Embedded commissions survey results

Alberta Securities Commission

Background

- In October 2017, the ASC engaged Innovative Research Group to conduct an online survey on investors' understanding of and views on embedded commissions
- This was done as part of our ongoing consultation process on issues raised in CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions*
- In total, 808 Albertans completed the full online survey
- This is a representative sample, weighted according to the Statistics Canada 2016 Census data

Background

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- In order to identify those Albertans who would have opinions about/be affected by embedded commissions, the survey first asked whether the respondent:
  - Currently holds an investment account not through their employer — "Investors"
  - Intends to open such an account within the next five years — "Likely Investors"
  - The remainder of the survey was taken only by "Investors" and "Likely Investors"

Findings – Investor knowledge

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Albertans are largely unfamiliar with investment fees:

- 59% of those surveyed were unfamiliar with embedded fees
- 40% of those surveyed who have advisors do not know how much they pay that advisor (via direct or embedded fees)

Financial literacy is low:

- 86% of those surveyed answered only half or fewer of the general financial literacy questions/questions about fees correctly

Findings - Investor beliefs

Respondents in our survey were conflicted about the option of discontinuing embedded fees, exacerbated by lack of knowledge:

- 44% felt embedded fees should not be allowed
- 29% felt embedded fees should be allowed
- 27% felt they did not understand the issue enough to have an opinion

There is a geographic discrepancy:

- Respondents from rural and smaller urban areas were more likely to approve of an embedded commission compensation model than those from Calgary and Edmonton

These results in context

- While the majority of those respondents who had an opinion were in favour of discontinuing embedded commissions, a significant 27% self-identified as not feeling they knew enough to have an opinion
- Of the 44% who were in favour of discontinuance, only 13% chose the "Definitely do not allow embedded commissions" option — the other 31% chose "Probably do not allow," indicating a degree of indecision

Findings - Investor beliefs

- Do-It-Yourself (DIY) investors are the most certain (61%) they prefer to pay directly
- Advised investors are evenly split on whether they prefer to pay directly or not
- “Likely investors” are the most uncertain about what they would prefer (only 33% said they would prefer to pay directly, and 37% felt they didn’t know enough to say)

Findings – Investor priorities

When asked how they felt about investment fees in general:

- 61% of respondents said that it was important to them to understand exactly how much they were paying their adviser and what they were receiving in return
- 29% of respondents said that the details of how their adviser is paid are not too important as long as the overall performance of their investments is satisfactory
- 10% of respondents did not feel that they knew enough to have an opinion

Findings – Investor priorities

When asked why they felt the way they did, respondents who were in favour of discontinuing embedded fees cited:

- Potential conflicts of interest (27%)
- Transparency (14%)
- Desire to know exactly what they are paying (14%)

Trust is a factor:

- Among advised investors, concerns about embedded fees decrease with the length of the advisor relationship

Findings – Investor behaviour

If embedded commissions are discontinued, what happens?

- Investors with a commission-based account are most likely to move to a fee-based account
- Investors with accounts that are not commission-based and “likely investors” are more likely to switch to a bank than to a fee-based account
- Investors most strongly opposed to embedded commissions are the most likely group to switch to a discount brokerage

Findings – Investor behaviour

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Demographics make a difference:

- Those with high financial literacy and those with investment account sizes greater than $250K are more likely to choose fee-based accounts
- Those with a household income less than $80K, and those with investment account sizes less than $250K, are more likely to invest with a bank

Findings – Investor views

In summary, in the event that embedded commissions are discontinued, investors want to keep doing what they are doing:

- Those with a commission-based account want to keep their same advisor, and just pay fees
- Those investing with a bank want to continue to do so

There is a need for increased financial education in Alberta:

- Many respondents self-identified as not knowing enough to have an informed opinion on these issues
- Low scores on financial literacy questions

Next steps

- On June 21, 2018 the CSA published:
  - CSA Staff Notice 81-330 *Status Report on Consultation on Embedded Commissions*
  - CSA Staff Notice and Request for Comment *Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)*

Next steps

- CSA Staff Notice 81-330:
  - specifically addresses conflicts of interest associated with embedded commissions. Rules to be proposed in September 2018 prohibit:
    - all forms of the deferred sales charge (DSC) option
    - the payment of trailing commissions to advisors who do not make a suitability determination

Next steps

- CSA Staff Notice and Request for Comment *Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)* addresses conflicts that are not specifically related to embedded commissions
- The proposed amendments would require that:
  - conflicts of interest be addressed in the best interest of the client
  - the client's interest is put first when making a suitability determination
  - more is done to clarify for clients what they should expect from their advisor
- The comment period will run for 120 days and closes October 19, 2018