to ensure suitability of that advice.[227]

True to its leadership in dynamic regulation, the FCA also initiated discussions regarding a "Global sandbox" in January 2018.[228] While national regulatory sandboxes are useful and promote innovative growth, many aspects of financial markets and finance technologies are effectively global. Concretely, a global sandbox would allow innovative businesses to conduct tests of their models and technologies in several jurisdictions at once, working together with the involved regulators.[229] According to the FCA, the potential gains and advantages of a global sandbox are twofold. First, working with regulators across different jurisdictions in a seamless way could be invaluable to the global growth of innovative firms. Second, from a regulatory standpoint, the FCA argues that a global sandbox would facilitate regulators working hand-in-hand to solve cross-border regulatory issues, and help streamline the sharing of knowledge and experience amongst themselves to address common issues.[230]

(b) Moving forward in Canada

(i) The task at hand for Canadian securities regulators

The sudden surge of robo-advisers and FinTechs poses a number of challenges for Canadian regulators. The United States, Australia and United Kingdom initiatives are rich case studies and offer useful insight to that matter. From the review of the initiatives in those jurisdictions, it appears Canadian regulators should utilize both the dynamic regulation and adapted regulation approaches in a joint manner. The two approaches are complementary. Dynamic regulation like hubs and sandboxes facilitate development and proof of concepts of new technologically-innovative business models, but may have overall limited outcomes. The new FinTechs that effectively receive licenses and go on to serve the general market[231] still have to comply to the same regulation, which might

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227 See Financial Conduct Authority (FCA), *Regulatory sandbox lessons learned report* (2017) at paras. 2.6, and 4.39 to 4.42.

228 "Global sandbox" *FCA* (14 February 2018), online: Financial Conduct Authority <https://www.fca.org.uk>.

229 *Ibid.*

230 *Ibid.*

231 To give the reader an idea, out of 69 applicants for the FCA Sandbox (1st Cohort), 24 were eligible, and 18 proceeded to the testing. Most of these 18 are said to have secured investments and successfully applied for full FCA licenses (see "Regulatory Sandbox"

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still be ill-adapted to them. Consequently, the adapted regulation approach will be unavoidable to favour innovation in the financial industry.

While traditional financial firms and emerging technology-based business models are not necessarily in direct competition, they generally have a different stance on the way regulators should react. For instance, established financial firms lobby for a level playing field and a more uniform application of regulation. Conversely, new entrants argue that regulatory requirements create heavy barriers to entry to market. These barriers stifle innovation, which in turn stifles competition.[232]

Another generalized concern is that operations of FinTechs are so innovative, or technologically sophisticated, that they fall out of scope of the regulation and thus remain unregulated. Currently, regulation reaches Canadian online advisers models, as they offer straightforward portfolio management services. More sophisticated and technologically advanced robo-advisers, for instance providing more complex investment products, or utilizing highly sophisticated artificial intelligence, might be more difficult to "fit" into the scope of the current regulatory framework. Nonetheless, as things currently stand, the Canadian securities framework will continue to reach securities intermediary activity, such as portfolio management, that triggers regulation, however technology-based they are. In other words, when performing a regulated activity, a person — whether natural or legal — bears the legal and regulatory responsibility for it, regardless of the technology they use to perform that activity. As technology becomes an integral part of the financial industry, this reasoning can also be helpful in a broader sense. A given technology-based service that is performed through highly sophisticated artificial intelligence for example, should by no means be perceived as being legally independent from its enabling firm.

Finally, new entrants have the responsibility to demonstrate that they have the potential to achieve positive impacts on consumer outcomes without compromising their financial safety nor the soundness of the financial markets.[233] One of the main advantages to traditional institutions is their proven economic resilience. This is a huge factor and is probably why they conserve most of the business of Canadian consumers and investors. Even if new technology-based business models are generally depicted as highly advantageous for consumers, they have yet to demonstrate how they will handle heavy shifts in financial markets.[234]

FCA (15 June 2017), online: Financial Conduct Authority <https://www.fca.org.uk>; see also ASIC, Media Release, 16-129MR, "Innovation Hub: Regulatory sandbox proposal" (4 May 2016).

232 *Ibid.*

233 Bauer & Williams, *supra* note 11.

234 *Ibid.*

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(ii) Current initiatives in Canada

In February 2017, CSA Staff launched a nation-wide regulatory sandbox and are now accepting applications. The sandbox is for new business models that are innovative for the Canadian market, but is not restricted to start-ups. This means that traditional firms and finance incumbents may submit an application if they are looking to test a new service technology-based model. Potential eligible models include: crowdfunding and peer-to-peer lending portals, technologically innovative platforms for securities trading and advising (e.g. robo-advisers), models using artificial intelligence for securities trading or advising, distributed ledger technology (blockchain), and RegTech.[235] During the application, businesses might have to provide CSA Staff with business plans, their potential benefits for investors and the manner in which risks to consumers are mitigated. They may also have to engage in some live environment testing.[236] In fall 2016, the OSC had also launched "Launchpad", a hybrid initiative mix of a hub and a sandbox.[237] Both these initiatives strive to help emerging businesses with regulatory compliance, licensing processes, as well as facilitate dialogue with regulators.[238] Both the OSC and the AMF also have FinTech working groups and committees composed of various experts. Finally, all Canadian securities regulators welcome and encourage businesses wanting to develop robo-advisers to contact them.[239]

(iii) Moving towards fully-automated robo-advisers

Canadian consumers and the Canadian economy cannot fully benefit from robo-advisory without allowing full automation. Although obligations like registration and suitability might readily apply to them, the requirement that imposes that adviser representatives review each and every algorithm-generated advice is ill-adapted, notably because it entails significant efficiency losses. Traditional financial firms and institutions mainly seek to give financial advice to high net-worth persons whom thus receive cost-efficient advice. Robo-advisers can provide such advice for average income investors. Moreover, Canadian securities regulators appear to be counting on robo-advisory filling the foreseeable gap between these two groups of investors following the enactment of upcoming reforms, as was observed in United Kingdom and Australia.[240] However, these jurisdictions allow for *fully-automated* robo-advisers. Ultimately,

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[235] CSA, News Release, "The Canadian Securities Administrators Launches A Regulatory Sandbox Initiatives" (23 February 2017).

[236] *Ibid.*

[237] OSC also concluded international Co-operation Agreements with ASIC and the FCA (*supra* note 191; *Co-operation Agreement*, Financial Conduct Authority and Ontario Securities Commission, 22 February 2017.

[238] See online: <https://www.osc.gov.on.ca/en/osclaunchpad.htm>.

[239] *CSA Staff Notice 31-342*, *supra* note 8.

[240] *CSA Consultation Paper 33-404*, *supra* note 148.

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the choice between traditional or robo-advisers should be that of investors, and securities regulators must ensure that investors are adequately protected regardless of their choice.

5. PROPOSED REGULATORY FRAMEWORK FOR FULLY-AUTOMATED ROBO-ADVISERS

This section outlines a regulatory framework that could apply to fully-automated robo-advisers in Canada, should securities regulators allow them. If the regulators remove the requirement of reviewing every robo-advisory, an important question needs to be answered: how will algorithm-generated financial advice be monitored to ensure that investors do not receive unsuitable or harmful advice? To answer this question, this section examines some of the regulatory requirements set forth in ASIC RG 255,[241] which targets robo-advisers specifically. According to ASIC, even if, in theory, robo-advisers are subject to the same regulatory requirements than traditional ones,[242] some of these requirements *apply* differently.[243] Adequate adapted regulatory requirements for robo-advisers, along with adequate oversight of their activities by securities regulators, will ensure investor protection and market integrity in Canada. This section offers some insight on potential additions to Canadian regulation, as well as the applicability of core existing rules regarding supervision of algorithm-generated advice, operational requirements, ethical duties and standard of care. It will also briefly address enforcement measures. This section first outlines the scope and general application of adapted regulation for robo-advisers.

As a premise, robo-advisers — i.e. legal persons — along with registered compliance officers, would ultimately be responsible for unsuitable or harmful advice.[244] In ASIC RG 255, a “digital advice provider” refers to the legal person providing the advice through a computer program and to whom the legislative and regulatory requirements apply.[245] Furthermore, the analysis regarding registration and suitability made in Section 2 above still applies. Robo-advisers should be subject to registration, as they would perform registrable activities — advising, and perhaps some dealing and financial planning. They should be subject to the same standards of advice suitability and standard of care than traditional advisers, even in the event of enhanced standards entailed by the reforms under way in Canada.[246]

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[241] *ASIC RG 255*, *supra* note 2 at para. 255.4. In the guide, “client” means “retail client” as defined in Australia’s *Corporations Act 2001* (Cth.), s. 761(G); see para. 255.3.

[242] *ASIC RG 255*, *supra* note 2 at para. 255.6.

[243] *Corporations Act 2001* (Cth), s. 961B.

[244] *ASIC RG 255*, *supra* note 2 at para. 255.115.

[245] *ASIC RG 255*, *supra* note 2 at para. 255.10; see *Corporations Act 2001* (Cth), Division 2 of Part 7.7A.

[246] See Section 3(c)(ii), above.

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(a) Supervising Digital and Algorithm-generated Financial Advice

Adequate supervision is key to fully-automated models. In order to do so, securities regulators must apply requirements that are adapted to robo-advisers' core components: algorithms. If an algorithm is defective, the advice generated might systematically deviate from the intended output, which may in turn cause poor financial advice, and financial loss for investors.[247] ASIC RG 255 gives great guidance for robustness tests and review procedures for both algorithms themselves, and the generated advice, and thus for requirements that could be incorporated in Canadian securities regulation in order to adequately regulate fully-automated robo-advisers.

(i) Understanding and monitoring the algorithms underpinning the advice

As part of human resources requirements,[248] ASIC expects robo-advisers to have at least one person who has a general understanding of the technology behind the algorithms underpinning the financial advice.[249] This does not mean understanding the complete coding of the algorithms. Rather, it means that at least one person within the business should understand "the rationale, risks and rules behind the algorithms underpinning the digital advice".[250] The precise extent of this requirement will vary depending on size of robo-advisers and complexity of algorithms.[251] Moreover, even if robo-advisers choose to outsource this function, ASIC still requires that they have persons *within* the business that understand the technology of the algorithms.[252] This type of requirement could readily be incorporated into Canadian regulation, for instance in NI 31-103.

Some findings in the recent IOSCO FinTech Report corroborate the relevance of this type of regulatory requirement. In order to avoid negative consequences stemming from incorrect algorithms, IOSCO writes that a robo-adviser must understand the "methodology embedded in the algorithm".[253] Moreover, IOSCO interestingly adds that robo-advisers should ensure that the algorithms used are aligned with the robo-advisers' general investment approach.[254] IOSCO also concludes that some algorithms might be overly simplistic and not "capture sufficient data to reflect the client's overall and unique financial situation" by not asking enough or adequate questions about

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[247] See *Consultation paper 254: Regulating digital financial product advice*, A.S.I.C. Consultation Paper (2016) [*Consultation Paper 254*] at para. 23; *FINRA Digital Investment Report*, *supra* note 3 at 3.

[248] *ASIC RG 255*, *supra* note 2 at paras. 255.61-255.65.

[249] *Ibid.* at para. 255.61.

[250] *Ibid.* at para. 255.62.

[251] *Ibid.* at para. 255.65.

[252] *Ibid.* at para. 255.61.

[253] See *IOSCO Fintech Report*, *supra* note at 33.

[254] *Ibid.*

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clients' profiles.[255] Inversely, while more complex algorithms may be able to "generate differentiated financial advice better suited to the specific profile of individual clients", they might be overly complex and difficult for investors to understand.[256] The person within the robo-adviser responsible for understanding algorithms should ensure that the algorithms used are neither too simple nor too complex, and that they are designed in accordance with the robo-advisers general investment approach.

A. Risk management requirements — monitoring the algorithms

Under ASIC RG 255, ASIC requires that robo-advisers put in place adequate risk management systems to monitor their algorithms.[257] ASIC first expects robo-advisers to carry robustness tests prior to releasing them on the market.[258] It then expects continued robustness tests to be carried regularly subsequently to market release.[259] The precise content and manner in which a robo-adviser chooses to monitor and test its systems will depend on nature, scale and complexity of the business model.[260]

Additionally, ASIC RG 255 requires that robo-advisers have detailed documentation detailing its system design, including the specific purpose, scope and design of its algorithms. This documentation should also include decision graphics (e.g. decisions tress) and decisions-making procedures, setting out different possible decisions when facing an issue and the consequences that may flow from these different possible decisions.[261] Robo-advisers also have to prevent unauthorized access and modifications of the algorithms and thoroughly document their security arrangements.[262] Further, robo-advisers have to keep records of all the different versions of algorithms it has utilized and do this for a minimum period of seven years.[263]

On top of periodic tests of their algorithms, ASIC RG 255 requires robo-advisers to review them whenever events may affect the accuracy of the algorithm's underlying economic assumptions. Events may include market changes and amendments to relevant legislation or regulation. Robo-advisers should also have set procedures to ensure that they react efficiently and thoroughly upon detection of an algorithm error. This is especially important when the error detected is likely to cause loss to their clients or if it puts the robo-adviser in breach of its legislative and regulatory obligations.[264] By way of

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[255] *Ibid.*

[256] *Ibid.*

[257] *ASIC RG 255*, *supra* note 2 at paras. 255.71-255.72.

[258] *Ibid.* at para. 255.74.

[259] *Ibid.*

[260] *Ibid.* at para. 255.72.

[261] *Ibid.*

[262] *Ibid.*

[263] *Ibid.*

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suggestion, these types of requirement could readily be incorporated in NI 31-103's "internal control and systems". Under this section, Canadian financial advice firms must establish a "compliance system"[265] which includes risk management requirements.[266]

(ii) Reviewing the financial advice rendered to clients

A. Periodic reviews of algorithm-generated advice

ASIC expects robo-advisers to periodically review the quality the financial *advice* generated for the clients, and thus ensure that the advice complies with all the applicable regulatory requirements. Concretely, ASIC RG 255 requires that a "suitably qualified individual" periodically and randomly review a sample of the advice given to investors to ensure quality and compliance.[267] ASIC thus expects that at least one person *within* the business have the skills, competence and experience to ensure rigorous reviews as part of human resources requirements.[268]

The periodic reviews of algorithm-generated advice should not be a "tick-a-box" exercise. It should rather be an in-depth assessment of the advice using all relevant information.[269] According to ASIC RG 255, individuals should use increased scrutiny in the period following modifications of the algorithms.[270] Again, the actual nature and extent of the review arrangements will vary according to nature, scale and complexity of the business model.[271]

Periodic reviews should also ensure that the digital questionnaires are thoroughly gathering client information and raising inconsistencies when they arise. According to IOSCO, some robo-advisers use standardized questionnaires that may not adequately resolve inconsistencies in client profile or adapt advice to unusual circumstances. They might be too short and thus not sufficient to adequately know the client and give suitable advice.[272] Periodic reviews of the advice will help ensure that questionnaires are indeed gathering adequate information regarding clients' circumstances and goals.

Finally, periodic reviews should also evaluate the adequacy of the *frequency* at which client information is updated. To that matter, IOSCO warns that if algorithms do not update client information at a sufficient frequency, it may fail to account for both changing investors' "financial circumstances" and the overall

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[264] *ASIC RG 255*, *supra* note 2 at para. 255.74.
[265] *NI 31-103*, *supra* note 38, s. 11.1.
[266] *Ibid.*, s. 11.1(a)(b).
[267] *Ibid.* at para. 255.110.
[268] *Ibid.* at paras. 255.61, 255.64.
[269] *Ibid.* at para. 255.111.
[270] *Ibid.* at para. 255.112.
[271] *Ibid.* at para. 255.113
[272] *IOSCO FinTech Report*, *supra* note 2 at 32.

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"macroeconomic conditions".[273] As explained in Section 3(c)(iii), this is an issue that equally needs to be addressed within traditional advisory. To that matter, CSA Staff want to add an explicit regulatory requirement requiring intermediaries to update client information every 12 months as part of their targeted reform.[274] Moreover, one could argue that the use of technology, rather than traditional channels, to comply with information update requirements might be more efficient to ensure regular client information updates and to adapt to changing circumstances in both client's circumstances and markets conditions.

(iii) Organisational competence: responsible managers

ASIC RG 55 requires that robo-advisers have at least one responsible manager meeting the required training and competence standards to manage its activities.[275] Specifically, ASIC requires that responsible mangers possess the required skills and knowledge to ensure the quality of the financial advice rendered and, more broadly, the compliance of the robo-advisers' activities.[276] Responsible managers are the individuals within firms that are directly responsible for day-to-day decisions regarding the on-going financial advice that is provided to clients.[277] Requiring that robo-advisers have at least one responsible manager ensures that at least one person responsible for important day-to-day decisions holds the required level of competence to ensure compliant services.[278] ASIC's responsible managers can be compared to Canadian regulation's Chief Compliance Officers (CCO).[279] The responsibilities of a CCO in Canada consist in establishing policies and procedures to ensure a firm's overall compliance with regulation.[280] The CCO is also responsible for monitoring and assessing the compliance on an on-going basis.[281] In Canada, CCOs could play a key role in compliance of robo-advisers as responsible managers do in Australia. They could be both responsible and accountable for the compliance of the services provided and the algorithm-generated advice. By way of example, they would be responsible for implementing adequate politics and procedures to ensure adequate monitoring of the algorithms and periodic review of the algorithm-generated advice.

For ASIC, the precise extent of skills and knowledge of responsible managers will vary depending on the nature of financial services provided by robo-

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273 *IOSCO FinTech Report*, *supra* note 2 at 33.

274 *CSA Consultation Paper 33-404*, *supra* note 148 at 3957-3958.

275 *ASIC RG 255*, *supra* note 2 at para. 255.53; see also *Regulatory Guide 105: Organisational competence*, A.S.I.C. RG 105 (15 December 2016).

276 *ASIC RG 255*, *supra* note 2 at 38.

277 *ASIC RG 255*, *supra* note 2 at 38.

278 *Ibid.* at para. 255.55.

279 *NI 31-103*, *supra* note 38, ss. 11.2 and 11.3.

280 *Ibid.*, s. 5.2(a).

281 *Ibid.*, s. 5.2(b).

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advisers.[282] Under NI 31-103, CCOs must satisfy proficiency requirements: she or he must possess sufficient education training and experience that a reasonable person would think necessary for the CCO to fulfil their duties in a competent manner.[283] They include, besides having completed some examinations, relevant securities industry experience at an investment dealer, registered adviser, or Canadian financial institution, in a compliance capacity, for prolonged periods of time.[284].

For a few years, and especially since recent financial scandals, securities regulators and self-regulatory organization have reinforced enforcement measures against individual registered as CCOs.[285] They can be key to having compliant robo-advisory activities, and their accountability will be important in earning the trust of both investors and regulators.

(iv) Communication requirements

Under ASIC RG 255, robo-advisers have to ensure effective communication with clients, although how this is accomplished will vary from one business model to another. Communication requirements are highly relevant and can help ensure that robo-advisers are well trusted by investors. Generally, this will include having a user-focused web design, digital communications means and clear disclosures techniques. ASIC suggests that firms test out how their clients respond to communication tools and make adjustments if needed.[286]

If a robo-adviser provides scaled or limited advice, it should clearly disclose and explain the scope of the advice that they offer and have clients actively demonstrate that the type of advice they want falls within that scope. Key information has to be disclosed at the right time during the process for clients to

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[282] For example, if a firm proposes, upon registration, to provide a range of personal advice services to retail and wholesale clients, through a digital platform, i.e. robo-adviser. It has three responsible managers. The first has a Bachelor of Economics, MBA and graduate diploma in applied finance, but has never provided advice to clients. She has experience in paraplanning and supervising advice representatives. The second manger has six years of experience in providing financial product solutions, development of investment portfolio custodial documentation, fund accounting and unit pricing. The third one holds a Master of Applied Finance from an Australian University and ten years of experience in the investment management industry. While the first manager is lacking in experience with assessing retail customers' circumstances, the second and third ones do have relevant experience. Considering the nature, scale and complexity of the business, ASIC would accept the collective knowledge, skill and experience of the three as sufficient to grant an AFS licence. Therefore, by combining the three, they have sufficient organisational competence; see *ASIC CP 260*, *supra* note 194 at para. 41.

[283] *NI 31-103*, *supra* note 38, s. 3.4(2); see also *CP 31-103*, *supra* note 61, s. 5.2 (Responsibilities of the chief compliance officer).

[284] *NI 31-103*, *supra* note 38, s. 3.13; these requirements also vary from category to another, i.e. the proficiency required for a chief compliance officer of a portfolio manager is not the same as those of an exempt market dealer.

[285] See Loranger et al., *supra* note 60 at para. 69.

[286] *ASIC RG 255*, *supra* note 2 at paras. 255.15-255.16.

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make informed decisions. It is thus important to consider how clients will *interpret* information. This should be done at the very beginning of the on-boarding process.[287] Moreover, at every important decision-making points in the process, the robo-adviser should disclose the limits of the scope and what it could mean concretely — i.e. the possible consequences and risks, as well as the benefits of the limited scope.[288]

(b) Operational Requirements

(i) Compensation arrangements

Under ASIC RG 255, robo-advisers are required to have adequate compensation arrangements, put in place in order to compensate customers for loss caused by a breach of its obligations.[289] An efficient regulatory framework will ensure investor compensation following loss without them having to file civil law suits. Civil law suits present notorious disadvantages, like stringent burden of proofs to trigger liability, long delays and high costs. Robo-advisers must thus have adequate professional indemnity insurance cover. What an adequate coverage constitutes will vary depending on the nature of the business and potential liability.[290] When evaluating the adequacy of compensation arrangements, they should consider, for example, the likely growth of its clientele and the potential extent of mass loss if using a flawed algorithm. Moreover, they should re-assess the adequacy of the compensation arrangements periodically. Accordingly, any material change in, for example, the nature of activities or the amount of potential liability and loss to clients should be reported to the insurer. ASIC RG 255 also requires that the insurance policy itself be reviewed annually to ensure it does not contain any gaps.[291] In Canada, there is a similar requirement under NI 31-103, under which registered firms — hence including existing online advisers — must also maintain insurance that contains a "full reinstatement of coverage".[292] For fully-automated robo-advisers, the coverage would depend on the types and sizes of accounts and model portfolios, and it would serve to indemnify harmed investors following regulatory breach or violation of agreements.

Moreover, assets managed by robo-advisers would typically be held with Canadian brokers, the accounts' custodians, who are part of the CIPF, which covers up to $1,000,000 in case of insolvency of that custodian.[293] This also means that clients' assets would not be included in robo-adviser's balance sheets

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287 *Ibid.* at para. 255.99.

288 *Ibid.*

289 *Ibid.* at para. 255.81.

290 *Ibid.* at paras. 255.82, 255.85.

291 *Ibid.* at para. 255.86.

292 *NI 31-103*, *supra* note 38, ss. 12.3-12.4; see Halsbury's Laws of Canada, Securities (2013 reissue) at para. 249.

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— in other words, they would still not be in possession of client assets. Therefore, in case of bankruptcy, investors' assets remain unaffected. Moreover, all firms (outside Quebec)[294] must be participating firms of the Ombudsman for Banking Services and Investments (OBSI).[295] OBSI gives independent dispute resolution if a firm and its client are unable to resolve a dispute to the client's satisfaction — it considers cases and assesses if compensation is warranted.

(ii) Financial conditions

Under NI 31-103, registered firms must maintain a certain minimum amount of free capital and maintain a certain level of excess working capital as a condition to obtain and keep the right to registration.[296] With certain adaptations, this requirement could readily apply to fully-automated robo-advisers, as they already do to online advisers. The capital requirements are meant to ensure that firms are financially stable. The minimum capital requirements are thus imposed to protect investors from loss, but also to ensure that firms are trustworthy and reliable.[297] Furthermore, all firms must deliver the required annual audited financial statement, interim financial information,[298] as well as all other audits required by regulators.[299] This would also allow Canadian regulators to supervise viability of robo-advisers.

(c) Ethical Duties and Sandard of Care of Robo-advisers

(i) Best interest duty

In Australia, all advisers, including robo-advisers,[300] must act in the best interest of clients when providing personal advice.[301] Consequently, they have the obligation to "prioritise the client's interests over its own interests or that of the advice provider's associates".[302] In Canada, whether it is the current applicable standard of care, or the enhanced ones proposed in the upcoming

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[293] CIPF Coverage Policy, online: <http://www.cipf.ca/Public/CIPFCoverage/Coverage-Policy.aspx>.

[294] In Quebec, the AMF offers the mandatory independent dispute resolution services (*An Act respecting the Autorité des marchés financiers*, C.Q.L.R., c. A-33.2, s. 4(1)).

[295] *NI 31-103*, *supra* note 38, s. 13.16.

[296] *Ibid.*, s. 12.1; see Halsbury's Laws of Canada, Securities (2013 reissue) at para. 249.

[297] See Loranger et al., *supra* note 60 at para. 65.

[298] *NI 31-103*, *supra* note 38, ss. 12.10ff; see Halsbury's Laws of Canada, Securities (2013 reissue) at para. 249.

[299] *NI 31-103*, *supra* note 38, s. 12.8.

[300] *ASIC RG 255*, *supra* note 2 at paras. 255.87-255.88; see *Corporations Act 2001* (Cth.), s. 961(B)(1).

[301] *ASIC RG 255*, *supra* note 2 at para. 255.88; see *Corporations Act 2001* (Cth.), s. 961(B)(1).

[302] *ASIC RG 255*, *supra* note 2 at para. 255.91; see *Corporations Act 2001* (Cth.), Part 7.7A, Division 2.

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reforms, robo-advisers will be subject to the same standard of care in their dealings with clients.

In a related consultation paper, ASIC explained that the fact that, as in Canada, the Australian Government is looking to raise professional, ethical and proficiency standards of advisers[303] does not change its position on robo-advisory. As an example, ASIC writes that robo-advisers' responsible managers must meet the required standard of care and comply with any ethical duties and code of ethics that are in place, regardless of their enhanced nature.[304]

(ii) Conflicts of interests

As traditional advisers, fully-automated robo-advisers would be required to adequately respond to conflicts of interests.[305] In CP 31-103, a conflict of interest is defined as "any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent."[306] Based on the requirements proposed in Sections 5(a)(i) and 5(a)(ii), the individuals responsible for testing the *algorithms* would have to thoroughly ensure that those algorithms are designed free of embedded biases. The individuals responsible for reviewing the *advice* would have to thoroughly ensure that the advice rendered to client is not biased. They would also have to document the process to do so under the risk management requirements.

CCOs of robo-advisers, or any other compliance officers, would accordingly have to establish policies and procedures to adequately identify conflicts of interests, determine the level risk they represent and adequately respond.[307] As in traditional advisory, the type of response depends on the nature of the conflict of interest. Moreover, when assessing the response to a conflict, robo-advisers would be required to apply the standard of care applicable their dealings with clients.[308] For instance, Canadian robo-advisers might, like most current Canadian online advisers, voluntarily undertake (in their client agreement) to prioritize the client's best interest in account dealings. Consequently, that is the standard they have to apply when choosing how to adequately respond to conflicts of interests.

There are generally three available responses to conflicts: avoidance, control and disclosure.[309] A conflict of interest should be avoided when it presents a high risk of either harming investors or the integrity of the markets.[310] A conflict should also be avoided if it is prohibited by law or of it is "sufficiently contrary to

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303 *Consultation Paper 254*, *supra* note 247 at para. 18.

304 *Ibid.,* paras. 18-21.

305 *NI 31-103*, *supra* note 38, s. 13.4(2).

306 *CP 31-103*, *supra* note 61, s. 13.4.

307 *Ibid.*

308 *Ibid.*

309 *Ibid.*

310 *Ibid.*

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the interests of a client that there can be no other reasonable response."[311] Firms can rather choose to *control* conflicts when they are closely tied to structural matters. For instance, this type of conflicts may arise if advisers and compliance officers have to report to exploitation units like marketing or business sales. Firms can thus control these conflicts by a restructuration that separates the conflicting units by using information barriers for communications between these internal units.[312] Finally, firms may choose to disclose a conflict of interests to have clients waive that conflict.[313] Such a disclosure must be clear, specific and meaningful to the client[314] and made before or at the time of the advice.[315] Just as a traditional adviser, robo-advisers would have to clearly "explain the conflict of interest and how it could affect the service the client is being offered".[316] CP 31-103 explicitly prohibits disclosing conflicts by providing "generic disclosure", "partial disclosure that could mislead their clients" or by obscuring "conflicts of interest in overly detailed disclosure".[317] Moreover, the disclosed information must be updated, as the obligation is continuous, not static.[318]

A. Connected products providers

As any adviser, fully-automated robo-advisers would also be obligated to disclose related or connected issuers.[319] Moreover, and as with other obligations, firms holding discretionary accounts like robo-advisers have more stringent obligations in relation to securities that are connected to it or to its partners, officers and advisers.[320] Currently, some Canadian online advisers have a business relationship with their ETFs and fund providers, which they adequately disclose in their agreements.

B. Commissions and fees

Fully-automated robo-advisers would also be subject to the specific disclosure rules concerning commissions and fees. Conflicts of interests related to commissions and fees are an important matter and are currently the subject of a few regulatory reforms and actions in Canada.[321] It is important to ensure that

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[311] *Ibid.*

[312] *Ibid.*

[313] *Ibid.*

[314] *Ibid.*

[315] *Ibid.*

[316] *Ibid.*

[317] *Ibid.*

[318] Loranger et al., *supra* note 60 at paras. 13, 157.

[319] *NI 31-103*, *supra* note 38, s. 13.6.

[320] *Ibid.,* s. 13.5.

[321] As stated in Section 3(c)(ii), CSA is notably looking at the option of discontinuing embedded commissions connected to mutual funds in Canada; see *CSA Consultation Paper 81-408*, *supra* note 16; There also has been a long on-going regulatory reform

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financial advice is free of biases connected to monetary gains for advisers. Arguably, the fact that algorithms, rather than individuals, deliver financial recommendations has the potential to rid financial advice of conflicts connected to sale contests, bonus and other types of promotion and thus ameliorates transparency in financial services.

Currently, Canadian online advisers adequately address elements like broker commissions, trading commissions and soft dollar arrangement in their agreements. They establish pertaining policies and commit to abiding to those policies when making decisions, such as selection of brokers for a transaction, for instance. Such policies may also provide that trade allocations paid to brokers are to be decided on a case-by-case analysis. They commit to reviewing trade allocations every year and to re-assess their appropriateness. Fully-automated robo-advisers should follow the same policies and practises to adequately manage conflicts of interest and ensure transparency in their services.

(iii) United States: robo-advisers as fiduciaries

In the United States, the application of enhanced standards of care to robo-advisers is currently creating some controversy. Some commentators do not think that robo-advisers can satisfactorily fulfil such standards. As stated above, American robo-advisers are typically required to register as investment advisers under the *Investment Advisors Act of 1940* and applicable state law, and are thus subject to fiduciary duties.[322] The *Investment Adviser Act of 1940* imposes on advisers the duty to act in the utmost good faith, to make a full and fair disclosure of all material facts, which includes putting the client's interest first, before their own.[323] The question that has sparked debates is thus: can robo-advisers truly be fiduciaries? This debate is worth following for Canada, as the upcoming reforms might both entail a surge of online or robo-advisers and the same type of conceptual questions about their duties.

One factor that contributed to sparking this debate was a recent decision by the Department of Labour (DOL) to extend fiduciary duties to all individual retirement accounts advice.[324] After years of resistance from Wall Street and the insurance industry,[325] the DOL introduced new regulation with respect to

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regarding fee and remuneration disclosure (commonly known as CRM and CRM2), see *CSA Staff Notice 31-345 — Cost Disclosure, Performance Reporting and Client Statements — Frequently Asked Questions and Additional Guidance*, O.S.C. CSA Notice, 39 O.S.C.B. 3569 (2016); *CSA Notice and Request for comments — Proposed Amendments to NI 31-103 and its Policy, NI 33-109 and OSC Rule 33-506 (including related forms)*, O.S.C. CSA Notice, 39 O.S.C.B. (Supp-2) (2016).

[322] Melanie L. Fein, "Robo-Advisors: A closer look" (2015) (Paper commissioned by Federated Investors Inc. unpublished) [Fein, "A closer look"].

[323] See Massachusetts State Securities Regulator, *Policy Statement: Robo-Advisers and State Investment Adviser Registration* (1 April 2016) at 2; *Investment adviser Act of 1940*, s. 206; 15 U.S.C. §80b-6.

[324] *CSA Consultation Paper 33-404*, *supra* note 148 at 26.

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individual retirement accounts and 401(k)s (that are comparable to Canada's RRSPs).[326] This decision by the DOL was considered to *favour* robo-advisory, as robo-advisers already hold fiduciaries duties.[327]

The Massachusetts State Securities Regulator issued a warning in April 2016 in which it questions whether or not robo-advisers can truly act as fiduciaries and thus as investment advisers.[328] The warning claims that their "depersonalized structure" may render them unable to give appropriate investment advice.[329] Again, as explained in Section 4(a)(i), this type of premise by U.S. regulators are somewhat misleading in that it encourages the misconception that there is a huge gap between traditional advisory and robo-advisory. The questionnaires used by robo-advisers are highly similar those used by traditional advisers, especially those for average-income investors. Moreover, some of the tools used by robo-advisers, like algorithms and platforms, are also similar to those used by the traditional advisers. They simply have been made directly available to the investors via digital platforms.[330] In its FinTech Report, IOSCO noted that although traditional advisers have some flexibility to inquire about inconsistencies and assess unusual circumstances during the KYC process, there are still risks that they fail to ask enough questions or the right questions to thoroughly assess clients' profile.[331]

Some American lawyers and scholars have also taken a robo-adviser-adverse position. As regulators cited above, it appears that they omit to consider the issues they bring up as equally applicable to traditional advisers. Law professor Arthur Laby writes that robo-advisers cannot address subtleties that take place in conversations with human advisers.[332] According to Laby, robo-advisers do not offer "full-scale" financial services[333] and, as a result, cannot act as fiduciaries nor investment advisers. In her paper commissioned by Federated

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325 Cavaliere, *supra* note 23.

326 Tara Siegel Bernard, "'Customers First' to Become the Law in Retirement Investing", *The New York Times* (6 April 2016).

327 However, the Trump administration stayed the implementation of the new DOL rule by decree in February 2017, and asked that the DOL to re-examine it; see Richard Cloutier, "Trump s'attaque à la régulation des marchés financiers", *Finance & Investissement* (6 February 2017). Following that decree, the DOL pushed back the implementation 2 months (April 10 to June 9) to further inquire on the matter and made a new call for comments about it; see James Langton, "U.S. Labor Dept. delays implementation of fiduciary rule", *Investment Executive* (1 March 2017).

328 Massachusetts State Securities Regulator, *Policy Statement: Robo-Advisers and State Investment Adviser Registration* (1 April 2016).

329 *Ibid.*

330 See *FINRA Digital Investment Report*, *supra* note 3.

331 *IOSCO FinTech Report*, *supra* note 2 at 32.

332 Bernard, "The Pros and Cons of Using a Robot as an Investment Adviser", *supra* note 16.

333 *Ibid.*

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Investors Inc., lawyer Melanie L. Fein concluded that robo-advisers do not meet the DOL's fiduciary standard using the same types of arguments as Laby.[334] Fein however fails to explain how her arguments don't equally apply to traditional advisers. She ignores *big* issues that are found in financial services provided by traditional advisers. Incidentally, it was these very issues that triggered the multiple regulatory reforms targeting poor conduct of traditional advisers in the United States, Canada, the United Kingdom and Australia in the last decade. Further, Fein stresses that performance of robo-advisers have not yet been tested in a market downturn. She writes that human advisers can be crucial during market volatility when investors are far more likely to make investment mistakes. However, Fein fails to account for the fact that many robo-advisers establish systems that identify inconsistencies or other triggers and prompt direct communication with investors to address them. In Canada, this is already a requirement for current online advisers as discussed in Sections 3(a)(v) and 3(b)(i). Moreover, regulatory requirements for robustness tests and thorough periodic reviews of both algorithms and the generated advice, paired with strong organisational competence and communication requirements, can help ensure adequate investor protection in difficult markets conditions or downturns.

(d) Enforcement Measures

The current enforcement measures, upon breach of Canadian securities regulation, could readily apply to robo-advisers with some adaptations. Regulators would have the same enforcement powers, allowing them to investigate upon complaints made by investors, or irregularities noted while exercising their oversight powers. They would thus have powers to pursue enforcement measures against robo-advisers (legal persons), as well as CCOs, the ultimate designated person and any other registered compliance officers. Concerning sanctions, the securities tribunal and disciplinary boards of SROs may impose a reprimand if the breach is not serious — which should not apply to any of the obligations and requirements that have been discussed in this paper. They may also impose fines which can go up to $5,000,000 Canadian dollars. Moreover, regulators may suspend registration rights and privileges of firms or the individuals. They may impose some conditions in order for the firm or the individual to maintain registration rights. Upon very serious infractions, they can revoke the rights and privileges temporarily or permanently.[335] Additional discussion on this matter falls outside the scope of this paper, but would be a relevant point to further the discussion on the regulation of robo-advisers in Canada.

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[334] Fein, "A closer look", *supra* note 322; see also Fein, "Cracked", *supra* note 4.

[335] Loranger et al., *supra* note 60 at para 215.

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(e) Additional Matters

Cybersecurity is an important dimension of robo-advisory that also needs to be considered, but falls outside the scope of this paper. As stated in CSA Notice 31-342, however, these types of concerns also apply to traditional registrants as most now use some online interactions to provide services to clients (e.g. online accounts).[336] There are also consumer protection laws issues to consider. For instance, some Canadian online advisers provide for the governing law in their agreements. They also provide for the applicable jurisdiction if judicial proceedings were to be instituted regarding the agreement. In consumer protection law, there are often rules to favour consumers' governing laws and jurisdictions when contracts occur with businesses that are outside their domicile province. In the case of online or robo-advisers, the fact that all the services and interaction take place digitally ought to advantage, not disadvantage, consumers. Consequently, securities regulators might find it relevant to develop rules that ensure consumer protection in case of dispute with regards to governing law and jurisdiction.

6. CONCLUSION

Robo-advisers can certainly be considered disruptive. However, they are unlikely to make traditional advisers and firms disappear. Rather, the type of disruption they introduced on the market is one that will incite traditional firms to adapt their business models and offer better services at lower costs; perhaps spurring some healthy competition. According to IOSCO, robo-advisers change the scalability of rendering financial advice, notably by reaching typically underserved segments of investors.[337] FinTechs in general are both responding to and creating a demand for new, more efficient business models and user experience that may bypass trusted traditional intermediaries.[338]

On the other hand, they pose challenges for securities regulators because the regulatory frameworks are based on traditional, longstanding rules. Legislation and regulation as they exist today never contemplated the types of technology and innovative business models like robo-advisers as they now exist.[339] Moreover, at the current pace of technological innovation, regulating emerging business models compares to attempting to regulate a moving target.[340] Trying to make emerging FinTechs and robo-advisers "fit" into those frameworks might stifle innovation. Conversely, it is also important to create equivalent duties not to provoke regulatory arbitrage in the industry to the detriment of traditional financial service providers.

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[336] *CSA Staff Notice 31-342*, *supra* note 8.

[337] *IOSCO FinTech Report*, *supra* note 2 at 30.

[338] Scavone et al., *supra* note 27 at 62.

[339] Thouin, *supra* note 29.

[340] *Ibid.*

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Digitalization of financial services has become unstoppable, one could argue. All stakeholders, including incumbents, have a role to play in ensuring that the "culture of innovation" is allowed to expand,[341] as it presents great potential for Canadian investors and financial markets.

Some experts believe that the truly innovative feature of robo-advisers is the increased access to healthy savings methods, not the creation of model portfolios with simple funds and low costs.[342] One of the primary difficulties in financial services is to get consumers to adopt adequate savings practices. Robo-advisers address this issue by making saving stimulating and attractive. Moreover, robo-advisers attract segments of the population that do not seek or cannot afford traditional advice. By filling this gap, robo-advisers help to educate and promote healthy financial habits throughout the Canadian population, which in turn is beneficial for overall Canadian economic health.

Since 2017, there has also been more openness of incumbents to 'partner up' with robo-advisers and other Fintechs. Some robo-advisers have in fact developed platforms for adviser representatives in firms to improve scalability and efficiency of those firms.[343] The advisers thus have access to a white label digital platform, allowing both advisers and their clients to benefit from some of the advantages of robo-advisory technology.[344] According to IOSCO, robo-advisers can reduce costs that traditional advice firms incur to provide advice services by using automated tools and can help them reach and render financial advice to a wider range of investors, notably those who have little assets to invest.[345]

According to commentator Rob Carrick, the recent surge of robo-advisers has also spurred regulators to take a "smothering, paternalistic approach to protecting clients".[346] For Carrick, this approach might downright stifle innovation. This is negative, as innovative business-models have much to offer to Canadian investors, especially those whom are not sought by the traditional financial industry.[347] To a certain extent, Carrick's arguments illustrate in a concise manner many points made in this paper. Carrick further writes that the current business model of Canadian online advisory will make it that much more difficult to generate a sufficient "level of profitability". Carrick recognizes that regulators need to ensure investor protection. However, they must also allow

[341] Bauer & Williams, *supra* note 11.

[342] Yves Gingras, "Et voici les robots-épargnants", *Finance & Investissement* (1 February 2017).

[343] Fiona Collie, "Working with robo-advisors", *Investment Executive* (28 June 2016).

[344] Fiona Collie, "Credential to partner with Nest Wealth", *Investment Executive* (16 March 2017).

[345] *IOSCO FinTech Report*, *supra* note 2 at 30.

[346] Rob Carrick, "The surprising threat to investment innovation", *The Globe and Mail*, (3 February 2017).

[347] *Ibid.*

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robo-advisers to thrive. Carrick goes further and states that robo-advisers are "becoming an essential part of the investing ecosystem", as traditional firms are less and less interested in investors with small sums to invest.[348]

Finally, the next element that will impact robo-advisory and financial services in general is the exponential sophistication of artificial intelligence currently seen on the market. Using artificial intelligence technology like deep learning will enable robo-advisers to better predict individual investor behaviour as well as changing market conditions. As new and more sophisticated robo-advisers business models are emerging, Canadian regulators should remain opened to adapting regulation to new technology-driven models. The CSA sandbox and other regulatory initiatives will be useful to learn about technologies like artificial intelligence, and to continue adapting regulation to emerging technologically-driven business models.

[348] *Ibid.*

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