Canadian Securities Administrators
Autorités canadiennes en valeurs mobilières

CSA CONSULTATION PAPER 81-408 – *CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS*

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Administering the Canadian Securities Regulatory System

Les autorités qui réglementent le marché des valeurs mobilières au Canada

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PART 1 – INTRODUCTION

Background

On December 13, 2012, the Canadian Securities Administrators (the **CSA** or **we**) published CSA Discussion Paper and Request for Comment 81-407 – *Mutual Fund Fees* (the **Original Consultation Paper**).[1] In that paper, we identified potential investor protection and market efficiency issues arising from the prevailing practice of remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions, paid by investment fund managers (**embedded commissions**). In particular, we identified how embedded commissions give rise to conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of the investors they serve.

Since the publication of the Original Consultation Paper, the CSA completed roundtable consultations and discussion forums[2], and commissioned independent research to further examine the identified investor protection and market efficiency issues.[3] After an extensive review of these inputs, in addition to our review of many other independent studies, we find that embedded commissions raise the following three key investor protection and market efficiency issues in Canada:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;

2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and

3. Embedded commissions paid generally do not align with the services provided to investors.

[1] The Original Consultation Paper is available on the websites of the members of the CSA.
[2] See transcript of Ontario Securities Commission roundtable held June 7, 2013, https://www.osc.gov.on.ca/documents/en/Securities-Category8/rpt_20130607_81-407_mutual-fund-fees-roundtable.pdf. The British Columbia Securities Commission and Autorité des marchés financiers held discussion forums in the summer and fall of 2013, respectively.
[3] Brondesbury Group, "Mutual Fund Fees Research", Spring 2015, https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_engwr.pdf; Douglas Cumming, Sofia Johan and Yelin Zhang, "A Dissection of Mutual Fund Fees and Performance" (Feb. 8, 2016), https://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_dissection-mutual-fund-fees.pdf

The evidence we have gathered to date shows that embedded commissions encourage the sub-optimal behavior of fund market participants, including that of investment fund managers, dealers, representatives and fund investors, which reduces market efficiency and impairs investor outcomes. In particular, the data and research we reviewed suggests that embedded commissions can:

- incent investment fund managers to rely more on payments to dealers than on the generation of performance to gather and preserve assets under management; this incentive can in turn lead to underperformance and drive up retail prices for investment products due to a competition between investment fund managers to offer attractive commissions to secure distribution;

- incent dealers and their representatives to sell funds that compensate them the best or focus on only those funds that include an embedded commission rather than recommend a more suitable investment product; specifically, they can encourage a push for higher commission generating funds, such as higher-risk actively managed funds, which can impair investor outcomes;

- due to their embedded nature and complexity, inhibit the ability of investors to assess and manage the impact of dealer compensation costs on their investment returns; and

- cause investors to pay (indirectly through fund management fees) dealer compensation that may not reflect the level of advice and service they may actually receive; the cost of the advice and service provided may exceed its benefit to investors.

These issues and their causes appear to be driven by a compensation model with inherent conflicts of interest that research suggests are pervasive and are difficult to manage effectively. Based on the evidence we have gathered, we believe that a change to a different compensation model must be considered. Investors should be provided with a compensation model that empowers them and that better aligns the interests of investment fund managers, dealers and representatives with those of investors.

Consultation on direct pay arrangements

Before taking any regulatory action, and while we consider related regulatory initiatives underway, we want to consult with stakeholders on the potential option of discontinuing embedded commissions and transitioning to direct pay arrangements that:

- better align the interests of investment fund managers, dealers and representatives with those of investors;
- deliver greater clarity on the services provided and their costs; and
- empower investors by directly engaging them in the dealer and representative compensation process.

Direct pay arrangements could consist of various types of compensation arrangements including upfront commissions, flat fees, hourly fees, fees based on a percentage of assets under administration or other arrangements, provided in all cases:

i. the arrangement is negotiated and agreed to exclusively by the investor and the dealer, through the representative, pursuant to an explicit agreement; and

ii. the investor exclusively pays the dealer for the services provided under the agreement.

Under a direct pay model, we would expect dealers to offer their clients a compensation arrangement that suits their particular investment needs and objectives and the level of service desired. Investment fund managers could facilitate investors' direct payment of dealer compensation through payments taken from the investor's investment (for e.g. deductions from purchase amounts or periodic redemptions from the investor's account).

We recognize that such a change could have a profound effect on the fund industry and on investors in Canada, including potential unintended consequences. Therefore, a decision on whether to discontinue embedded commissions will only be reached after careful consideration and assessment of the possible impacts on investors and market participants and consultation with stakeholders. Accordingly, the aims of this consultation paper (**Consultation Paper**) are to obtain the requisite information the CSA needs to make an informed decision about discontinuing embedded commissions. Specifically, our objectives are to:

- assess the potential effects on investors and market participants of discontinuing embedded commissions, including on:
    - the provision and accessibility of advice for Canadian investors, and
    - business models and market structure, including the competitive landscape of the Canadian fund industry;
- if we decide to move forward, identify potential measures that could assist in mitigating any negative impacts of such a change; and
- obtain feedback on alternative options that could sufficiently manage or mitigate the identified investor protection and market efficiency issues.

We emphasize that we have not made a decision to discontinue embedded commissions. While we continue to consult and contemplate whether regulatory action should be taken to address the issues we have identified with the current commission-based compensation model, we encourage industry to create market-driven solutions and innovations that address the concerns we raise in this Consultation Paper, including adopting business models that:

- have at their core the interests of investors;
- align the benefits to the investment fund managers, dealers and representatives with the benefits to investors;
- make for more informed, engaged and empowered investors that expect and demand services that align with the fees they pay; and

- promote fair, competitive and efficient capital markets, and foster confidence in our market.

Impact analysis

This consultation will build on our previous consultations and the important body of research we have considered to date. We particularly seek from stakeholders analysis and perspectives that:

- were not raised in the prior consultations; and

- wherever possible, are evidence-based, data-centric and Canadian-focused.

The fund industry has to date provided research that finds that higher levels of wealth are achieved by advised investors over time, and maintains that embedded commissions are essential to delivering this benefit, particularly to investors with lower levels of wealth who may not otherwise be able to afford, or may not want to pay directly for, advice.

The fund industry has also pointed to the consequences of relevant regulatory reforms in other jurisdictions (such as the U.K. and Australia) as potential evidence of the likely impact of the discontinuation of embedded commissions in Canada. While observations about the impacts of relevant reforms in other jurisdictions are informative and insightful, we consider that the potential impacts from similar reforms in Canada might not be the same. The unique features of those foreign markets, including the characteristics of their respective market participants and the specific competitive dynamics within which they operate, their market structure, the savings habits of their local investors, as well as the scope of their respective reforms may all play a role in shaping the specific impacts.

The objective of this consultation is therefore to identify the potential effects of discontinuing embedded commissions in Canada based on what we know of our fund market and its participants, including our investment fund managers, our dealers, and the investors they currently serve. This objective includes understanding the potential impact such a change may have on the accessibility and affordability of advice for Canadian investors, including lower-wealth investors, and identifying ways to minimize this impact. Ultimately, our goal is to ensure that any regulatory action we may decide to take will provide a Canadian solution to challenges specific to the Canadian market, will result in more positive outcomes for Canadian investors and will minimize disruption for market participants. For this purpose, the contribution of the stakeholders to this consultation is very important.

Related regulatory initiatives and other alternatives

We are aware of the view of many fund industry participants that mutual fund fee reforms may be unnecessary in the wake of recent reforms aimed at improving investor awareness and understanding of fees and performance under the CSA's Point of Sale disclosure (**POS**) and Client Relationship Model Phase 2 (**CRM2**) projects, and the concept proposals to enhance the registrant-client relationship discussed in CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* (**CSA CP 33-404**). We also understand that industry participants are concerned by the number of current policy initiatives that affect their business and that require substantial changes in their operations and systems. Industry has urged us to allow full implementation of the POS and CRM2 reforms and fairly assess their results, and conclude consultations under CSA CP 33-404, before signaling that significant new reforms are needed.

We are of the view that the discontinuation of embedded commissions could be complementary to our recent reforms and proposals in that those existing and ongoing initiatives were not designed to, and may not fully address, the key investor protection and market efficiency issues we have identified in this Consultation Paper. In particular, we think that as long as dealer compensation remains embedded in the fund product, investment fund managers may continue to place greater emphasis on payments to dealers than on performance to gather and preserve assets under management. This compensation model may continue to encourage higher fund fees and impair investor outcomes and market efficiency, including effective competition in our market. We believe that discontinuing embedded commissions may address these issues by better aligning the interests of investment fund managers, dealers and representatives with those of investors. In this Consultation Paper, we seek your views on our assessment of the extent to which the discontinuation of embedded commissions may be required to address our key issues, including your views on whether recent disclosure reforms and proposals to enhance the registrant-client relationship may on their own sufficiently address our concerns.

We have also canvassed and thoughtfully considered a number of alternative options to address the investor protection and market efficiency issues we have identified. As more fully discussed in Appendix B of this Consultation Paper, we did not retain those other options as we found that they did not directly or fundamentally address the identified issues to the extent that discontinuing embedded commissions may.

Comment process

We welcome comments from investors, participants in the investment fund and financial services industries, and all other interested parties to the matters discussed in this Consultation Paper. Some CSA jurisdictions will hold in-person consultations in 2017 to facilitate additional feedback and further our consideration of the issues. Please see Part 7 of this Consultation Paper for information on how to submit comments. The comment period closes on **June 9, 2017**.

Structure of Consultation Paper

The remainder of this Consultation Paper is structured as follows:

- Part 2 discusses the key investor protection and market efficiency issues we have identified in connection with embedded commissions and highlights the evidence of these issues;

- Part 3 describes the potential scope of the discontinuation of embedded commissions if we were to proceed with rule-making;

- Part 4 sets out our assessment of the potential impacts of discontinuing embedded commissions on the Canadian fund market and specific stakeholders, including the potential impacts on market structure, business models and access to advice for Canadian investors, based on an analysis of data about Canadian fund investors and market participants;

- Part 5 explores measures that could mitigate the potential impacts and unintended consequences to investors and the Canadian fund market of discontinuing embedded commissions;

- Part 6 provides an overview of existing regulatory tools and related regulatory initiatives and our assessment of the extent to which these tools and initiatives may help address the key investor protection and market efficiency issues we have identified in connection with embedded commissions;

- Part 7 explains how stakeholders may provide comments and discusses next steps;

- Appendix A provides a detailed overview of the research that provides evidence of the key investor protection and market efficiency issues discussed in Part 2;

- Appendix B discusses other options we previously considered and the reasons why we did not retain them;

- Appendix C provides an overview of relevant reforms pertaining to dealer compensation in other jurisdictions; and

- Appendix D provides a list of the consultation questions.

PART 2 – KEY INVESTOR PROTECTION AND MARKET EFFICIENCY ISSUES RAISED BY MUTUAL FUND FEES AND RELATED EVIDENCE

Further to the CSA’s consultations on the Original Consultation Paper and our review of recent Canadian and other independent research on mutual fund fees as well as various other pieces of evidence, we have identified the following three main investor protection and market efficiency issues in connection with the mutual fund fee structure in Canada:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;

2. Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs; and

3. Embedded commissions paid generally do not align with the services provided to investors.

Below, we discuss each of the three issues in greater detail and reference various pieces of research and other data set out in Appendix A that evidence the issues.

We then consider the policy implications of the available evidence and the extent to which they suggest a need for change.

A. <u>The issues and related evidence:</u>

<u>Issue 1:</u> **<u>Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors</u>**

Based on the available evidence, the current embedded commission dealer compensation model appears to facilitate a mutually beneficial relationship between the investment fund managers who manufacture fund products and the dealers and representatives that distribute them. It aligns the investment fund manager's asset gathering and preservation objectives with the dealer's revenue maximization objectives. The evidence suggests that this alignment of commercial goals can alter the behavior of investment fund managers, and of the dealers and representatives who distribute the investment fund manager's products, in a way that is detrimental to market efficiency and investor outcomes. Specifically:

i. embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance;

ii. embedded commissions can encourage dealers and representatives to make biased investment recommendations which may negatively affect investor outcomes; and

iii. embedded commissions encourage high fund costs and inhibit competition by creating a barrier to entry.

i. Embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance

Investment fund managers who pay embedded commissions to dealers may be incented to rely more on those payments than on generating performance to attract and preserve assets under management. Consequently, the embedded commission structure may encourage investment fund managers to regard dealers and representatives, rather than their fund investors, as their "customers".[4]

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[4] This observation was similarly made by Gloria Stromberg in *Regulatory Strategies for the Mid-'90s, Recommendations for Regulating Investment Funds in Canada,* January 1995, at pages 17-18 where she discusses this concern as follows:

> "Another result that has flowed from the need to secure distribution channels is that independent investment fund organizations no longer appear to regard the investors in their sponsored investment funds as being their "customers" in terms of such investors being the persons whose needs, expectations and interests that their operations are intended to serve. Instead, their organizations regard the distributors – i.e. mutual fund dealers, mutual fund specialists, financial planners, investment dealers and, in some cases, the individual sales representatives that are employed by these firms – as being their "customers" and their

The research that we have gathered and reviewed suggests that this inherent conflict of interest diminishes the investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns.

ii. Embedded commissions can encourage dealers and representatives to make biased investment recommendations which may negatively affect investor outcomes:

Dealers and representatives who are compensated through embedded commissions may be incented to make biased investment recommendations that give priority to maximizing compensation over the interests of the client. The research we have gathered and reviewed suggests that:

- compensation bias arising from embedded commissions can incent dealers and representatives to:
  - recommend higher cost fund products that pay them higher embedded commissions than other suitable lower-cost and, possibly, better performing products, and
  - promote the use of a particular purchase option[5], such as the deferred sales charge (**DSC**) option[6], that pays higher upfront embedded commissions, regardless of the

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immediate focus is on satisfying the needs of these people instead of the needs of the investors in their sponsored investment funds."

We note the U.K.'s Financial Services Authority (**FSA**) (now known as the Financial Conduct Authority) also made similar observations in the work leading up to its Retail Distribution Review reforms discussed in Appendix C of this Consultation Paper. In a speech entitled "Is the present business model bust?" given on September 16, 2006, the Chairman of the FSA stated the following:

> "And one of the key questions that must be addressed is this: who is the real customer of the provider – is it the policyholder who invests their money in the hope of seeing a decent return? Or is it the distributor, who in the main, secures access to the end-consumer for the provider? If, as many commentators would have it, it is indeed the distributor who is the actual customer of the provider, this raises all manner of difficulties which further perpetuate the shortcomings of the current model – particularly with regard to treating the real customer fairly. I understand well that many are frustrated by what they describe as the "commission stranglehold" that the advisory community enjoys, but so long as providers continue to compete over the attractiveness of their commission proposition, the fundamental flaws in the present business model will remain."

[5] Mutual funds in Canada can be purchased under one of four primary options:

1. **No load:** The investor does not pay any direct charges for fund securities purchased or redeemed; the dealer is paid a trailing commission by the investment fund manager.
2. **DSC:** The investor does not pay a sales charge for fund securities purchased, but may have to pay a redemption fee if the securities are sold before a predetermined period has elapsed; the dealer is paid both an upfront commission and a trailing commission by the investment fund manager. For more details on this option, see note 6.

availability of other purchase options that may better suit the investor's needs and objectives; and

- biased advice has an economically significant cost on investor outcomes.

iii. Embedded commissions encourage high fund costs and inhibit competition by creating a barrier to entry:

The research we have gathered and reviewed suggests that competition between investment fund managers to offer high embedded commissions to attract and secure distribution encourages and preserves high overall fund fees and discourages the manufacturing and sale of lower-cost

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3. **Front end:** The investor pays a negotiable sales charge to the dealer at the time of purchase that is deducted from the amount invested, but does not pay a redemption fee to redeem; the dealer is paid a trailing commission by the investment fund manager.
4. **Fee based:** The investor does not pay a sales charge to purchase, or a redemption fee to redeem, fund securities, but instead pays an ongoing fee directly to the dealer pursuant to an agreement with the dealer; the dealer generally does not receive any compensation from the investment fund manager.

[6] When purchasing fund investments under the DSC option (also known as the "back end load" option), the investor does not directly pay a sales commission to their dealer or representative at the time of purchase. The entire amount paid by the investor is accordingly invested in the fund at the time of purchase. While the investor does not directly pay a sales commission to the dealer or representative at the time of purchase, the dealer and the representative, through the dealer, typically receive a commission from the investment fund manager equivalent to 5% of the amount purchased. The investment fund manager may borrow the money necessary to pay these upfront commissions and therefore will incur financing costs. These costs are recouped by the investment fund manager through the ongoing management fees charged to the fund. Accordingly, the cost of the upfront commissions is embedded in the ongoing costs of the fund.

While investors do not pay a sales charge to their dealer at the time they make their purchase under the DSC option, they may pay a redemption fee to the investment fund manager if they redeem their investment within a predetermined number of years from purchase, typically 5 to 7 years. The redemption fee is designed to deter an investor from redeeming the investment and accordingly preserve assets under management. The redemption fee works on a declining scale, typically starting around 6% in the first year and declines by about 1% each year down to 0% at the end of the specified holding period. The investor may switch his investment to other funds within the investment fund manager's fund lineup without triggering redemption fees. However, a switch fee of typically up to 2% may apply.

Many investment fund managers offer a low-load sales charge option, which works like the DSC option, but on a shorter schedule – typically 3 years or less. The upfront commission paid by the investment fund manager to the dealer and the redemption fee payable by the investor on a redemption made within the specified holding period are also correspondingly reduced (down to approximately 2 to 3%).

In this Consultation Paper, unless otherwise indicated, references to the "DSC option" include the "low-load sales charge option".

According to data from Investor Economics, as at December 2015, 20% of Canadian fund assets totalling $234 billion were held in the DSC option.

alternatives, thus limiting price competition in Canada. This competition on the basis of commissions has a distorting effect on the allocation of capital by rewarding some investment fund managers more than is warranted, and others less than is warranted, while discouraging some from entering the market entirely.

Evidence:

In Appendix A, we provide evidence substantiating how the conflicts of interest inherent in embedded commissions alter the behavior of investment fund managers, dealers and representatives at the expense of market efficiency and investor interests.

<u>Issue 2:</u> **<u>Embedded commissions limit investor awareness, understanding and control of dealer compensation costs</u>**

Based on the available evidence, embedded commissions appear to limit investor awareness, understanding and control of dealer compensation costs. Specifically:

i. the lack of saliency of embedded commissions reduces investors' awareness of dealer compensation costs;

ii. embedded commissions add complexity to fund fees which inhibit investor understanding of such costs;

iii. the product embedded nature of dealer compensation restricts investors' ability to directly control that cost and its impact on investment outcomes.

i. The lack of saliency of embedded commissions reduces investors' awareness of dealer compensation costs:

To facilitate the sale of funds, the Canadian fund industry has over the last several years gradually shifted away from transaction-based sales commissions paid directly by investors toward a greater reliance by both investment fund managers and dealers on product embedded commissions. For example, in 1996, trailing commissions accounted for slightly more than one quarter of a typical representative's book of business; by 2011, that share had grown to an estimated 64%.[7]

This move away from transaction-based sales commissions has reduced the saliency of dealer compensation costs for investors and, accordingly, reduced their sensitivity to such costs. The research we have gathered and reviewed is clear that the majority of Canadian fund investors are not aware of what they pay for financial advice or that they pay for financial advice at all.[8] Consequently, these costs do not figure into their decision-making. The research we have

[7] Investor Economics, *Investor Economics Insight,* March 2012, at p.9.

[8] The new report on charges and other compensation implemented in the context of CRM2 was designed to increase the transparency of dealer compensation costs for investors. In Part 6 of this Consultation Paper, we provide an analysis of the extent to which CRM2 is expected to respond to Issue 2 above.

gathered and reviewed suggests that investors are more sensitive to salient upfront fees like front-end loads and are more likely to control such visible and salient fees that they must pay directly.

ii. Embedded commissions add complexity to fund fees which inhibit investor understanding of such costs:

Further contributing to investors' limited awareness and understanding of fund fees, including embedded commissions, is the complexity of fund fees in terms of structure and options on offer. Although all dealer compensation costs that fund investors pay directly (such as sales charges) and indirectly through ongoing fund fees (such as trailing commissions) are disclosed in the fund's prospectus, the fund facts document and the annual report on charges and other compensation, the variance in such fees between investment fund managers, fund types (i.e. asset classes), fund series and purchase options can overwhelm investors' capacity to understand the specific fund fees, including dealer compensation costs, that apply to their investment.

The complexity of the mutual fund fee structure can make it challenging for all but sophisticated investors to measure the value of the services they receive against the costs they pay and assess the impact of fees on their investment returns.

The research we have gathered and reviewed suggests that price complexity in retail financial products increases the information asymmetry between investors and product manufacturers and distributors, which increases investors' reliance on more informed intermediaries for their investment choices and decisions.

iii. The product embedded nature of dealer compensation restricts investors' ability to directly control that cost and its effect on investment outcomes:

Since the cost of dealer compensation is embedded in the fund's ongoing management fees, investors have no ability to directly negotiate this cost and consequently have no control over the amount they ultimately pay their dealer and their representative. The only control investors have on dealer compensation costs under the embedded commission model is to vote on a proposed increase to fund management fees (from which dealer compensation is paid).[9]

Opportunities for retail investors in Canada to reduce the trailing commissions they indirectly pay or avoid them altogether are very limited. As a result, investors who may desire little or no advice (e.g. do-it-yourself investors) may often bear the cost of full unreduced trailing commissions. And investors who do desire advisory services but who wish to pay for them directly rather than through embedded commissions similarly have limited options because direct pay arrangements are typically available only through dealers servicing higher net worth investors. We note that even though the vast majority of investment fund managers now offer fee-for-service series (e.g. Series F) for minimal investments, the distribution of such series is

[9] Under section 5.1 of National Instrument 81-102 *Investment Funds*, the prior approval of securityholders of an investment fund is required for an increase in a fee or expense that is charged to an investment fund or directly to its securityholders.

still limited in comparison to the distribution of series with embedded commissions due to the fee-based account minimums imposed by the dealer.[10]

Furthermore, because trailing commissions are deducted at the fund level rather than the account level, some investors indirectly subsidize certain dealer compensation costs that are not attributable to their investment in the fund, which means they indirectly pay excess fees. This situation is called “cross-subsidization”. For example, front-end load investors in a fund may cross-subsidize the costs attributable to DSC investors.[11] Opportunities for cross-subsidization would be reduced if each investor were charged a fee covering his/her own distribution costs at the account level, which would enable each investor to pay only for his/her costs and thus have greater control over such costs.

Investors’ inability to make an informed choice based on fund costs, including dealer compensation, and to control such costs due to their product-embedded nature can lead to sub-optimal investment choices and outcomes.

Evidence:

At Appendix A, we provide evidence that:

- the lack of saliency and the complexity of fund fees, including embedded commissions, impacts investors’ awareness and understanding of such fees and accordingly reduces the significance of fund fees as a factor in investor decision-making; and

- the product embedded nature of dealer compensation restricts investors’ ability to directly control that cost and its impact on investment outcomes; this evidence includes an overview of:
  - the cross-subsidization that results from dealer compensation charged at the fund level, and
  - the limited options investors currently have in Canada to limit or avoid the payment of embedded commissions.

Issue 3: Embedded commissions paid generally do not align with the services provided to investors

There is generally no clear relationship between the level of embedded commissions set and paid by the investment fund manager to the dealer and the level of services and advice the dealer and the representative provide to investors in exchange for such compensation. Specifically:

i. investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid; and

[10] Investor Economics, *Investor Economics Insight*, July 2016.

[11] We refer you to note 6 where we explain the DSC option and the associated cost to the investment fund manager of funding the payment of an upfront commission to dealers for sales made under that option.

ii. the cost of advice provided through commissions may exceed its benefit to investors.

i. Investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid:

As mentioned above, trailing commission rates may vary between investment fund managers, fund types, fund series and purchase options. They may also in some cases vary over the course of the investment.[12] While a reasonable assumption might be that the rate of the trailing commission is reflective of the level of service an investor receives from a dealer and their representative (i.e. the greater the rate, the greater the service), current practice suggests that no such relationship exists between the fees paid and the services provided in exchange.

Embedded commissions are paid to dealers regardless of the extent of the services that a representative provides to the investor in connection with an investment in a fund. The same compensation is paid irrespective of whether the representative provides only transaction-oriented advice or provides a broader range of ongoing investment services and financial advice that is tailored to the investor's specific needs. For example, our review of the Canadian fund market finds that higher than average trailing commissions are sometimes paid on investment funds offering pre-packaged investment solutions (i.e. funds-of-funds) that relieve the representative from having to do much of the fund selection and asset allocation they might otherwise have to do for a client. Similarly, discount brokers who provide execution-only services often distribute fund series that pay them the same trailing commission that would be paid to a full service dealer.

The 'one-size-fits-all' nature of the trailing commission payment therefore seems misaligned with the provision of services and advice customized to the investor's specific needs, expectations and preferences. A contributing factor to this misalignment is likely investors' low awareness and understanding of fees including dealer compensation (as discussed under Issue 2 above), which causes investors to not demand a level of service and advice commensurate with the fees they have indirectly paid for.

Absent a clear relationship between the rate of the embedded compensation paid to the dealer and their representative and the level of services an investor receives in return, the payment of embedded compensation may be perceived to be tied to the simple distribution of the fund product as opposed to the provision of ongoing advice and services. Certain industry submissions received in response to our Original Consultation Paper would seem to confirm this view as several commenters indicated that trailing commission payments support dealer operations and sales activity more than the provision of ongoing advice.

[12] For example, we have seen trailing commission rates that increase in steps with each year the investor continues to hold the investment, reaching a specified maximum rate after a certain number of years. It is also typical for trailing commission rates to double at the expiration of a DSC redemption schedule (5 to 7 years). For example, a trailing commission rate of 0.50% for an investment held in an equity fund under the DSC option may increase to 1.00% at the expiration of the redemption schedule.

If investors are getting basic one-time services centered on the trade as opposed to ongoing advice and services in exchange for the ongoing embedded commissions paid out of their funds' management fees, they may be indirectly paying too much for the services they are actually receiving. Moreover, since the aggregate amount of embedded commissions that investors pay increases as their holding period increases, those investors who remain invested longer may pay more fees than others for the same basic service.

ii. The cost of advice provided through embedded commissions may exceed its benefit to investors:

Some of the research we reviewed suggests that investors may derive no measurable net benefit from financial advice paid for through embedded commissions and may in some cases be worse off because of it. Certain research finds that the advice of representatives may be skewed not only by compensation biases, but may also be affected by representatives' varying skills and knowledge about investing which in some cases may benefit from increased proficiency requirements. Other research suggests that the benefits that investors derive from the advice of representatives may be largely behavioral and thus intangible in nature, such as the development of good savings discipline, overcoming inertia, the reduction of anxiety, and the creation of trust.

Evidence:

In Appendix A, we provide evidence that:

- investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid; and

- the cost of advice provided through embedded commissions may exceed its benefit to investors.

Questions

1. Do you agree with the issues described in this Part? Why or why not?

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

B. Policy implications:

The foregoing shows that product embedded commissions affect the behavior of fund market participants in a way that undermines investor protection and the fairness and efficiency of our capital markets as well as confidence in our market. This situation suggests a need to consider regulatory action.

To address the investor protection and market efficiency issues outlined in this Consultation Paper, the CSA considered and discussed the range of policy options set out in the chart below:

Potential regulatory options									
1. Use existing tools		**2. Enhancements to disclosure**		**3. Investment fund manager focused initiatives**			**4. Enhancements to registrant-client relationship**	**5. Mutual fund fee reforms**	
Roll out POS and CRM2 and monitor impact	Conduct NI 81-105 mutual fund sales practices reviews	CRM2 cost reporting / performance reporting benchmarking	Better fee disclosure in fund facts (giving more context for fund costs)	Require separate series for each purchase option	Make distribution costs an expense of the fund	Require DIY discount series	Consider extent to which concept proposals under CSA CP 33-404, if implemented, may respond to fund fee issues	Cap all forms of embedded compensation to a maximum limit	Discontinue all forms of embedded compensation

CSA regulatory project focus	Regulatory options not retained

<u>Guiding considerations for evaluation of options:</u>

Our evaluation of the range of options and determination of which options should be retained and which ones should not were guided by the extent to which an option directly addresses the three investor protection and market efficiency issues we identified. We specifically considered the questions below:

a. How many problems does the option address and to what degree?

b. Would the impact be direct/immediate rather than indirect/over time?

c. What is our level of uncertainty regarding the impacts/what is our expectation regarding unintended consequences?

d. Does it simplify or add to the complexity of the fund fee structure?

e. Does it enhance competition in our market and market efficiency generally?

Where we determined that an option would potentially address one issue to some degree, but at the same time would fail to address or would likely exacerbate another issue, or would potentially increase the complexity of fund fees or fail to enhance competition in the market, we opted to not retain the option.

When we evaluated the options through this lens, our analysis drew us to not retain the options highlighted in red and retain the options highlighted in green in the table above.

The options we opted to not retain and the reasons why are described in Appendix B of this Consultation Paper.

The options we retained include:

i. maintain and use our existing tools, namely enhanced transparency of fund fees under POS and CRM2, and review of sales incentives under NI 81-105 *Mutual Fund Sales Practices* (**NI 81-105**);

ii. continue to explore concept proposals under CSA CP 33-404 to strengthen the obligations of dealers and their representative towards their clients; and

iii. discontinue embedded commissions and transition to direct pay arrangements.

Following a thorough evaluation, we believe that options "i" and "ii" may provide only a partial resolution to the issues identified in this Consultation Paper and that option "iii" may need to be considered in conjunction with options "i" and "ii" to achieve the desired outcomes. We accordingly view option "iii" as being complementary to options "i" and "ii".

In Part 6 of this Consultation Paper, we provide our detailed assessment of the extent to which the above key issues may be addressed by existing CSA regulation and ongoing proposals, and seek your views on that assessment.

PART 3 – OVERVIEW OF THE PROPOSED OPTION TO DISCONTINUE EMBEDDED COMPENSATION

In this part, we discuss the potential scope of the discontinuation of embedded commissions should the CSA decide to move forward with rule-making. In particular, we consider:

- what types of securities would be affected, and
- what types of payments would be discontinued.

1. Types of securities affected

NI 81-105, implemented in 1998, governs the payments that investment fund managers may make to dealers in connection with the distribution of securities of a mutual fund.[13] While that

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[13] NI 81-105 came into force on May 1, 1998. Part 2 of Companion Policy 81-105CP provides background on NI 81-105 and describes its purpose. NI 81-105 was adopted by the CSA as a response to the concern of many participants in the mutual fund industry that prospectus disclosure of sales practices, coupled with the discipline imposed by competitive market forces, were not sufficient to discourage sales practices and compensation arrangements that gave rise to questions as to whether dealers and their representatives were being induced to sell mutual fund securities on the basis of the incentives they were receiving as opposed to what was suitable for and in the best interests of their clients.

The purpose of NI 81-105 is to ensure that the interests of investors remain uppermost in the actions of participants in the mutual fund industry by setting minimum standards of conduct designed to minimize the conflicts between the rule currently applies only to mutual funds that are reporting issuers, we recognize that its regulatory objectives have equal application to the distribution of other investment funds and comparable investment products that we regulate.[14]

Over the last few years, the CSA have made regulatory changes to ensure a consistent regulatory framework in key areas for all types of retail investment funds, regardless of whether structured as a mutual fund, an exchange-traded mutual fund (**ETF**) or a non-redeemable investment fund.[15] We have also recognized the growth of structured notes[16] as a retail investment product and communicated our intention to regulate them in a similar manner to investment funds, where appropriate.[17]

While investment funds and structured notes sold in the exempt market have to date generally not been subject to the same requirements as retail investment funds, we consider that the investor protection and market efficiency issues that stem from embedded commissions, as

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legitimate commercial goals of industry participants and the fundamental obligations that are owed by industry participants toward investors.

[14] See "Request For Comments on Sales Practices Applicable To The Sale Of Mutual Fund Securities – Notice of Proposed Rule and Proposed Companion Policy Under The Securities Act", Ontario Securities Commission (**OSC**) Bulletin, (1996) 19 OSCB, page 4727, in which the OSC sought comments on a local rule proposal that would later become NI 81-105 and be adopted by all CSA jurisdictions. At page 4728, the OSC states: "Although the proposed Rule applies only to the distribution of publicly offered mutual funds, the Commission is of the view that the regulatory objectives of the proposed Rule have equal application to the distribution of all collective money management schemes. Ultimately, the distribution of all schemes should be subject to the same or equivalent rules and standards."

[15] See "Modernization of Investment Fund Product Regulation (Phase 2) – Final Amendments", in force as of September 22, 2014, https://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20140619_81-102_final-amendments-phase2.htm. The objective of Phase 2 of this project was to identify and address any market efficiency, investor protection and fairness issues that arose out of the differing regulatory regimes that applied to publicly offered mutual funds and non-redeemable investment funds and make the necessary amendments to achieve consistent product regulation across the spectrum of retail investment funds. Under these amendments, certain investment restrictions and operational requirements applicable to mutual funds and ETFs were extended to non-redeemable investment funds.

[16] A structured note, or linked note, is a specified derivative, as defined in National Instrument 44-102 – *Shelf Distributions*, for which the amount payable is determined by reference to the price, value or level of an underlying interest that is unrelated to the operations or securities of the structured note issuer. Structured notes issued under the shelf prospectus are generally non-principal protected securities issued by a deposit taker.

[17] In CSA Staff Notice 44-305 – *2015 Update – Structured Notes Distributed under the Shelf Prospectus System* (**CSA Staff Notice 44-305**), the CSA recognized the growth of structured products as a retail investment product and our intention to adapt our regulatory approach to ensure consistency, where appropriate, in how we regulate structured notes and similar retail products such as investment funds. CSA Staff Notice 44-305 noted that some structured note issuers charge fees on a basis similar to investment funds. These fees may include sales commissions and embedded ongoing service fees or trailing commissions paid by the structured note issuer to dealers and their representatives.

evidenced under Part 2, require consistent treatment both in the prospectus-qualified and prospectus-exempt markets. To do otherwise would create an opportunity for regulatory arbitrage.[18]

Recognizing that the fee structure of various types of investment funds and structured notes commonly includes embedded commissions, and with the aim of promoting a level playing field amongst comparable investment products and limiting opportunities for regulatory arbitrage, we currently anticipate that any regulatory proposal to discontinue embedded commissions would affect:

- an "investment fund"[19], as defined under securities legislation and
- structured notes,

whether sold under a prospectus or in the exempt market under a prospectus exemption.

Although investment fund-like products, such as segregated funds, are not within the purview of securities legislation and therefore would not be captured in any CSA rule proposal to discontinue embedded commissions, we recognize the importance of a harmonized approach to regulating such products given their similarity to investment fund products, including their payment of product embedded commissions to intermediaries. The CSA will accordingly continue to liaise with insurance regulators to address the potential risk of regulatory arbitrage between investment funds and individual segregated funds.

In the interest of achieving a harmonized approach, the Canadian Council of Insurance Regulators (**CCIR**) established a Segregated Funds Working Group in 2015, with a mandate to, among other things, identify potential gaps in the comparative regulatory frameworks for segregated funds and mutual funds and assess the potential risk of regulatory arbitrage by dually-licensed (insurance and mutual funds) insurance agents. In their May 2016 issue paper calling for input on how to address key gaps between the regulations pertaining to mutual funds and segregated funds[20], the CCIR indicates that although it is currently not aware of any statistical evidence to demonstrate that regulatory arbitrage is occurring between mutual funds and segregated funds, it will act proactively to amend regulation where appropriate to ensure that intermediaries have little incentive to prioritize their own interests over those of clients. The issue paper identifies the CSA's consultation on how to address the potential investor protection and market efficiency issues arising from embedded commissions as an issue of particular

[18] In the Original Consultation Paper, we recognized that there may be other investment fund products whose fee structure may raise similar investor protection and fairness issues for investors, and that accordingly, any regulatory initiative that we would ultimately undertake would assess whether the same initiative should also apply to other investment funds and comparable securities products.

[19] The definition of "investment fund" captures conventional mutual funds, ETFs and non-redeemable investment funds.

[20] Canadian Council of Insurance Regulators, *Segregated Funds Working Group Issues Paper*, May 2016, http://www.ccir-ccrra.org/en/init/IVIC_POS/IVICs%20Issues%20Paper%20(ENG).pdf.

relevance, and the CCIR will review the CSA policy direction on this matter and assess its appropriateness for segregated funds.[21]

Questions

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

   - mutual fund
   - non-redeemable investment fund
   - structured note

   should the product be subject to the discontinuation of embedded commissions? If not:

   a. What would be the policy rationale for excluding it?

   b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

2. Types of payments discontinued

NI 81-105 currently prohibits mutual funds that are reporting issuers and members of the organization of such mutual funds from making payments to dealers or their representatives in connection with the distribution of securities of a mutual fund. The rule however excepts from this prohibition the payment of commissions (including trailing commissions) and the provision of support to dealers for marketing and educational practices by members of the organization of mutual funds.

If the CSA were to move forward with a rule proposal, we currently anticipate that we would seek to discontinue any payment of money to dealers in connection with an investor's purchase or continued ownership of a security described above that is made directly or indirectly by any person or company other than the investor. The rule would preclude compensation to dealers that is paid or funded by the investment fund or the investment fund manager or structured note issuer out of fund assets or revenue.

[21] Ibid. p. 15

We anticipate this change would at a minimum prohibit the payment by investment funds, investment fund managers or structured note issuers to dealers of the following embedded commissions:

- ongoing trailing commissions or service fees; and
- upfront sales commissions for purchases made under the DSC option.

To be clear, the discontinuation of embedded commissions would enable dealers and their representatives to adopt various types of compensation arrangements. Under direct pay arrangements, dealers and their representatives could opt to be compensated through upfront commissions (such as front-end sales loads), hourly fees, a flat fee, a fee based on a percentage of the client's assets under administration (**fee-based arrangement**), or other suitable compensation arrangement, provided in all cases:

a. the method and the rate of the representative's compensation in connection with the purchase of a security and other services provided to the investor are negotiated and agreed to exclusively by the investor and the dealer, through the representative, pursuant to an explicit agreement; and

b. the investor exclusively pays the dealer for the services provided under the agreement.

Under direct pay arrangements, we would expect dealers and representatives to offer their clients a compensation arrangement that suits their particular investment needs and objectives and reflects the level of service desired. For example, ongoing fees should be charged for ongoing services.

We believe that the above terms mitigate the close alignment of interests between investment fund managers, dealers and representatives.

While investment funds, investment fund managers and structured note issuers would no longer be allowed to pay or fund compensation to dealers from their own assets or revenue in connection with an investor's purchase or continued ownership of a security, we anticipate allowing them to facilitate the investor's payment of dealer compensation. Specifically, the investment fund manager would be permitted to collect the dealer's compensation, either through deductions from purchase amounts or through periodic withdrawals or redemptions from the investor's account, and remit it to the dealer on the investor's behalf, provided the investor consents to this method of payment.

At this time, we anticipate that we would permit the following types of dealer compensation payments:

- referral fees paid for the referral of a client to or from a registrant;[22]

[22] Referral fees are defined in NI 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and would continue to be permitted subject to the requirements of that rule.

- dealer commissions paid out of underwriting commissions on the distribution of securities of an investment fund or structured note that is not in continuous distribution under an initial public offering;

- payments of money or the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; [23] and

- internal transfer payments[24] from affiliates to dealers within integrated financial service providers[25] which are not directly tied to an investor's purchase or continued ownership of an investment fund security or structured note.

We acknowledge that the above types of payments may give rise to conflicts of interest that may continue to incent registrant behavior that does not favour investor interests. We therefore seek your responses to the questions below.

Questions

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note,

[23] Under Part 5 of NI 81-105, members of the organization of a mutual fund may:

- pay to a dealer direct costs incurred by the dealer relating to investor conferences or investor seminars or other conferences or seminars prepared or presented by the dealer (ss. 5.1 and 5.5),

- provide a non-monetary benefit to a representative of a dealer by allowing him or her to attend a conference or seminar organized and presented by the investment fund manager (s.5.2),

- pay the registration fees of a representative of a dealer for a conference, seminar or course that is organized and presented by a person or company other than the investment fund manager (s.5.3), and

- provide a non-monetary benefit of promotional nature and of minimal value to a representative of a dealer,

subject in each case to compliance with specified requirements.

[24] See MFDA Bulletin #0689-P, *Implementation of Requirements under CRM2 Phase 2 Amendments to NI 31-103 – Frequently Asked Questions (FAQs)*, May 13, 2016. Question #18 and the MFDA response on pages 8 and 9 discuss internal transfer payments.

[25] For the purpose of this consultation, an "integrated financial service provider" is a firm that is comprised of at least one dealer and one investment fund manager or structured note issuer that are affiliates of each other.

including:

a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;

b. referral fees; and

c. underwriting commissions.

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

10. With respect to internal transfer payments:

    a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?

    b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

    c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

PART 4 – REGULATORY IMPACT

The purpose of this part is to outline our assessment of the possible market impacts of discontinuing embedded commissions. In particular, we assess the potential impacts this change could have on the Canadian investment fund sector, including on market structures, business models and on the accessibility and scope of advice provided to retail investors, based on data we have gathered and the conclusions we have drawn from this data.

The regulatory impact part is divided into four sections. In section one, we provide a number of important facts about Canadian households, the fund market and the distribution of funds and securities in general that will help us anticipate possible market impacts of discontinuing embedded commissions. In section two, we outline possible overall or high-level impacts on the market in the event of the discontinuation of embedded commissions. This section is followed, in section three, by a more narrow focus on the impacts to specific stakeholders. Finally, in section four, we conclude by outlining how the discontinuation of embedded commissions may address the key issues outlined previously in Part 2 of this Consultation Paper. We look to all stakeholders to provide feedback and data responding to the conclusions that we draw here.

1. *Important facts about the fund market and fund market participants today*

A prerequisite for the CSA's assessment of possible policy options regarding fund fees was to understand and analyze what we know about the market today and in particular, what we know about the respective market participants – advised and non-advised fund investors, consumers of financial services generally, access to advice by retail investors, investment fund distribution channels and investment fund managers.

We provide pertinent information for each of these groups below using data from Investor Economics, Investment Industry Regulatory Organization of Canada (**IIROC**), Mutual Fund Dealers Association (**MFDA**), Morningstar Direct and the Ipsos Canadian Financial Monitor survey.[26]

a. *Canadian Households*

At the end of 2015, financial wealth of Canadian households reached $3.8 trillion dollars, increasing an average 5.8% per year since 2005. In comparison, household credit (due primarily to the increase in residential mortgages) grew 7.6% over the same period reaching just under $2 trillion dollars at the end of 2015. In aggregate, and as widely reported elsewhere,[27] Canadian households have become more leveraged over the last 10 years.

Within the asset side of the balance sheet, Canadian households, in aggregate,[28] had a significant and growing share of their total financial wealth in funds and cash and cash equivalents. At the end of 2015, Canadian households held $1.5 trillion or 40% of their aggregate financial wealth in investment fund securities and $1.2 trillion or 32% of aggregate wealth in cash and cash

[26] We have tried to provide the most recent data available wherever possible.

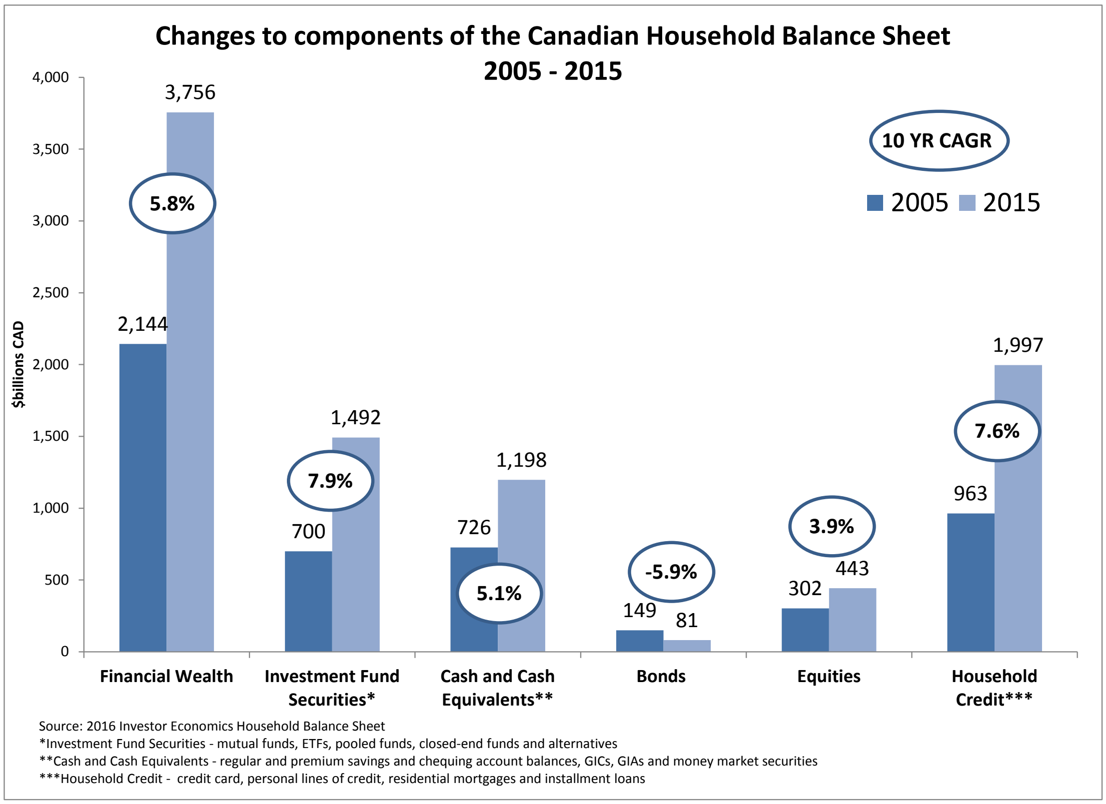
[27] See for example, Maciej Onoszko, "Canada's record household debt is threatening its financial stability, global bankers fear", *Bloomberg News,* October 24, 2016.

[28] It is important to note that aggregated household wealth figures do not provide information regarding the importance of these savings and investment products to the average household or to specific household segments (e.g. mass market, affluent, etc.). For example, investment funds may make up 40% of aggregate household financial wealth at the end of 2015 but they do not make up 40% of the average Canadian household's financial wealth.

equivalents[29]. In comparison, directly held securities (stocks and bonds) made up only $524 billion or 14% of aggregate financial wealth. Total assets held in bonds in particular declined over the last 10 years while assets held in equities saw relatively modest growth.

While both investment fund securities and cash and cash equivalents made up a significant portion of aggregate household financial wealth at the end of 2015, assets within investment funds have grown faster since 2005. On average, investment fund assets increased by 7.9% per year over the last ten years compared to 5.1% for cash and cash equivalents.

<u>Figure 1: The Canadian household balance sheet in aggregate</u>



We turn now to the distribution of assets and investment fund ownership across households by analyzing the data from the 2012 Ipsos Canadian Financial Monitor.[30]

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[29] Investor Economics, *Household Balance Sheet Report, Update and Rebased Forecast*, July 2016. In this report, "Financial Wealth" encompasses financial products held for the purpose of accumulating and preserving wealth including short-term instruments, deposits (including GICs and market-linked securities), fixed income securities, equities, investment funds and assets held in capital accumulation plans such as defined contribution plans (but not defined benefit plans).

[30] The Ipsos Canadian Financial Monitor survey is a syndicated survey based on an annual sample of 12,000 households that are demographically and regionally representative of the Canadian population. Each household completes a detailed questionnaire providing comprehensive information on all aspects of its financial holdings and activity.

The majority of Canadian households have investable assets below $100,000

Table 1: Household distribution by investment fund ownership and investable asset band

Breakdown of households by investable assets and fund ownership (base: all households)

Household Investable Assets	Household owns investment funds	Household does not own investment funds	% of total households
Up to $100k	14.6%	52.6%	67.2%
$100 - $500k	18.0%	8.9%	27.0%
Greater than $500k	4.5%	1.4%	5.9%
% of total households	**37.1%**	**62.9%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

The first important fact with respect to Canadian households is that the majority of households that save have investable assets of $100,000 or less. At the end of 2012, 67% of households had investable assets[31] of $100,000 or less (**mass-market households**), 27% had investable assets of between $100,000 and $500,000 (**mid-market households**) and 6% of households had investable assets of $500,000 or more (**affluent households**).

The majority of Canadian households do not own investment funds

The second relevant fact is that the majority of Canadian households do not own investment funds. At the end of 2012, 37% of Canadian households held investment funds[32] while the balance did not.

Mass-market households make up the largest share of those that do not own investment funds

Table 2: Household distribution by investment fund ownership

Breakdown of households by investable assets and fund ownership (base: fund ownership type)

Household Investable Assets	Household owns investment funds	Household does not own investment funds	% of total households
Up to $100k	39.4%	83.6%	67.2%
$100 - $500k	48.6%	14.2%	27.0%
Greater than $500k	12.0%	2.2%	5.9%
% of household ownership type	**100.0%**	**100.0%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

By far, the majority of households that do not hold investment funds (84%) are those with investable assets of $100,000 or less.

[31] "Investable assets" include holdings of cash, GICs, bonds, stocks and investment funds. Only households with positive investable asset balances and households with total income below $30,000 that are holding cash in excess of 30% of household income are considered as possessing investable assets.

[32] Throughout this section, we look at holdings of investment fund products and fund wraps of all types including mutual funds, segregated funds, structured notes, principal protected notes, hedge funds etc. in order to get a sense of the entire investment fund and fund wrap market as utilized by Canadian households.

However, among investment fund owning households, the majority have relatively modest to moderate levels of accumulated financial wealth

Yet, like their share of Canadian households generally, mass-market and mid-market households made up the largest share of households that own investment funds.

At 2012, 39% of all households that owned investment funds were mass-market households, 49% were mid-market households, and the remaining 12% of fund owning households were affluent households.

Investment funds, like most securities, are more frequently owned by households with higher levels of accumulated financial wealth

The distribution of fund ownership, like the distribution of financial wealth generally, skews toward households with higher levels of investable assets.[33] Mass-market households appear underrepresented relative to their share of total households (i.e. only 39% of those households own funds despite comprising 67% of all households), while the opposite appears true for mid-market and affluent households. Investment funds, like most securities, tend to be a higher-wealth product.

Investment funds are less popular than traditional savings vehicles with mass-market households

Table 3: Household distribution by investable asset band

Breakdown of households by investable assets and fund ownership (base: household investable asset band)

Household Investable Assets	Household owns investment funds	Household does not own investment funds	% of households in investable asset band
Up to $100k	21.8%	78.2%	**100%**
$100 - $500k	66.8%	33.2%	**100%**
Greater than $500k	76.1%	23.9%	**100%**
% of total households	**37.1%**	**62.9%**	**100%**

Source: 2012 Ipsos Canadian Financial Monitor

We can see this lack of relative popularity more clearly when we look at the proportion of investment fund ownership across investable asset bands. Table 3 above provides the breakdown of the Canadian households that own investment funds (i.e. 37% of all households).

At the end of 2012, only 22% of mass-market households held investment funds. These households will typically hold more conservative financial products instead, such as cash, GICs etc. For mid-market and affluent households, the majority held investment funds at the end of 2012. 67% of mid-market households held investment funds and 76% of affluent households held investment funds at the end of 2012. Once again, investment fund ownership is less

[33] At the end of 2015, Investor Economics estimates that households with financial wealth below $100,000 held 7% of total financial wealth while those households with greater than $500,000 in financial wealth held 81% of total financial wealth in Canada (2016 Investor Economics Household Balance Sheet).

prevalent for households with modest levels of savings relative to households with higher levels of accumulated wealth.

Investment fund owning households with lower levels of accumulated wealth are less likely to state that they use advice

Table 4: Fund owning household distribution by investable asset band

Investment fund owning households by investable assets and advisor usage (base: household investable asset band)

Household Investable Assets	Use Advisor	Do not use Advisor	% of households in investable asset band
Up to $100k	45.0%	55.0%	**100%**
$100 - $500k	66.0%	34.0%	**100%**
Greater than $500k	72.4%	27.6%	**100%**
% of investment fund owning households	**58.5%**	**41.5%**	**100%**

Source: 2012 Ipsos Canadian Financial Monitor

Table 4 above provides a breakdown of the households that own investment funds (i.e. the subset of 37% of all households) and their use of an advisor[34].

As Table 4 highlights, the data suggests that advice usage tends to be more of a higher-wealth product. Its prevalence among investment fund owning households rises with the level of investable assets. At the end of 2012, only 45% of investment fund owning mass-market households stated that they used an advisor[35] while the majority of investment fund owning mid-market (66%) and affluent households (72%) used an advisor.

b. Investment Fund Distribution

Whether advised or not, households must purchase their investment funds through a dealer. A key piece of information needed in order to anticipate the possible market impact of the discontinuation of embedded commissions is an understanding of where investors access investment funds today. We will look at this question from a number of different angles and data sources, starting with the Ipsos Canadian Financial Monitor data.

In the tables below, we have grouped fund distribution by the following firm types:

- deposit-taker owned[36] fund distributors;
- insurer owned[37] fund distributors;

[34] The term “advisor”, as used in this Consultation Paper, is not indicative of an individual’s category of registration with Canadian securities regulators, but is rather a plain language term that is commonly used by the public, including fund industry participants and investors, to refer to a representative.

[35] Survey respondents said yes to the question, “Does anyone in your household use a financial planner / advisor to help manage his / her financial portfolio?” Note that this question is dependent on the respondent’s impression of whether or not they have an advisor. No specific definition of “advisor” was provided in the survey.

[36] We use the term ‘deposit-taker owned’ to refer to dealers or investment fund managers that are owned by deposit taking institutions including banks, credit unions and caisses populaires.

- independent[38] fund distributors; and
- other integrated[39] fund distributors.

In each of the tables, we take a closer look at where households that hold investment funds accessed their funds. Households may have multiple relationships with different types of fund distributors (e.g. a household may work with a deposit-taker and an insurer or a deposit-taker and an independent or just a deposit-taker etc.). We have cross-tabbed fund distributor types by grouping deposit-takers and insurers (the traditional integrated financial product distributors) together and independents and other distributors (the group traditionally labeled as independent fund dealers) together.

Note that households that have not purchased their funds through a deposit-taker/insurer or through an independent/other dealer have purchased their funds through an association[40] or have not identified where they purchased their funds.

Most households purchase their funds through a deposit-taker or insurer owned dealer

Table 5: Fund owning household distribution by fund dealer relationship

Households by relationship type (base: All investment fund owning households)

Relationship Type	Purchased from Independent/Other	Not purchased from Independent/Other	% of investment fund owning households
Purchased from Deposit-taker/Insurer	8.2%	78.5%	86.7%
Not purchased from Deposit-taker/Insurer	9.5%	3.8%	13.3%
% of investment fund owning households	**17.7%**	**82.3%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

Deposit-taker and insurer owned fund dealers dominate fund distribution in Canada. At the end of 2012, of the 37% of households that owned investment funds, 87% purchased their funds through a deposit-taker/insurer owned distributor while only 18% purchased their funds through an independent/other fund distributor (a small percentage of households purchased their funds from both dealer groups).

[37] We use the term 'insurer owned' to refer to dealers or investment fund managers that are owned by or affiliated with an insurer.

[38] We use the term 'independent' to refer to dealers or investment fund managers that are not owned by deposit-takers or insurers and are not affiliated with an investment fund manager

[39] We use the term 'other integrated' to refer to dealers that are not owned by or affiliated with a deposit-taker or insurer but that are affiliated with an investment fund manager, or to investment fund managers that are not owned by or affiliated with a deposit-taker or insurer but that are affiliated with a dealer.

[40] The term 'association' refers to a dealer or investment fund manager that is owned by a trade or professional association.

Households with lower levels of accumulated wealth are less likely to purchase their funds through an independent dealer

Table 6: Mass-market household distribution by fund dealer relationship

Households by relationship type (base: fund owning households with up to $100k in investable assets)

Relationship Type	Purchased from Independent/Other	Not purchased from Independent/Other	% of fund owning households in asset band
Purchased from Deposit-taker/Insurer	5.3%	82.6%	87.9%
Not purchased from Deposit-taker/Insurer	8.8%	3.3%	12.1%
% of fund owning households in asset band	**14.0%**	**86.0%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

Table 7: Mid-market household distribution by fund dealer relationship

Households by relationship type (base: fund owning households with $100k - $500k in investable assets)

Relationship Type	Purchased from Independent/Other	Not purchased from Independent/Other	% of fund owning households in asset band
Purchased from Deposit-taker/Insurer	9.7%	75.9%	85.6%
Not purchased from Deposit-taker/Insurer	10.2%	4.2%	14.4%
% of fund owning households in asset band	**19.8%**	**80.2%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

Table 8: Affluent household distribution by fund dealer relationship

Households by relationship type (base: fund owning households with $500k or more in investable assets)

Relationship Type	Purchased from Independent/Other	Not purchased from Independent/Other	% of fund owning households in asset band
Purchased from Deposit-taker/Insurer	11.8%	75.3%	87.1%
Not purchased from Deposit-taker/Insurer	9.4%	3.4%	12.9%
% of fund owning households in asset band	**21.2%**	**78.8%**	**100.0%**

Source: 2012 Ipsos Canadian Financial Monitor

Mass-market households are less likely to purchase their funds through an independent/other fund distributor. At the end of 2012, only 14% of mass-market households purchased their funds through an independent/other fund distributor compared to 18% of households overall and 21% of affluent households. Mass-market households were also much more likely to be solely purchasing their funds through a deposit-taker/insurer owned dealer (i.e. 83%) than were households with higher levels of investable assets (i.e. 76% and 75% respectively for mid-market and affluent households).

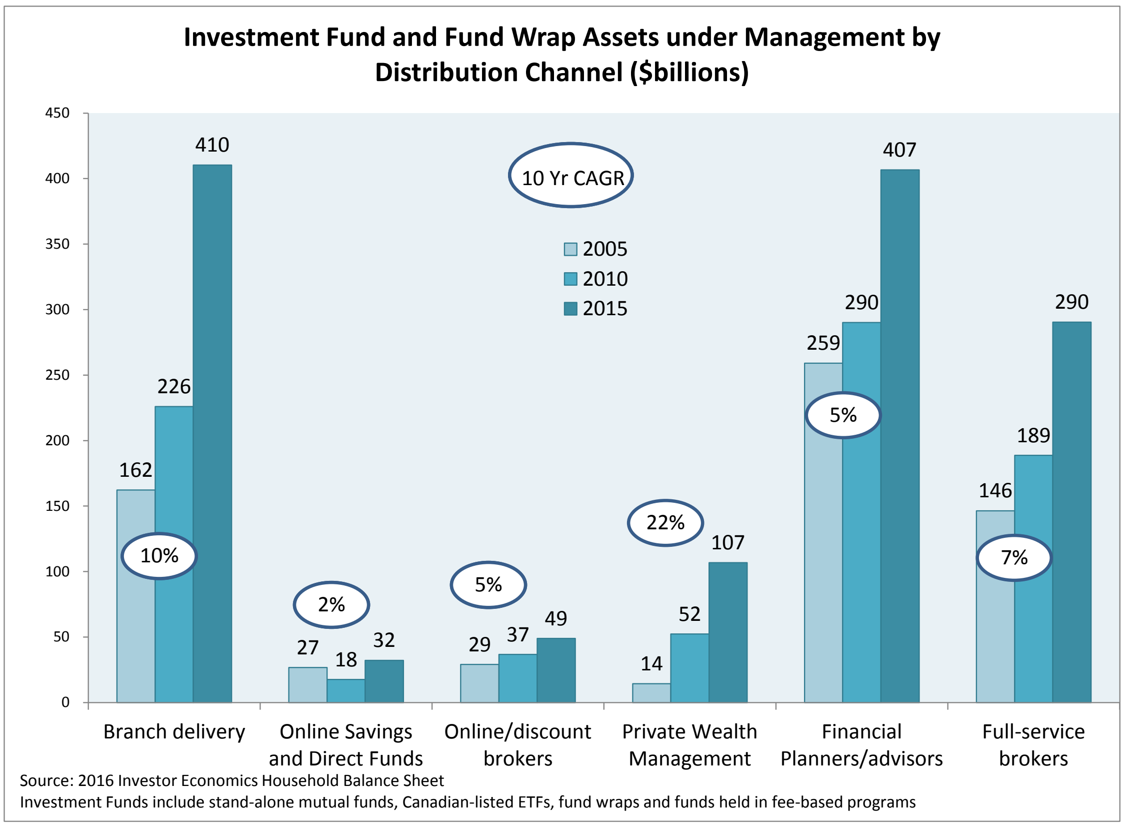
Fund distributors owned by deposit-takers and life insurers dominate investment fund distribution

Across all levels of investable assets, deposit-taker and insurer owned fund distributors tended to dominate fund distribution. The majority of households were working with a deposit-taker/insurer for at least one of their investment fund holdings (i.e. 88% for mass-market, 86% for mid-market and 87% for affluent households). Usage of deposit-taker/insurer fund distributors did not fall below 86% of households for all household types and for the industry as a whole. The data suggests that Independent/Other fund distributors tend to have a relatively small footprint in the market today.

These insights are also confirmed by data from Investor Economics.[41] In the two graphs below, we show investment fund and fund wrap assets, their 10 year compound average growth rates (CAGR) and market share for Investor Economics' six distribution categories – branch delivery, online savings and direct funds, online/discount brokers, private wealth management, financial planners/advisors and full-service brokers. We also highlight the change in market share for deposit-taker and insurer owned fund distributors in each channel.

Deposit-taker and insurer owned fund dealers dominate investment fund distribution today

Figure 2: Investment fund assets by distribution channel



As is shown in Figure 2 above, the majority of fund assets reside in the branch delivery channel and the financial planner/advisor channel.

The branch delivery channel saw the second highest rate of fund asset growth over the last ten years (10%) after the private wealth channel (22%). This growth rate is particularly impressive given the size of the branch delivery channel 10 years ago.

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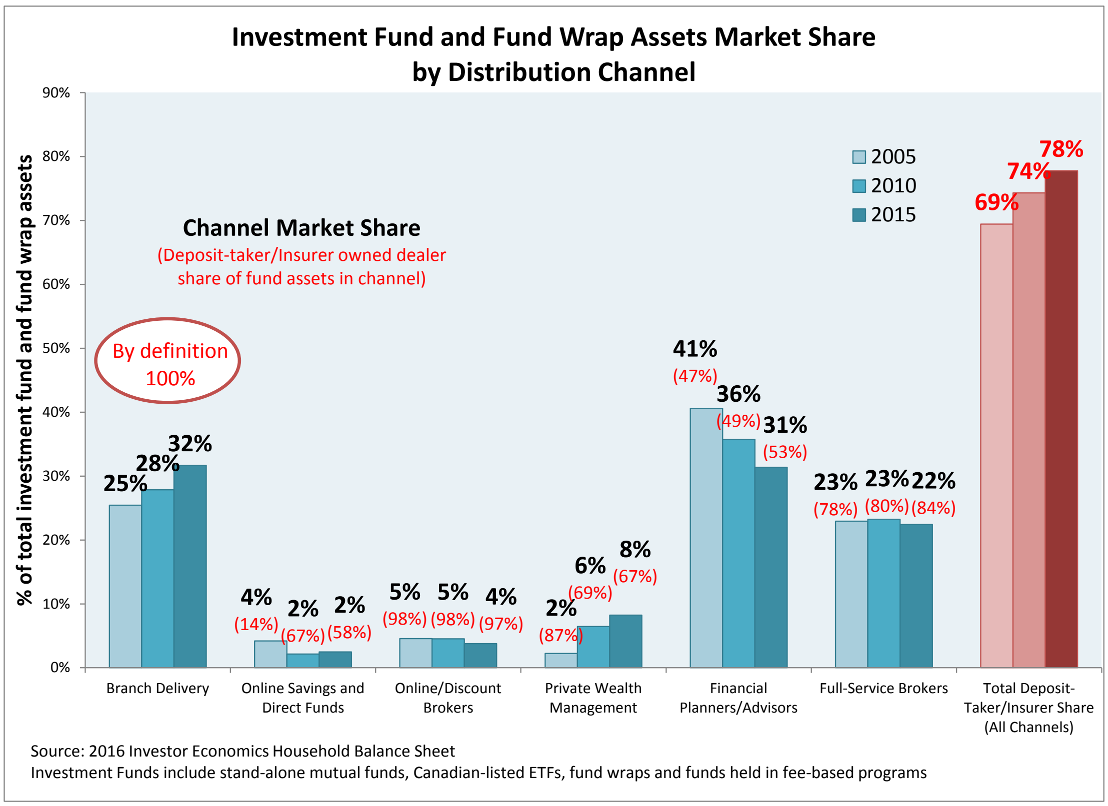
[41] This data is similar to the Ipsos data in that it looks at investment fund distribution. Investor Economics also uses their own categorization for distributors which does not neatly line up and in some cases encapsulates groups outside of our registration categories.

The financial planner/advisor channel[42], which had possessed the largest share of investment fund assets ten years ago, was still the second most important distribution channel at the end of 2015 but had grown much slower than all but the online savings and direct funds and the online/discount brokerage channels. Investment fund asset growth in the financial planner/advisor channel was also slower (5%) than in the full-service brokerage channel over the period (7%). Growth of investment fund assets in the full-service broker channel in particular was driven by a number of factors including the growth in fee-based account usage and in the share of investment funds used in these accounts.[43]

Figure 3: Investment fund assets market share by distribution channel and dealer type



The relative growth of investment fund assets in the financial planner/advisor channel is noteworthy because this is where the majority of independent mutual fund dealers are captured. As shown in Figure 3 above, at the end of 2015, the financial planner/advisor channel was the only channel where the deposit-taker/insurer share of investment fund assets was below 55%. Although, even in that channel, there has been an increase in deposit-taker and insurer ownership over the last ten years, increasing from 47% to 53% of investment fund assets in the channel.

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[42] The financial planner/advisor channel is probably the most heterogeneous of Investor Economics' distribution channels. It is made up of non deposit-taker mutual fund dealers, non-registered financial planning firms, insurance firms and some ‘fund-centric’ IIROC firms.

[43] Investor Economics, *Retail Brokerage and Distribution Advisory Service*, (various years) as well as data series from these reports requested by OSC staff.

As also highlighted in Figure 3, the branch delivery and full-service brokerage channels which had the second and third highest average annual growth over the last ten years, also had significant deposit-taker and insurer ownership at the end of 2015 (the former category is by definition 100% deposit-taker owned distribution).

At the end of 2015, the branch delivery channel held 32% of total investment fund assets, up from 25% ten years earlier. Much of that growth in market share came at the expense of the financial planner/advisor channel which saw its share of market decline from 41% to 31% over the period. The full-service broker channel saw its investment fund market share remain essentially constant while deposit-taker and insurer owned share of that channel increased from 78% to 84%. In total, at the end of 2015, deposit-taker and insurer owned dealers administered 78% of the investment fund and fund wrap assets held by Canadian households, up from 69% ten years earlier. In dollars, investment fund assets held through deposit-taker and insurer owned dealers, across all channels, increased from $443 billion in 2005 to $1 trillion at the end of 2015.

Next, we turn to data from the MFDA and IIROC in order get a sense of whether or not the insights from the Investor Economics and Ipsos data, which focused on investment fund distribution, carry over to retail securities distribution generally.

i. MFDA Channel

As outlined above in our review of the Ipsos Canadian Financial Monitor data and the Investor Economics Household Balance Sheet data, deposit-taker and insurer owned dealers have a strong market presence in the fund industry. This presence also extends across specific registration channels with deposit-taker and insurer owned dealers administering the largest share of assets in the MFDA and IIROC channels.

95% of assets in the MFDA channel are administered by integrated dealers[44]

Table 9: MFDA member assets and approved persons by dealer type[45]

MFDA Member Type	# Members	% of Total	Assets Under Admin $B	% of Total	# Approved Persons	% of Total
Independent	**60**	**61%**	**29.1**	**5%**	**3,399**	**4%**
Integrated	**39**	**39%**	**552.7**	**95%**	**77,970**	**96%**
Of which,						
Bank	*15*	*15%*	*349.1*	*60%*	*52,167*	*64%*
Insurer	*10*	*10%*	*177.0*	*30%*	*23,893*	*29%*
Other	*12*	*12%*	*25.5*	*4%*	*1,881*	*2%*
Association	*2*	*2%*	*1.1*	*0.2%*	*29*	*0.04%*
Of which,						
Proprietary Only	*20*	*20%*	*403.3*	*69%*	*54,458*	*67%*
Proprietary and Third Party	*19*	*19%*	*149.4*	*26%*	*23,512*	*29%*
Total	**99**	**100%**	**581.9**	**100%**	**81,369**	**100%**

Source: Mutual Fund Dealers Association at December 2015, OSC categorizations

[44] An “integrated dealer” is a dealer that is owned by or affiliated with an investment fund manager.

[45] In addition to the fund dealers which were members of the MFDA at the end of 2015, we note that there were also 21 mutual fund dealers in Québec that were not members of the MFDA and that employed 700 representatives. 71% of these dealers were independent and employed 83% of the representatives.

The MFDA channel is fairly concentrated and highly integrated. At the end of 2015, there were a large number of both integrated and independent firms in the channel with the majority of firms being independent of asset management. However, the majority of the assets in the channel and approved persons employed were at the integrated firms. At the end of 2015, integrated MFDA firms administered 95% of assets and employed 96% of approved persons in the channel.

90% of assets in the MFDA channel are administered by deposit-taker and insurer owned dealers

The 25 deposit-taker owned and insurer owned MFDA firms administered 90% of assets and employed 93% of approved persons. Independent/Other[46] MFDA firms, while making up 73% of firms in the channel, administered only 9% of assets and employed 6% of approved persons.

Independent MFDA dealers have tended to serve higher-wealth clients

Independent MFDA dealers have tended to serve higher-wealth clients while deposit-taker/insurer owned firms have tended to serve all client types.[47] Deposit-taker/insurer owned dealers had traditionally focused on clients with investable assets up to $250,000 but have increasingly focused on more affluent clients. Typically, mass-market clients will be serviced by front line representatives at the branch, while those with investable assets above $100,000 will be serviced by 'financial planners'[48] at the branch. Clients with assets above $1 million or more will typically be referred to the related IIROC dealer or the related private wealth management arm for service.

For independent/other MFDA firms, typically they will not take on clients unless they have at least $100,000 in investable assets. This information, coupled with our analysis of the Ipsos data, suggests that the majority of households (particularly mass-market households) will be working with a deposit-taker or insurer owned MFDA dealer.

[46] Similar to the Ipsos analysis, "Other" MFDA firms refer to dealers that are owned by non-deposit-taker and non-insurer asset managers. We group Independent and Other firms together here as this is typically what commentators refer to as 'independent' fund distributors.

[47] Information in this section comes from Investor Economics *Retail Brokerage Reports* as well as OSC review of mutual fund dealers.

[48] Financial planners within the branch will typically have attained a financial planning qualification such as the Personal Financial Planner (PFP) designation through the Canadian Securities Institute, the Certified Financial Planner (CFP) designation through the Financial Planning Standards Council or the *Institut québécois de la planification financière*.

The majority of assets in the MFDA channel today are administered by dealers that focus on proprietary funds

Given that the majority of integrated mutual fund dealer firms limit their product shelf primarily to proprietary products[49], this restriction also implies that the majority of mass-market households are primarily sold proprietary products. At the end of 2015, 69% of assets in the MFDA channel were held at dealers that focused primarily on proprietary products.

The majority of investment fund owning mass-market households are working with representatives that are not compensated by commissions

For many integrated fund dealers and in particular for the deposit-taker owned fund dealers, compensation for the representative is not derived from commissions but rather through non-activity based transfer payments from affiliated corporate entities.[50] Given that deposit-taker owned fund dealers administered 60% of the assets and employed 64% of approved persons in the channel at the end of 2015 and that these firms tend to service the majority of households with modest levels of investable assets, the majority of mass-market investors today are working with representatives that are not compensated via embedded commissions.

ii. IIROC Channel

95% of retail assets in the IIROC channel are administered by integrated firms

Table 10: IIROC member assets and approved persons by dealer type

IIROC Member Type*	# Members	% of Total	Assets Under Admin $B	% of Total	# Approved Persons	% of Total
Independent	**46**	**45%**	**90**	**5%**	**2,895**	**11%**
Integrated	**56**	**55%**	**1,878**	**95%**	**22,383**	**89%**
Of which,						
Deposit-taker	*14*	*14%*	*1,515*	*77%*	*15,291*	*60%*
Insurer	*4*	*4%*	*33*	*2%*	*1,361*	*5%*
Other	*36*	*35%*	*306*	*16%*	*5,198*	*21%*
Association	*2*	*2%*	*24*	*1%*	*533*	*2%*
Of which,						
Proprietary Only	*8*	*8%*	*6*	*0.3%*	*126*	*0.5%*
Proprietary and Third Party	*48*	*47%*	*1,872*	*95%*	*22,257*	*88%*
Total	**102**	**100%**	**1,968**	**100%**	**25,278**	**100%**

Source: Investment Industry Regulatory Organization of Canada at December 2015, OSC categorizations

*Note: Only IIROC members categorized as Retail, Managed Account, Integrated and Discount Broker are included. Total assets for each firm include both retail and institutional client assets.

[49] MFDA dealers with 80% or more of their mutual fund assets held in funds managed by an affiliate were considered proprietary only.

[50] See the discussion in MFDA Bulletin #0689-P, supra note 24 for an explanation.

The IIROC channel also has a wide range of both integrated and independent dealers. At the end of 2015, integrated IIROC firms administered 95% of assets[51] and employed 89% of approved persons in the channel. Independent dealers – when one includes the 'other integrated' dealer category, made up 80% of firms, administered 20% of assets and employed 32% of approved persons at the end of 2015. Deposit-taker and insurer owned dealers, while only making up 18% of firms, administered 79% of assets and employed 66% of approved persons.

The IIROC channel is almost entirely "open shelf" today

While slightly less concentrated among integrated dealers than the MFDA channel (where independent and other integrated firms administered 10% of assets) the IIROC channel is still dominated by the deposit-taker owned dealers. Where the two channels differ is with respect to the level of related party product distribution. While the deposit-taker and insurer owned MFDA firms primarily distribute proprietary funds, their counterparts in the IIROC channel are primarily open shelf largely due to the types of representatives employed in this channel. Almost 100% of integrated IIROC firms offer proprietary and third party products. IIROC representatives also have more flexibility and are able to offer a wider variety of security types. Therefore, IIROC representatives tend to be more independent than their MFDA counterparts, even if they are working for a firm that offers their own mutual funds, making them and the whole channel less focused on the sale of proprietary products including proprietary funds.[52]

Deposit-taker-owned IIROC dealers also tend to differ in their methods of compensating representatives relative to their mutual fund dealer peers owned by deposit-takers. Representatives employed by deposit-taker owned IIROC dealers tend to be compensated via commission grid while their counterparts at deposit-taker owned MFDA dealers are typically compensated via salary plus a performance bonus which may impact the way in which the firm can incent behavior in the two channels.

IIROC representatives also tend to be more selective regarding their clientele. IIROC dealers typically aim to service households with investable assets of $500,000 or more, although some IIROC dealers will service clients with lower investable assets.[53] This fact, coupled with what we have highlighted from the Ipsos data, suggests that the potential market for the IIROC channel is roughly 6% to 14% of households. These households are typically the wealthiest

[51] IIROC representatives may deal in a wider range of securities compared to dealer representatives in the MFDA channel, thus assets here will include not only mutual funds but also equities, fixed income, ETFs and in some cases options and other derivatives.

[52] Information in this section comes from Investor Economics and the CSA review of advisor compensation practices. See for example, the following main stories from Investor Economics, *Retail Brokerage and Distribution Advisory Service*: "Investment fund attraction still strong in full-service brokerage channel," Spring 2011; "Accessing today's and tomorrow's distribution paradigm," Spring 2012; "Profitability Update: Gauging the Changing Influence of Revenue Costs and Compensation on the Industry's Bottom Line," Summer 2012; "Branch Advice: Managing Growth and Success into the Future," Fall 2012; "Mutual Funds in Full-service Brokerage—Either Ride the Fee-based Wave or Be Pulled Under by It!," Summer 2016.

[53] Investor Economics, *Retail Brokerage Report*, Winter 2012.

households in Canada which is one of the reasons why retail assets under administration in this channel are over three times the size of assets in the MFDA channel. The IIROC channel administers more assets but services fewer households than the MFDA channel.

Table 11: Combined MFDA and IIROC member assets and approved persons by dealer type

Total MFDA and IIROC	# Members	% of Total	Assets Under Admin $B	% of Total	# Approved Persons	% of Total
Independent	**106**	**53%**	**119.6**	**5%**	**6,294**	**6%**
Integrated	**95**	**47%**	**2,430.6**	**95%**	**100,353**	**94%**
Of which,						
Deposit-taker	*29*	*14%*	*1,864.1*	*73%*	*67,458*	*63%*
Insurer	*14*	*7%*	*209.7*	*8%*	*25,254*	*24%*
Other	*48*	*24%*	*331.3*	*13%*	*7,079*	*7%*
Association	*4*	*2.0%*	*25.6*	*1.0%*	*562*	*0.5%*
Of which,						
Proprietary Only	*28*	*14%*	*408.9*	*16%*	*54,584*	*51%*
Proprietary and Third Party	*67*	*33%*	*2,021.8*	*79%*	*45,769*	*43%*
Total	**201**	**100%**	**2,550.3**	**100%**	**106,647**	**100%**

Sources: Mutual Fund Dealers Association at December 2015, OSC categorizations
Investment Industry Regulatory Organization of Canada at December 2015, OSC categorizations
*Note: Only IIROC members categorized as Retail, Managed Account, Integrated and Discount Broker are included. Total assets for each firm include both retail and institutional client assets.

We can see that in total, 95% of the assets under administration in Canada are administered by integrated firms. 16% of these assets are administered by dealers that primarily offer proprietary products. As explained above, dealers that only offer proprietary products are concentrated in the MFDA channel. Deposit-taker and insurer owned dealer firms administered 81% of the assets and employed 87% of approved persons. We also note that, at the end of 2015, there were 106,647 registered representatives just in the MFDA and IIROC channels alone[54] servicing a total population of 35.8 million Canadians. This equates to one representative for every 336 Canadians.

By way of comparison, in 2011, the year before the Retail Distribution Review (**RDR**) reforms were implemented in the United Kingdom (see Appendix C for an overview of the RDR reforms), there were 40,566 advisers registered[55] servicing a total population of 63 million (one advisor for 1,553 people) and only 21% of these advisers were employed by a bank or building society.[56]

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[54] This does not include portfolio manager and exempt market dealer registrants, although it is fair to say that this number would cover retail securities advice. Note that we have also not included those registered to sell insurance.

[55] Association of Professional Financial Advisers, *The Financial Adviser Market: In Numbers*, 2015, page 5, http://www.apfa.net/documents/publications/financial-adviser-market/apfa-the-financial-adviser-market-in-numbers-v4.0.pdf.

[56] If Canada was to see the same post-ban decline that was experienced in the U.K. - a 23% decline, 3 years after the ban - we would still have a representative coverage rate close to four times the rate per capita in the U.K pre-RDR.

This comparison suggests that Canadian investors currently have access to a relatively large number of representatives, particularly in the deposit-taker owned channel. 63% of the representatives were employed by a deposit-taker owned dealer and a further 24% were employed by an insurer owned dealer.

It also suggests that the distribution landscape in Canada is relatively more concentrated and vertically integrated than is the distribution landscape in the United Kingdom.[57]

In the next section, we take a closer look at the online/discount brokerage channel – the non-advised market for funds.

iii. Online/Discount Brokerage Channel

Table 12: Online/discount brokerage assets under administration

Online/Discount Brokerage Channel

$Millions	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015
Investment Fund Assets held in Online/Discount Brokerage	38,706	42,607	47,398	55,109	56,516
Total Online/Discount Brokerage Assets under Administration	231,560	254,480	292,606	324,665	330,448
Investment Fund % Share	17%	17%	16%	17%	17%

Source: Investor Economics

The online/discount brokerage channel shows a lower use of investment funds relative to other channels. As shown in Table 12 above, investment funds' share of total assets in the online/discount brokerage channel has been constant over the last five years, remaining at approximately 17% of channel assets over that period. In contrast, investment funds' share of assets in the financial planner/advisor and branch delivery channels stood at 78% and 33% respectively of channel assets at December 2015.[58] In total, there was $330 billion held by do-it-yourself (**DIY**) investors in the online/discount brokerage channel at December 2015.

ETFs have become more popular over time with DIY investors

Table 13: Investment funds in the online/discount brokerage channel

Online/Discount Brokerage Investment Funds

$Millions	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015
Mutual Funds	26,059	26,083	27,893	29,792	30,227
Exchange Traded Funds (ETF)	12,647	16,524	19,505	25,317	26,289
Investment Funds Total	**38,706**	**42,607**	**47,398**	**55,109**	**56,516**
ETF % Share	33%	39%	41%	46%	47%

Source: Investor Economics

[57] For example, at 2012, before RDR was introduced, bank and insurer owned advisory firms serviced only 41% of advised individuals. See, Deloitte, *Bridging the advice gap: Developing investment products in a post-RDR world* (2012), https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-rdr-bridging-the-advice-gap.pdf.

[58] Investor Economics, 2016 Household Balance Sheet, page 141.

ETFs have always been popular with DIY investors and they have become more popular over time. While the share of investment funds held within the online/discount brokerage channel has remained steady, DIY investors' preference between mutual funds and ETFs has moved in favour of ETFs over time. At December 2015, DIY investors held $30 billion in mutual funds and $26 billion in ETFs. ETF assets owned by DIY investors have more than doubled since December 2011 and as a share of total assets in the online/discount brokerage channel, ETFs increased from 33% to 47% over the period.

Canadian ETF managers must compete with their U.S. domiciled peers while Canadian mutual fund managers do not

Table 14: ETFs held in the online/discount brokerage channel

Online/Discount Brokerage Exchange Traded Funds (ETF)

$Millions	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015
ETFs Canadian Domiciled - Common Share Class	9,459	12,474	13,947	17,897	18,695
ETFs Canadian Domiciled - Advisor Share Class	42	58	61	75	67
ETFs Foreign Domiciled (U.S.)	3,146	3,991	5,497	7,345	7,527
ETFs Total	**12,647**	**16,524**	**19,505**	**25,317**	**26,289**
% Passive	97%	95%	94%	94%	92%
% Foreign Domiciled	25%	24%	28%	29%	29%

Source: Investor Economics

Unlike investment fund managers of conventional mutual funds in Canada, investment fund managers of ETFs in Canada must compete both within the Canadian market and compete with ETFs domiciled in other markets, primarily the U.S. market.[59]

DIY fund investors buy both Canadian domiciled and U.S. domiciled ETFs. At December 2015, Canadian DIY investors held $19 billion in Canadian domiciled ETFs and $8 billion in U.S. domiciled ETFs – fully 29 cents of every dollar invested in ETFs by DIY investors is invested in U.S. domiciled ETFs.

ETFs held in the online/discount brokerage channel are overwhelmingly passively managed

In contrast to the conventional mutual fund space, passively managed funds make up the largest share of assets. At December 2015, passively managed ETFs made up 87% of the Canadian domiciled ETF market. This preference for passively managed products is even more prevalent for Canadian DIY investors investing in ETFs. At December 2015, 92% of ETF assets were held in passively managed ETFs although that market share has declined over the last five years as more actively managed ETFs have entered the market.

[59] In many cases, these investment fund managers may be competing with their own products in these other markets.

The majority of DIY investors investing in mutual funds pay full trailing commission despite not receiving advice

Table 15: Do-it-yourself mutual funds

Low Cost/Discount Brokerage Fund Series (Series D)

$Millions		Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015
Mutual Funds (Series D)	Total	10,746	10,705	10,752	11,961	11,957
	% Passive	6%	9%	12%	14%	16%

Estimated amount of Series D in the Online/Discount Brokerage at the end of 2015 - 4.6 Billion
Source: Investor Economics

If we look more closely at the types of mutual fund series sold through the online/discount brokerage channel, we see that the majority of fund series sold are the full trailing commission fund series despite the increased availability of Discount/DIY fund series (typically denoted "D" series) [60] in the market. Consequently, many DIY mutual fund investors in the online/discount brokerage channel indirectly pay for services they do not receive.

Assets held in the Discount/DIY mutual fund series are however slowly increasing. These assets totaled $12 billion at December 2015 up from $11 billion in December 2011, although by the most recent estimate, the majority of these assets were not held in the online/discount brokerage channel. At the end of 2015, it is estimated that out of the total $12 billion of Discount/DIY fund series assets, only $4.6 billion was actually held in the online/discount brokerage channel.[61] This data suggests that $25 billion of the total $30 billion held in mutual funds in the channel (83%) remains in the full trailing commission paying fund series.

As is the case for many DIY mutual fund investors in the online/discount brokerage channel, there are also some DIY ETF investors that indirectly pay trailing commissions without receiving advice because they hold the trailing commission paying "Advisor" class units of the ETF.[62] However, the amount of assets held in these "Advisor" class units is relatively low (only

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[60] Some investment fund managers offer a series (typically Series D) of their funds that is designed for Discount/DIY investors. These fund series pay a much lower trailing commission than do the traditional full service retail series (typically 25 bps compared to 100 bps for the traditional full service retail series of an equity fund) to account for the fact that no advice is provided to investors in the online/discount brokerage channel. This is further discussed in Appendix A.

[61] Investor Economics estimate. The remaining $7.4 billion of DIY series assets was purchased directly by investors outside of the online/discount brokerage channel.

[62] Advisor class units that are offered by some ETF providers are designed for advised investors and are meant to be purchased through an advisor. The only difference between this class of units and the common class units is the trailing commission component (or alternatively denoted the "service fee" component) embedded in the management fee of the Advisor class.

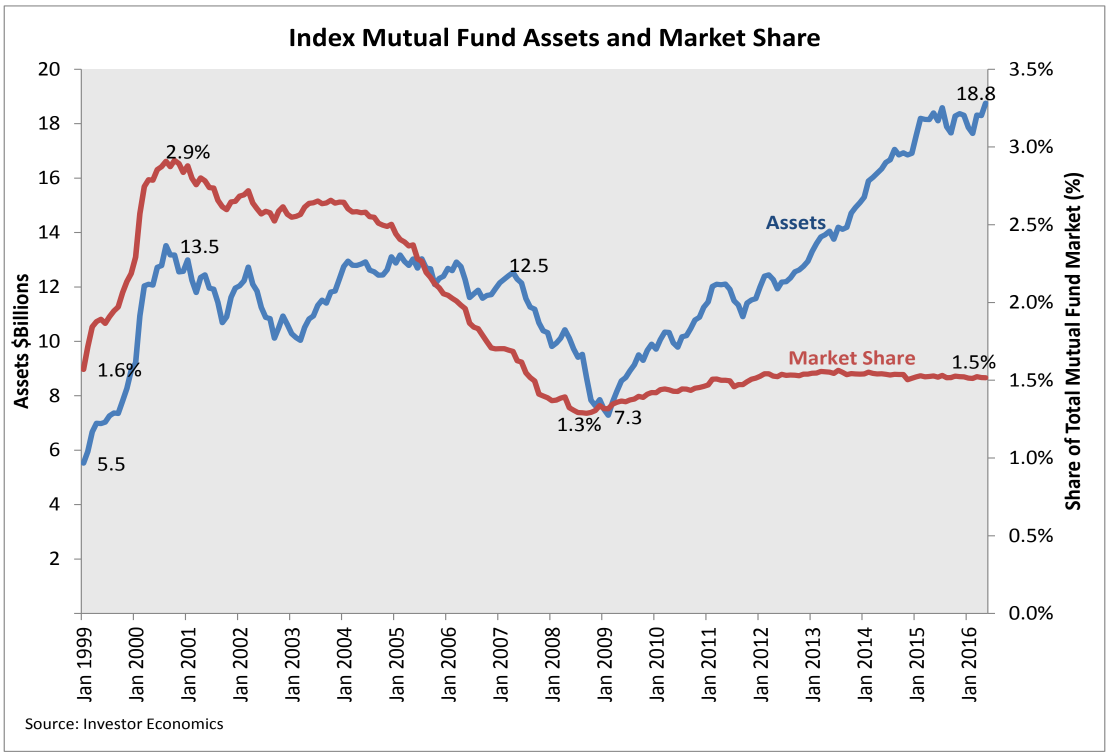
We do not know if these holdings of Advisor class units in the online/discount brokerage channel are a consequence of previously advised assets transferring in or are due to investor error. However, we note that some discount brokerages do make Advisor class units available for trade on their platforms.

$67 million at December 2015) in comparison to the share of full trailing commission paying mutual funds in the online/discount brokerage channel.

Finally, we note that unadvised fund investors as a group (those buying Discount/DIY fund series) have a higher share of assets invested in passively managed mutual funds relative to advised mutual fund investors.

At the end of 2015, 1.5% of total mutual fund assets (excluding ETFs) were held in passively managed funds. Index fund market share has remained essentially unchanged over the last 10 years. However among the relatively new Discount/DIY fund series, index funds made up a much larger share of assets (16% or $2 billion) that has been growing steadily over time.[63]

Figure 4: Index mutual funds in Canada



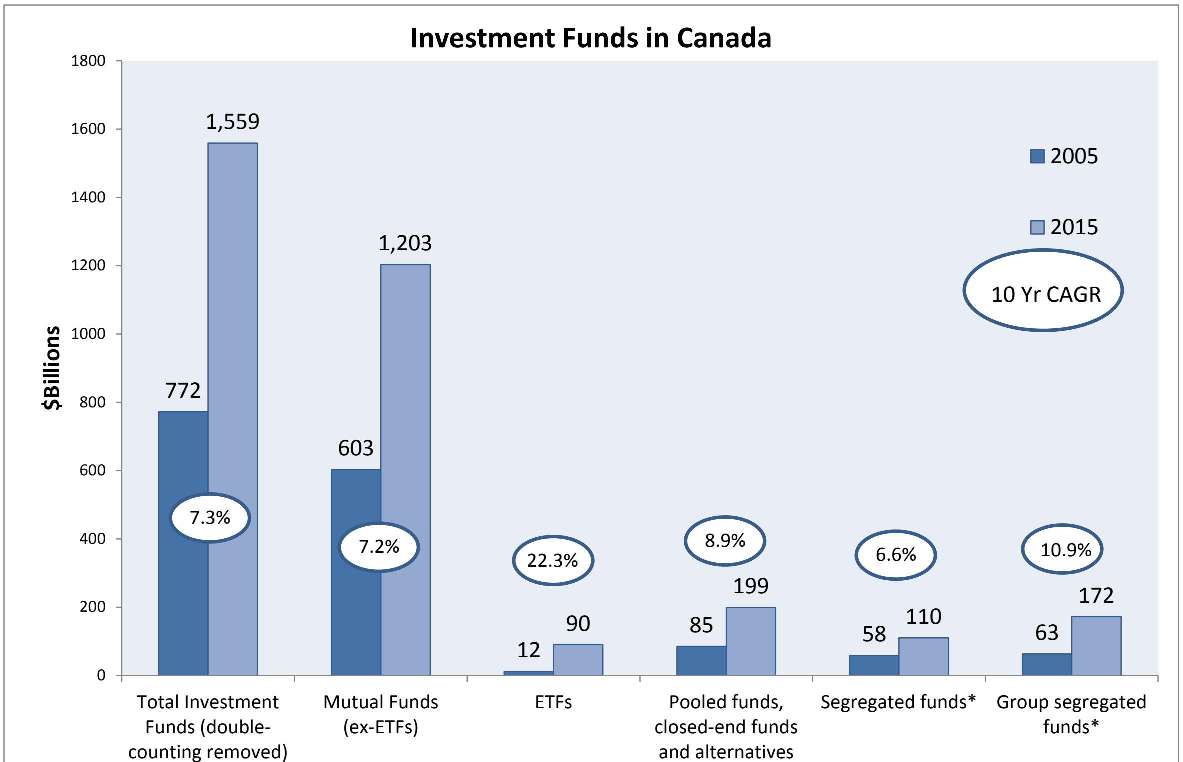
We now turn our attention to some important facts about investment fund managers.

[63] Some have argued that while index mutual fund ownership among advised investors is perennially low in Canada, index fund usage by Canadians is substantially higher when one includes the index-tracking ETFs held by Canadians. In fact, within the full service brokerage channel, of the $47 billion in ETFs held in this channel only $17 billion was held by clients of commission-based advisors (not all of which was held in index tracking ETFs). The remaining $29 billion was held by clients of fee-based advisors. Source: Investor Economics ETF and Index Fund Report 2016 Q2.

c. Investment Fund Management

Mutual funds are by far the dominant type of investment fund sold in Canada today. This has been the case since organized investment fund asset monitoring in Canada started in the early 1990s. At the end of 2015, Canadians held $1.2 trillion in mutual fund assets, $90 billion in ETF assets, $110 billion in segregated fund[64] assets, $172 billion in group segregated fund assets, and $199 billion in pooled fund, closed end funds and alternative fund assets. Although there have been articles at various times in the past regarding the growth of ETFs and segregated funds, and despite impressive annual growth rates for ETFs, the dominance of mutual funds has never been challenged in a significant way. [65]

Figure 5: Investment funds by fund type



Source: 2016 Investor Economics Household Balance Sheet
*Segregated funds and group segregated funds are not securities and therefore are not governed by securities law
Note: Fund assets do not sum to total due to fund wrapping.

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[64] Segregated Fund - a separate and distinct group of assets (fund) maintained by an insurer in respect of which the non-guaranteed benefits of a variable insurance contract are provided. Source: Canadian Life and Health Insurance Association (CLHIA) Guideline G2 – Individual Variable Insurance Contracts Relating to Segregated Funds; Autorité des marchés financiers, Guideline on Individual Variable Insurance Contracts relating to Segregated Funds, January 2011.

[65] See for example, Rob Carrick, "Segregated funds on the rise: Seven key things you need to know", *Globe and Mail*, May 29, 2015.

Fund management is concentrated but is less concentrated than fund distribution

Table 16: Mutual funds by investment fund manager type

IFM Type	AUM $M	% of Total	#IFMs	% of Total
Independent	**288,619**	**22%**	**61**	**58%**
Integrated	**1,010,263**	**78%**	**44**	**42%**
Of which,				
Deposit-taker	*625,598*	*48%*	*13*	*12%*
Insurer	*199,712*	*15%*	*9*	*9%*
Other	*150,065*	*12%*	*15*	*14%*
Association	*34,888*	*3%*	*7*	*7%*
Total	**1,298,882**	**100%**	**105**	**100%**

Source: Investor Economics, SEDAR, SEC Filings at December 2015. OSC Categorizations

Similar to what we found with the Ipsos, Investor Economics, IIROC and MFDA data, the investment fund manager market in Canada is dominated by the deposit-taker and insurer owned fund managers. At the end of 2015, integrated investment fund managers[66] made up 42% of the firms but managed 78% of mutual fund assets. Deposit-taker and insurer owned investment fund managers managed 64% of the mutual fund assets. We also note that 73% of all mutual fund assets were managed by the 10 largest investment fund managers in Canada.[67]

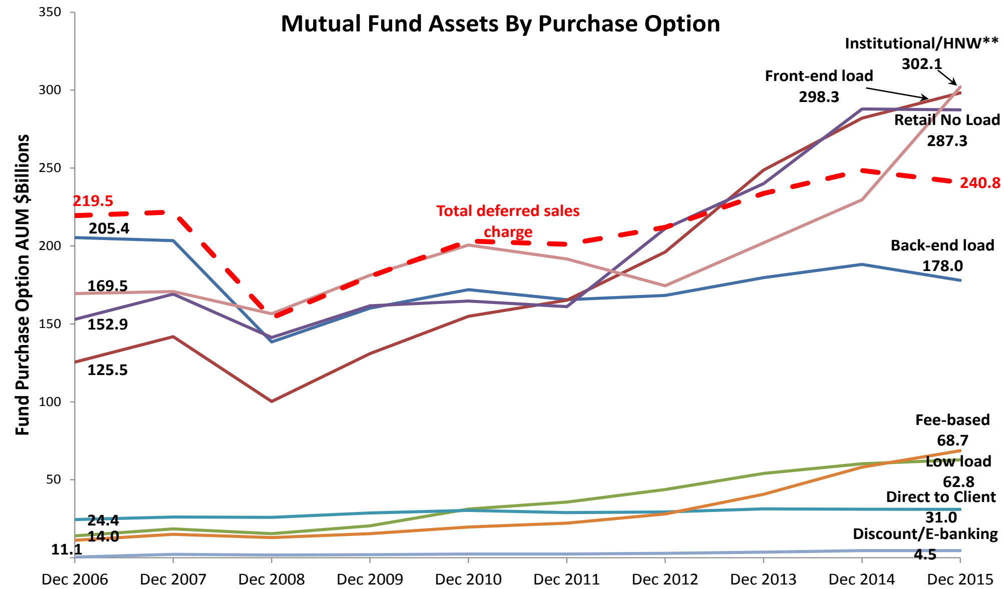
While asset management is concentrated among the deposit-taker and insurer owned investment fund managers, it is relatively less concentrated than distribution where deposit-taker and insurer owned dealer firms administered 81% of assets in the combined IIROC and MFDA channel. Using the traditional definition of independent investment fund manager which would encompass both 'Independent' and 'Other Integrated' investment fund managers, these firms managed 34% of industry assets.

[66] An "integrated investment fund manager" is an investment fund manager that is affiliated with at least one dealer.

[67] Sources: *Investor Economics Insight*, January 2016 Annual Review; SEDAR; SEC filings at December 2015; OSC calculations.

d. Fund Purchase Option Popularity

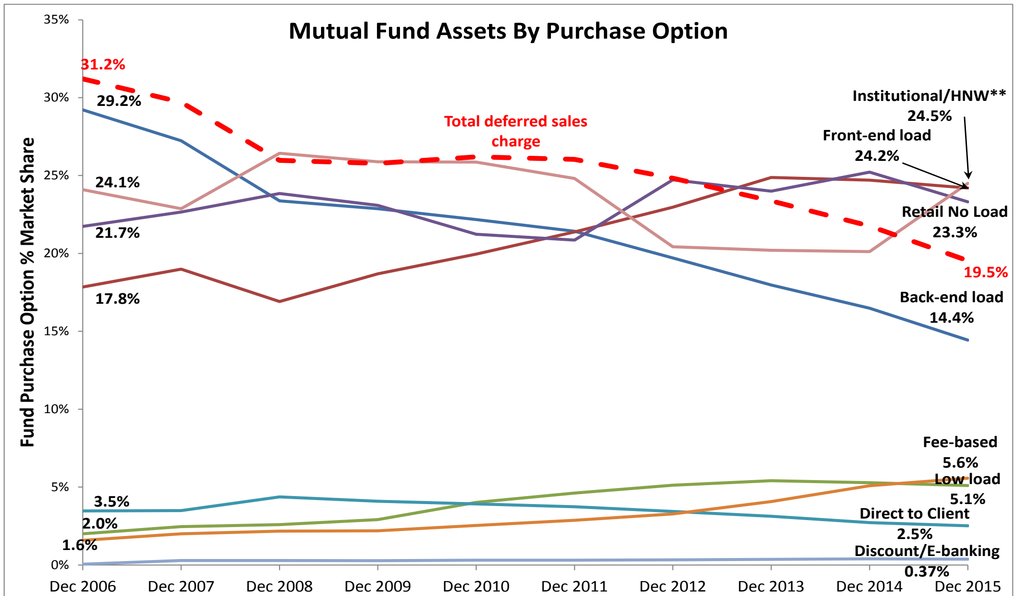
Figure 6: Mutual fund assets (ex-ETFs) by fund purchase option



Source: Investor Economics (various surveys)
Load assets estimated from survey data collected from 19 fund companies representing 76% of industry assets
**This category is reported as a residual to remove double-counting of the assets used in fund-of-fund products. Due to data constraints, assets held by high net worth investors cannot be broken out from assets held by true institutional investors.

25% of mutual fund assets (net of wrapping) are held in institutional/high net worth series

Figure 7: Mutual fund market share (ex-ETFs) by purchase option



Source: Investor Economics (various surveys)
Load assets estimated from survey data collected from 19 fund companies representing 76% of industry assets
**This category is reported as a residual to remove double-counting of the assets used in fund-of-fund products. Due to data constraints, assets held by high net worth investors cannot be broken out from assets held by true institutional investors.

We update fund assets by purchase option, a graph included in the Original Consultation Paper, to show how fund purchase options have changed over the last few years.[68]

In terms of the types of fund purchase options available in the industry today, the institutional/high net worth (**HNW**) purchase option, which typically does not pay trailing commissions, made up the largest share of fund assets totaling $302 billion or 25% of market at December 2015. HNW fund series assets have grown by 51% over the last five years.

The majority of mutual fund assets are still held in traditional fund series that include embedded commissions

The front end purchase option[69]was the second largest purchase option by assets with $298 billion or 24% of market at the end of 2015, growing 93% over the previous five years.

The retail no load purchase option – the option commonly offered within the branch network and through some vertically integrated fund managers – was the third largest purchase option by assets at $287 billion at December 2015, making up 23% of the market and growing 70% over the last five years.

The back-end load and low-load purchase options, which are both a form of DSC purchase option, remained a large component of industry assets at the end of 2015. Though DSC options have been falling in terms of market share, assets in these series continue to grow.[70] In total, $241 billion was held in DSC options at the end of 2015, and these options grew 19% over the last five years (largely due to the growth of low load fund series assets which grew 101% over the last five years versus 3% for traditional back-end load series).[71]

It is still the case that trailing commission paying fund series make up the bulk of mutual fund assets in Canada. At the end of 2015, trailing commission paying purchase options – back-end, low load, front end, and retail no load – made up 67% of assets and increased by 58% over the five years ending 2015.

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[68] CSA Discussion Paper and Request for Comment 81-407 *Mutual fund fees*, (2012), 35 OSCB, page 11248.

[69] Although there are reports that many front end load funds are sold with 0% commissions, this is based on surveys of investment fund managers rather than fund distributors. We still see many front end fund sales with commissions in the market today. We would expect front-end sales commissions to continue to be charged in order to reflect factors such as differences in the scope and timing of advice and services provided, and the experience and skill level of the advisor, etc.

[70] The decline in market share also masks its importance to certain investment fund managers and fund dealers where DSC share of firm assets can be as high as 80% or more.

[71] The Canadian fund market is unique in its relative reliance on DSC and low load options. While making up 20% of mutual fund assets in Canada today, these options make up less than 1% of mutual fund assets in the United States and Europe.

A small, but fast growing, share of mutual fund assets are held in fee-based purchase options

Fee-based purchase options remain a very small part of the mutual fund market, but they are growing quickly. Fee-based fund series made up only $69 billion or 6% of industry assets at the end of 2015. However, fee-based assets had the highest rate of increase over the five years ending 2015, increasing by 248%.

Fee-based options, while growing quickly, remain a small part of the mutual fund market as these purchase options are not available to all investors in all channels.

Not all purchase options are available to all investors in all channels

Given the number of series and purchase options available in the market, it may seem that investors are provided a wide range of purchase options.[72] However, not all (or in some cases not many) purchase options are made available to all investors in all channels.

Figure 8 below lays out the availability of fund purchase options in Canada using the information previously discussed regarding the MFDA and IIROC channels and data from Investor Economics, Morningstar, and Ipsos. Availability of products and purchase options tend to vary by the level of investable assets, by distribution channel, and by distributor type.

Mass-market households will typically choose between the purchase of proprietary funds with advice[73] or the full universe of fund products (and securities generally) with no advice, and may have limited access to certain other purchase options, such as fee-based options.

Dealers that offer an open shelf of fund products typically service investors with $100,000 or more in investable assets. Investors that do not want proprietary funds may have to forgo advice and purchase through a DIY channel. As previously discussed, despite the availability of Discount/DIY purchase options, the majority of online/discount brokerage channel purchase options will be sold under the no load or front end (with front end commission waived) options with the same rate of trailing commission paid as the fully advised channel.

Fee-based purchase options are typically not available for mass-market households. In terms of the purchase options available to mass-market households, all purchase options (no load, DSC purchase options and front end load) *except* for fee-based options are generally available. If the fund investor is investing through a deposit-taker owned mutual fund dealer, the investor will typically be offered a no load purchase option. If the investor is working with an insurer owned mutual fund dealer, the investor will typically be offered front end, no load and DSC purchase options. Fund investors with little to invest are the most likely to be offered DSC purchase

[72] See page 1 of Investment Funds Institute of Canada, *Paying for Advice: Why Options are Important*, August 2014 for example.

[73] We note that there tends to be more variation with respect to the use of proprietary products across insurer owned fund dealers relative to deposit-taker owned fund dealers, with some offering primarily proprietary products and others offering a wider universe of both proprietary and non-proprietary products. However, it is not clear that insurer owned fund dealers offering a wider universe of products target mass-market households.

options and some firms primarily offer their clients DSC options.[74] The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and the representative's revenue requirements.

Fund investors typically gain access to advice and a wider range of product options as their investable assets increase. For mid-market households, those with investable assets between $100,000 and $500,000, there will be a wider range of products and types of advisor available. These investors can choose to invest through a deposit-taker owned or insurer owned mutual fund dealer focused on proprietary products or an independent mutual fund dealer offering the full universe of fund products.[75] They will also be able to invest in a wider range of investment fund and non-investment fund securities through an IIROC dealer.

Fee-based purchase options have historically been limited for mid-market households, although access to these options has begun to increase recently.[76] When purchasing through a deposit-taker owned mutual fund dealer, mid-market households will typically be offered a no load option. When purchasing through other mutual fund dealers or through independent IIROC dealers, mid-market households will typically be offered front end, no load and DSC options.

These investors also have the option of foregoing advice and choosing to purchase their funds directly without trailing commissions through direct-to-client purchase options[77] offered by some investment fund managers.

Those with large amounts of investable assets get access to advice, product options and a broader choice in purchase options. Affluent households, those with investable assets above $500,000, have access to all purchase options, product options and advisory options available in the market. They can access a fee-based or commission-based advisor who can offer them the universe of fund products (and other securities), or they can choose to work with a traditional commission-based mutual fund dealer (who may also be a financial planner). Investors with $1 million or more in investable assets can also work with a deposit-taker owned portfolio manager and those

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[74] We note that one of the largest integrated firms in Canada recently announced that they will discontinue offering the DSC option. See Rudy Luukko, "Investors Group will eliminate deferred sales charge option", *Morningstar Canada*, September 19, 2016. We estimate that, based on assets at December 2015, this change will impact 25% of total assets held in the DSC option.

[75] Although open shelf fund dealers can offer the full universe of fund products, they will typically focus on a subset of funds from a smaller list of preferred fund families. See for example, the 2015 Environics Advisor Perception Study (http://environicsresearch.com/wp-content/uploads/2016/02/Infographic-E_FINAL.pdf).

[76] See for example, Rudy Mezzetta, "Credential introduces fee-based product for mutual fund advisors", *Investment Executive*, January 26, 2016, and Rudy Luukko, "Investors Group eases into fee-based investing", *Morningstar Canada*, November 22, 2016. We also note that other deposit-takers have recently been slowly rolling out fee-based options within their branch networks.

[77] Purchase options that are offered by an investment fund manager that sells investment funds directly to investors through a related mutual fund dealer via online or telephone access.

with investable assets above $500,000 can work with an independent portfolio manager firm directly, typically through a fee-based arrangement.[78]

We have provided data and our analysis of the mutual fund and securities market in Canada today. In the next section, we look at the anticipated effects if we transition away from embedded commissions.

[78] We note that the number of households working directly with portfolio managers is relatively low (i.e. below 200,000 households or less than 1% of all households). These firms also vary considerably in their usage of investment funds.

Figure 8
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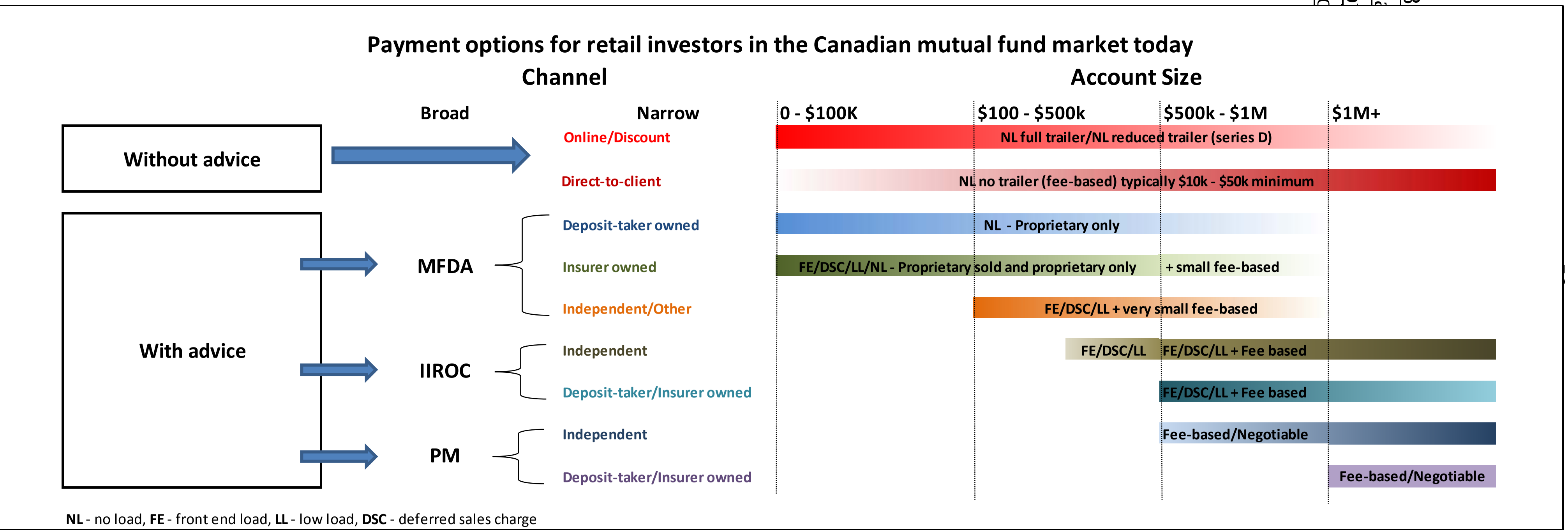
options b
and acco



#5323652

2. ***Overall market impact of the discontinuation of embedded commissions***

For the discussion that follows, unless otherwise indicated, we assume that the market has transitioned away from embedded commissions and that current details about the market hold.

We also assume that the requirements in CRM2 and POS are fully implemented, and where applicable, we discuss the implication of potential intersections between the discontinuation of embedded commissions and the proposals set out in CSA CP 33-404.

i. Reduction in fund series and in fund fee complexity:

We anticipate that the number of fund series available in Canada would significantly decline as a result of a transition away from embedded compensation. As also discussed in Appendix A, this effect is expected because the vast majority of fund series available in the market today differ only by the level and type of embedded compensation paid to the dealer.[79] The transition away from embedded commissions would make these series redundant given the embedded commission free fund series (i.e. series F and high net worth fund series) that are already available today.

Based on figures from Morningstar Direct at February 2016, if we were to eliminate the fund series that include some form of embedded compensation from the market today, the total number of fund series would fall from 13,899 to 4,901 – a 65% decline. This would significantly simplify fund fee structures which are currently very complex and difficult for investors to understand, as shown in Part 2. Fund series that remain would be larger on average after the change. For example, using total industry assets at December 2015 ($1.2 trillion) and the number of fund series that we estimate would remain after the discontinuation of embedded commissions if it were to take immediate effect today (4,901), average assets per fund series would rise from $86.6 million to $245.5 million – a 184% increase. We anticipate that this impact alone could drive down fund costs.[80]

[79] In addition to the number of fund series available, some fund series are available for purchase under more than one purchase option (e.g. back end, low load, front end purchase options available within one fund series). Taking into account available purchase options, there were 39,848 unique mutual fund series/purchase option combinations available in Canada (source: FundSERV - mutual fund and fund wrap products) at the end of June 2016 and a total of $1.3 trillion ($999 billion USD) invested in mutual funds (source: Investor Economics) at the end of June 2016. In contrast, there were 32,555 unique fund series/purchase option combinations available in the United States (source: Morningstar Direct) at the end of June 2016 and a total of $15.9 trillion invested in mutual funds (source: Investment Company Institute) at the end of June 2016.

[80] We also note that in some cases, investment fund managers today charge management fees on their series F that are less than the management fees net of trailing commission for their retail – trailing commission paying - series. If this pricing differential were to persist after the discontinuation of embedded commissions, then we would also expect to see a decline in fees from this as well. We also note that some investment fund managers, recognizing the extent of the complexity and confusion in the market, have already begun to rationalize their series offerings in order to simplify the cost structures for advisors and investors and to reduce price discrimination (see for example R. Luukko, "RBC flexes its muscle on fund fees", *Morningstar Canada*, February 29, 2016; J. Hemeon, "TDAM lowers management fees on certain funds series", *Investment Executive*, November 22, 2016).

Accompanying the simplification and standardization of fund series would be a simplification of, and amendments to, fund disclosure documents (fund facts, simplified prospectus, management report of fund performance, etc.). We do not anticipate significant cost implications arising from these amendments to fund disclosure documents.[81] Rather, we anticipate that any costs incurred would be offset by significantly lower ongoing fund series maintenance costs (in terms of both disclosure documents and marketing materials).

We do not anticipate that any switches between series of the same fund that may occur as a consequence of the simplification of fund series would have any financial or tax implications for fund investors because, as is the case today for switches between fund series of the same fund, these switches would not be considered a deemed disposition for tax purposes.

We do anticipate that, as is the case today with switches between series of the same fund, this activity will generate many in-kind transactions or book adjustments on client account statements that may require a conversation between the advisor and client to explain the occurrence or may be accompanied by a notice from the investment fund manager and/or fund dealer. Each would entail one-time costs.[82]

ii. *New lower-cost product providers may enter the market:*

We anticipate that new lower-cost product providers would enter the mutual fund market after a transition away from embedded compensation. Some lower-cost mutual fund providers have expressed to the CSA the view that embedded commissions function as a barrier to market entry.[83] We anticipate that these new product providers would enter the market with a wide range of passively and actively managed mutual funds.

Based on an analysis of low-cost fund product provider pricing in other markets,[84] while taking into account pricing practices specific to Canada (e.g. tax differences such as the HST etc.), the

[81] We anticipate these amendments to include only deletions from current disclosure documents and significant simplification and removal of sections such as the dealer compensation from management fee section, etc. We anticipate that investment fund managers will choose to merge assets into existing, and likely repriced, fund series rather than launch new series.

[82] We anticipate that these costs would be incurred in any case as the representative and client would need to communicate and agree on a direct pay arrangement going forward.

[83] See for example the transcript of OSC Roundtable Re Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees* (June 7, 2013) at p.98 - Question from Commissioner Deborah Leckman to Atul Tiwari, Managing Director/Head of Canada for Vanguard Investments, infra note 201. Other evidence that embedded commissions inhibit competition by creating barrier to entry is provided in Appendix A.

[84] The estimates for low-cost manager pricing come from a cross-sectional regression of non-institutional management fees and MERs controlling for fund size, domicile (U.S., Canada, U.K. Ireland, Australia), product structure (ETF or mutual fund), broad asset class and management type (active or passive). Current fee-based fund series pricing is for the Canadian fund market only. Currently, the average fixed income fund fee-based series MER in Canada is 48 bps for an index tracking fund and 92 bps for an actively managed fund. The average equity fund fee-based series MER in Canada is 77 bps for an index tracking fund and 124 bps for an actively managed fund. All data is sourced from Morningstar Direct at July 2016.

estimates suggest that management expense ratios (**MER**) for index funds offered by these new entrants could be up to 40 bps lower than average index fund costs today. Also, MERs for actively managed funds offered by these new entrants could be up to 75 bps lower than average actively managed fund costs today.

Aside from certain large low-cost product providers, it may be possible for smaller emerging asset managers that have a good track record of risk-adjusted performance to enter the mutual fund market (either through a public fund launch or through a sub-advisory relationship) after the transition away from embedded commissions. Those managers that offer a distinct mandate or a niche style - a comparative advantage – could have a greater chance of success in a post trailing commission world as they would compete on their performance without the trailing commission factor.

iii. Increased price competition / decrease in fund management costs:

Over time, the discontinuation of embedded commissions should curtail the incentive for mutual fund dealers and their representatives to recommend products that give priority to maximizing revenue over the interests of clients. Mutual fund dealers and their representatives are therefore likely to focus more on fund performance and fund fee levels, which in turn will put pressure on investment fund managers to improve their performance and reduce their fees. Investment fund managers with affiliated mutual fund dealers are also likely to be affected by this pricing and performance pressure over time.

The potential entrance of lower-cost product providers will likely increase the competitive pressure to decrease fund management costs even further (if not also distribution costs)[85] over time. We anticipate that the impact of new entrants into the mutual fund market will lead to a decline in the cost of existing funds as incumbent investment fund managers may adjust their pricing to retain market share. Based on the estimates provided above for low-cost provider pricing, we may see an MER decline of 25 to 50 bps for actively managed equity funds and 10 to 25 bps for actively managed fixed income funds shortly after the discontinuation of embedded commissions.[86]

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[85] See for example, Victor Reklaitis, "The Vanguard effect on fund fees, in one handy table", *Market Watch*, November 16, 2015, http://www.marketwatch.com/story/the-vanguard-effect-on-fund-feeds-in-one-handy-table-2015-11-13.

[86] This estimate is based on incumbent investment fund managers reducing their existing fees by one third to two thirds of the difference between their fees and those charged by new low-cost market entrants. Note, as well, that we saw similar price declines after the entrance of low-cost ETF providers into the Canadian market in 2011 and in reaction to competition from U.S. domiciled ETFs which were going through their own pricing war at about the same time. Unlike the mutual fund market, the ETF market in Canada is open to competition from abroad. Canadians routinely purchase U.S. domiciled ETFs. At March 2016, 27 cents of every retail dollar invested in ETFs in Canada was held in a U.S. domiciled ETF.

iv. Shift in product recommendations to lower-cost / passively managed products:

It is reasonable to assume that the transition away from embedded commissions, coupled with the growth of lower-cost passively managed fund products, will also likely drive a shift to lower-cost passively managed funds in terms of the (i) product shelf chosen by dealers, (ii) recommendations made by representatives, and (iii) funds chosen by mutual fund investors over time. However, we are cautious regarding the extent and pace at which this shift would likely occur. As noted earlier and in Appendix A**,** the Canadian mutual fund market (excluding ETFs) is overwhelmingly focused on actively managed funds.[87] While the level of trailing commissions paid historically on index funds relative to actively managed funds was likely a driver of their lack of popularity with fund dealers and representatives, we also acknowledge that it takes time for habits to change.[88] In addition, while there are several investment fund managers that have offered and continue to offer index funds, they have historically not always 'actively' marketed them.[89]

If we consider the experience in the U.K.,[90] they began to see a significant increase in both sales and assets held in index tracking funds several years before the RDR reforms were introduced in January 1, 2013. According to data from the Investment Association, shown in Figure 9 below, index tracking fund ("tracker funds") market share began to significantly increase after 2009.[91] Market share of index tracking funds increased from 6.3% to 12.4% and assets under management increased by 251% (£77 billion) between December 2009 and December 2015.

[87] While the mutual fund industry launches an average of about 200 funds a year, the most recent index fund launch was in 2013.

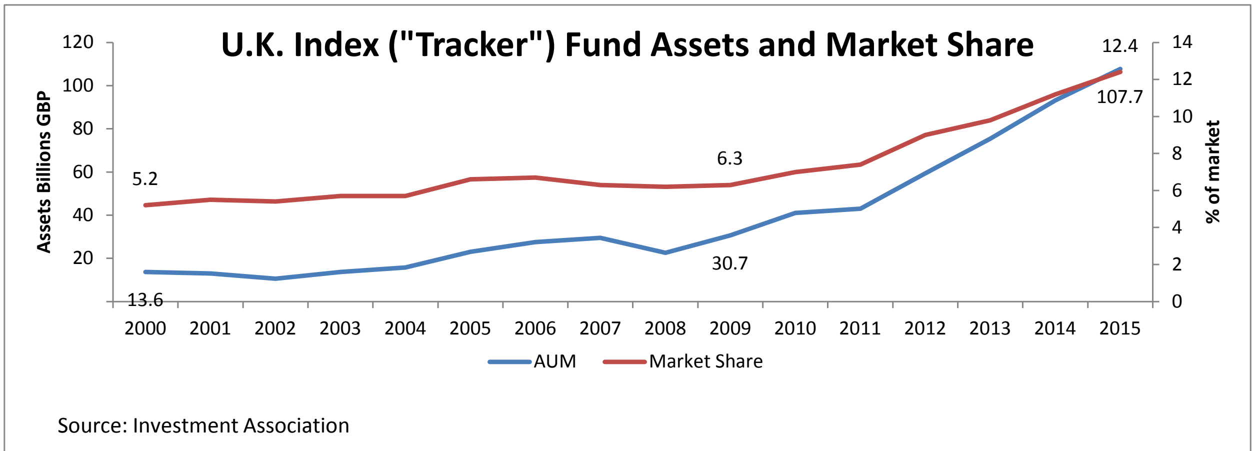
[88] Recent research highlighting the sub-optimality of the investment choices made by financial advisors for their portfolios suggests that established beliefs coupled with a lack of proficiency can be significant obstacles to change (See Juhani T. Linnainmaa, Brian T. Melzer, and Allessandro Previtero, "Costly Financial Advice: Conflicts of Interest or Misguided Beliefs?", December 2015, http://faculty.chicagobooth.edu/juhani.linnainmaa/MisguidedBeliefs.pdf). It's not clear from this research however how much of this product bias might be driven by the dealer's decisions regarding the product shelf. We know that the majority of mutual fund dealers in Canada are either proprietary only or are proprietary focused.

[89] See for example, Rob Carrick, "TD's e-series funds: Easy to love, hard to buy", *Globe and Mail*, May 9, 2011; Dan Bartolotti, "More Fun With the TD e-Series Funds", *Money Sense Magazine Online*, September 23, 2010; Dan Bartolotti, "TD Responds to e-Series Concerns", *Money Sense Magazine Online,* August 20, 2010.

[90] As mentioned in Part 1, while the analysis of relevant reforms in other jurisdiction is informative and insightful, the unique features of those markets, including the characteristics of their respective market participants and the specific competitive dynamics within which they operate, their market structure, the savings habits of their local investors, as well as the extent of their respective reforms, the specific impacts from the reforms in those jurisdictions might not be the same for the Canadian market.

[91] While final rules and guidance for the U.K.'s RDR reforms were released in March 2010, they were announced well before this date which allowed the securities industry to adjust in anticipation of the change (see for example, David Ricketts, "Rapidly evolving online platforms face competition", *Financial Times,* September 7, 2008).

Figure 9: Growth of Tracker Funds in the United Kingdom



If we were to see a similar increase in the run up to the discontinuation of embedded commissions in Canada, we would expect index fund market share to increase from their current share of 1.5% of market today ($18.8 billion[92]) to between 5% and 10% of market five years after the transition away from embedded commissions.[93]

v. Shift in assets across existing investment fund managers:

A shift toward lower-cost and passively managed funds stemming from the discontinuation of embedded commissions[94] would also likely occur between funds managed by the same investment fund manager. We may also see a shift of assets between conventional mutual funds and ETFs (whether managed by the same investment fund manager or not). In such cases, we would expect that all investment fund managers would be reviewing their fund offerings with respect to cost and performance and, in some cases, introducing or expanding their passively managed fund offerings.

Beyond the shift to passively managed products, we would also expect a potential shift in assets across active investment fund managers. For example, if active investment fund managers will need to compete more on the level of their risk adjusted performance after the discontinuation of

[92] See Figure 4 above (source: Investor Economics).

[93] This estimate is dependent on both how fast index fund demand increases after the discontinuation of trailing commissions and how strong aggregate growth is in the fund industry (among other factors). For example, if growth in the mutual fund industry over the last 10 years of around 7% were to persist, we were to see similar growth rates for index funds in Canada as we have seen in the U.K., and we were to eliminate embedded commissions in 2020, this would suggest total assets invested in index funds would grow from $18.8 billion today to $125 billion by 2025 – a 5% market share. If aggregate fund industry growth was to substantially slow (to 1 to 2% per year) and index fund growth was to remain the same, then index fund market share would move closer to the 10% mark.

[94] Besides the discontinuing of embedded commissions, many other factors could result in a shift in allocation of capital to lower-cost and passively managed funds.

embedded commissions than they do presently, it is reasonable to assume that actively managed funds producing negative alphas today could be considered at risk over time.

Based on a review of current actively managed fee-based (series F) fund offerings[95] and their five year alphas, the data suggests that:

- 87% of investment fund managers offering actively managed funds today have some funds with negative alphas which could be at risk of redemption if embedded commissions were discontinued and these managers were not able to adjust their fees or improve performance;[96]

- For active investment fund managers that manage funds with negative alphas, the proportion of assets at risk or redemption could be on average 53% of firm assets;

- In aggregate, an estimated 44% of actively managed fund assets may experience redemption and reallocation pressure to competitor investment fund managers over time if embedded commissions were discontinued and these managers were not able to adjust their fees or improve performance; and

- For active investment fund managers with little or no access to related party distribution[97], on average 59% of assets at these firms may experience redemption pressure over time assuming once again these managers were not able to adjust their fees or improve performance.

As we have emphasized throughout this section, much depends on how investment fund managers react to the discontinuation of embedded commissions. And as noted earlier, we expect investment fund managers to alter the way that they compete over time by reducing prices and refocusing their distribution efforts toward improvements in risk adjusted performance to retain market share.

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[95] Since we are looking at what would happen after the discontinuation of embedded commissions, we have focused on 5 year alpha based on fee-based pricing. All analysis in this section is based on data from Morningstar Direct at June 2016.

[96] These assets may already be at risk today. However with the discontinuation of embedded commissions we would expect this risk to increase further. For funds that are already in net redemptions, their redemption rate may increase further.

[97] We focus here on those investment fund managers without significant access to captive distribution because Canadian and other international research has shown that affiliation (i.e. access to affiliated distribution) can be an effective barrier to price and performance competition (see for example, Douglas Cumming et al., supra note 3). However, we note in the next section that even for fund managers with access to captive distribution we anticipate that there could be significant product price and performance pressure after the removal of embedded commissions.

vi. Market innovations in product distribution and advice:

When considering the overall effects on product distribution and advice, it is important to note that the discontinuation of embedded commissions would not require dealers to move to a fee-based arrangement. As discussed in Part 3, dealers could still charge commissions to clients directly, move to a fee-based arrangement, move to an hourly rate, or move to any other combination of payments as long as compensation is not embedded within the product or paid by the investment fund manager.[98]

It is anticipated that if we were to discontinue embedded commissions, existing and new market innovations would help ensure that mass-market households still have access to advice.

As we highlighted earlier, the majority of mass-market households do not own investment funds and would not be affected by the discontinuation of embedded commissions. However, based on current market developments, they are likely to have more access to online advice over the next few years.[99]

Online advice (typically referred to as robo-advice) is still an emerging sector within Canadian financial services, though there are a number of online advice platforms that have been established for some time. While online advisers[100] have yet to make a large impact, either in the number of households serviced or in the share of wealth held by these firms, considering that online advisers typically offer investment fund products under an asset allocation service, there are a number of reasons why we should anticipate that they will be disruptive to the status quo and could have the potential to increase access to advice over time.

First, online advice is often less expensive than traditional advice channels and would likely remain so particularly if we were to discontinue embedded commissions.

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[98] For example, in its latest data bulletin, the FCA reports that a number of charging structures are popular post-RDR including charging based on hourly rates (20% of firms), percentage of assets (48% of firms), fixed fees (22% of firms) and combined structures (10% of firms). Note that, unlike our current proposal, new front end commission arrangements were prohibited in the U.K. (Financial Conduct Authority, *Data Bulletin Issue 7*, October 2016).

[99] The result of a survey published by Ernst & Young in 2016 show that, in Canada, 8.2% of digitally active consumers have used at least two digital/online (**FinTech**) products within the last six months, in the form of money transfers and payments, and savings and investments, in comparison to 15.5% globally. The survey also shows that, if awareness of the available FinTech products by consumers increases, adoption rates could triple within a year from 8.2% to 24.1%.

[100] We refer to “online advisers” because in the Canadian market, advisers that provide advice using an online platform must be registered portfolio managers and restricted portfolio managers. These firms provide discretionary investment management services at a low cost to retail investors through an interactive website. Online advisers still have to review the accounts created through the automated process as outlined in CSA Staff Notice 31-342 *Guidelines for Portfolio Managers Regarding Online Advice*. The online advisers that have been approved to carry on business in Canada are not "robo-advisers" of the kind that are operating in the United States, which may provide their services to clients with little or no involvement of a representative of the adviser. By comparison, Canadian online advisers can be seen as providing hybrid services, in that they use an online platform for the efficiencies it offers, while their representatives remain actively involved in (and responsible for) decision-making.

The cost of distribution and advice when dealing with a traditional mutual fund dealer from a vertically integrated firm, not including any account fees or product costs, is typically 1% of assets or more.[101] Account pricing for online advice, net of mutual fund product costs, is typically between 0.15% and 0.7% of assets per year depending on the amount invested,[102]and the average fund MER on these platforms is approximately 0.25%. This ability of online advisers to undercut the costs of the dominant advice delivery channel for investment fund owning households with modest levels of accumulated wealth is likely to limit what this channel can charge going forward for investment fund distribution and advice.

In Figure 10 below, we show what the minimum, maximum and average online adviser costs in dollars are today for account assets up to $1 million. Against the traditional 1% mutual fund distribution cost model, it seems that online advice has the potential to become an important distribution model in Canada.

However, as we said at the outset, online advice is an emerging sector in Canada. Early pricing and services provided may not be indicative of pricing over the long term. For example, it remains to be seen whether these new online adviser entrants can gain enough scale before incumbents adopt innovation.[103] If these new entrants do not gain sufficient scale, the current pricing pressures that their entrance has brought about may be transitory. In addition, we have yet to see the entrance of low-cost, hybrid, online advice models in Canada as we have seen in other markets.[104]

If we were to discontinue embedded commissions, the ability of incumbents to limit this pricing pressure could be curtailed by the actions of more established and better capitalized entrants into the market post the discontinuation of trailing commissions.

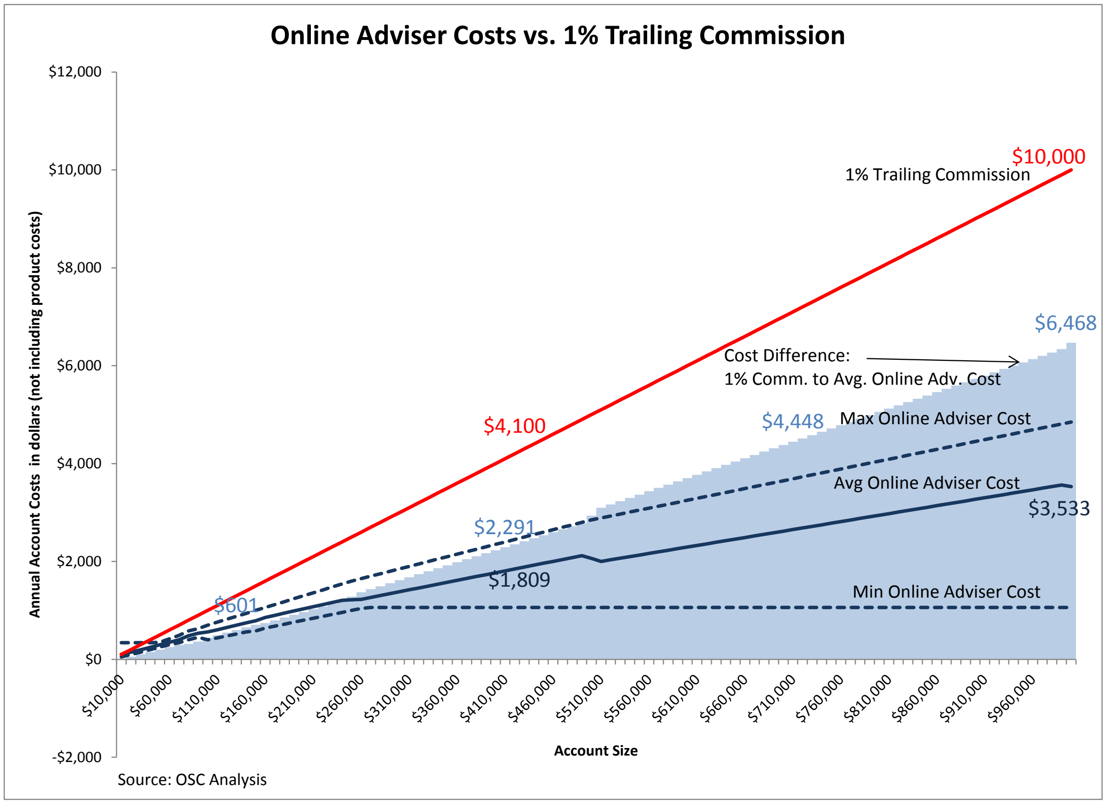
[101] The majority of mutual funds sold through bank branches are fund-of-funds (see for example, Investor Economics, *Insight Report*, November 2016, page 3). These funds typically include a posted trailing commission of 1% and in some cases more than 1%.

[102] We note however that not all online advice costs are this low today.

[103] We have seen some evidence of this already with BMO and RBC either moving or getting ready to move into online advice and Power Financial providing a large investment into Wealth Simple. See, for example: Fiona Collie, "RBC Wealth Management explores adding robo-advisor", *Investment Executive*, October 8, 2015; Paul Lucas, "Royal Bank of Canada turns to robo advisors", *Wealth Professional*, February 4, 2016. Several online advisers have also expanded to provide financial advisors a web-based platform that will allow them to keep offering services to non-core clients (i.e. mass-market households).

[104] See for example, the Vanguard Personal Advice Service offered in the United States, which offers clients with a minimum of $50,000 to invest automated advice coupled with access to a traditional advisor for an advice cost of 30 bps which decreases as assets rise (https://personal.vanguard.com/pdf/vpabroc.pdf). The program has been more successful relative to other automated advice only offerings. Assets in the program totaled $41 billion, one year after launch (see Alex Eule, "The Future of Mutual Funds", *Barron's*, July 9, 2016.).

Figure 10: Online adviser versus traditional advice costs



While online advisers are likely to have an impact on the price of distribution, they also may have an impact on the types of products distributed, particularly if embedded commissions are discontinued.

Once again, the majority of households with modest levels of accumulated savings have a relationship with a deposit-taker or insurer owned dealer. As previously discussed, the scale of the advice these households require may tend to be more limited and the types of products they are being offered are often packaged solutions such as fund-of-funds – because they are easy to sell and reduce the representative's compliance risk as they transfer the representative's portfolio creation role to the investment fund manager. In many ways, fund-of-funds are the equivalent of the asset allocation service offered by many online advisers. According to data from IFIC, for the six years ending December 2015, fund-of-fund net sales totaled $191 billion versus $32 billion for traditional stand-alone funds. They have become the dominant product in the mutual fund industry.

Fund-of-funds offered through the deposit-taker channel are typically invested in related party actively managed funds. Research suggests that while actively managed funds tend not to outperform their benchmarks, a portfolio of actively managed funds is even less likely to outperform a portfolio of passively managed funds.[105]

[105] Richard A. Ferri and Alex C. Benke, "A Case for Index Fund Portfolios: Investors holding only index funds have a better chance for success", June 2013. See additional research at Appendix A, note 194.

This trend is borne out by the performance of fund-of-funds in Canada. At the end of March 2016, and not accounting for survivorship bias,[106]which would reduce the percentage of outperformers further, only 8% of fund-of-fund products were able to beat their indices on a risk-adjusted basis[107] over 3 years, only 10% over 5 years, and only 8% over 10 years. Notably, only 3 funds were able to do it over all three periods.

As most fund-of-funds tend to be actively managed while many (but not all) portfolios managed by online advisers tend to be made up of lower-cost passively managed ETFs or mutual funds, we should expect that these portfolios will do at least as well as traditional fund-of-funds offered by vertically integrated firms today. Moreover, we should expect that the sophistication of online advice offerings will improve over time.

The fact that the advice is more automated means that, with the same number of representatives, online advice platforms have the potential to service more households relative to traditional advice channels. Furthermore, given that online advice tends to be less expensive and that it encompasses at least part of the benefits thought to be the potential drivers of value with traditional advice[108], we anticipate that its growth could potentially increase investors' access to advice in the future.[109]

Increased automation is also expected to benefit the traditional advice channel such that we should expect productivity gains here too. Automation may make it possible for the traditional advice channel to service parts of the market previously not covered.[110]

The discontinuation of embedded commissions, along with any potential enhancements to the obligations of dealers and representatives and the growth of online advisory services, may also drive up the demand and the supply of discretionary management[111] in Canada. This change is

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[106] Not accounting for funds that have closed or merged over the period. Including these funds would have reduced the percentage of outperforming funds even further.

[107] As measured by information ratios over the time periods cited.

[108] From the Vanguard Advisor Alpha report – the drivers of value that would be incorporated into online advice options would be asset allocation, usage of low-cost products and rebalancing. Ryan Rich, Colleen M. Jaconetti, Francis M. Kinnery Jr., Donald G. Bennyhoff, and Yan Zilbering, "Putting a value on your value: Quantifying Vanguard Advisor's Alpha in Canada", 2015, The Vanguard Group, Inc.

[109] Accenture notes that "much of the initial uptake and interest in robo-advice is coming from the "mass-affluent, delegator" market segment, which has traditionally been underserved". See Accenture "The Rise of Robo-Advice: Changing the Concept of Wealth Management," 2015, page 2.

[110] See for example: Tessie Sanci, "Nest Wealth readies launch of new tool for financial advisors", *Investment Executive*, April 19, 2016; James Langton, "Canada's robo-advisor market to see robust growth", *Investment Executive*, May 19, 2016; Tessie Sanci, "Wealthsimple for Advisors readies for launch", *Investment Executive*, May 11, 2016.

[111] Discretionary management means a form of investment management in which a portfolio manager has the authority to make investment decisions for a client's account, including the discretion to trade in securities for the

expected because these initiatives, along with the CRM2 initiative, may encourage dealers and their representatives to explain their value proposition to clients in a way many have never had to. In some cases, the easiest way for the representative to do this will be to show the client that the use of discretionary advice creates a savings discipline, simplifies their life and frees up their time. There is some evidence that this shift has occurred in the U.K. post-RDR and across Europe generally where similar changes have been introduced.[112] There is also an expectation that use of discretionary advice will continue to grow in these markets for the foreseeable future.

It is important to note that this trend, were it to occur either in response to the discontinuation of embedded commissions or other ongoing policy initiatives, would be likely to drive up the cost of advice. However we should also expect, in such a scenario, that the level of service and advice would be potentially more aligned with the costs paid.

Whether or not this shift is a benefit to investors depends on whether investors or dealer firms are driving the change. For example, European and U.K. firms surveyed have suggested that they have moved or are expecting to move more toward discretionary advice at least in part because they consider it is a less-time intensive (and thus more profitable) model to run from a compliance cost perspective relative to traditional advisory services.[113] Others surveyed have argued that, while this model is simpler and more scalable, what is equally driving the change is the fact that this model is also easier for clients to understand and thus more valuable to them.[114]

We anticipate that some dealers would be less impacted by the discontinuation of embedded commissions than others, at least initially. Those dealers, typically deposit-taker and insurer owned mutual fund dealers, that do not receive embedded commissions today but instead receive transfer payments unrelated to an investor's purchase or continued ownership of a mutual fund security from their non-securities registered parent firm, may be less affected by the discontinuation of embedded commissions. It is anticipated that even these firms would be encouraged to make changes over time to their products and services and their pricing in order to compete with new low-cost distribution models.[115]

We focus in the next section on the potential impact to specific stakeholders.

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account without requiring the client's express consent to a transaction (ref.: definition of "managed account" in National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*).

[112] See for example: Joint report of Oliver Wyman and J.P. Morgan, "The Future of European Wealth Management: Imperatives for Success", November 2014; BlackRock, "Wealth Management Industry Survey 2015"; David Boyle, "A strong DFM market", *Defaqto*, March 26, 2016; "DFMs open up a greater choice for clients", *FT Adviser*, October 24, 2016.

[113] Joint report of Oliver Wyman and J.P. Morgan, "The Future of European Wealth Management: Imperatives for Success", November 2014, page 15.

[114] BlackRock, "Wealth Management Industry Survey 2015".

[115] It is worth noting that some firms have anticipated these changes and have already begun to simplify their purchase options, lower product costs, and introduce direct pay arrangements within their branch network (see note 80).

3. ***Impact of the discontinuation of embedded commissions on specific stakeholders***

a. Investors

We set out below the potential impact of the discontinuation of embedded commissions on different investor segments. The impact we have outlined for one segment of investors could also apply to a certain degree to another segment of investors.

i. Investors with investable assets below $100k (mass-market)

As explained above, we anticipate that, like all fund investors, this group of investors would likely see the cost of active management and fund management generally decline. New players entering the market would likely service these investors and their usage of low-cost, passively managed funds would likely increase. In order to service these investors, dealers will likely be encouraged to increase or introduce the use of simplified online advice options. An implication of this development, coupled with the discussion earlier about the number of households in this group that do not own investment funds today, is that the size of this group has the potential to grow over time. Fund ownership has the potential to move beyond 37% of all Canadian households today.

Considering the shift in product recommendations discussed previously, we anticipate that representatives, particularly at independent mutual fund dealers which offer an open product shelf, would focus more on lowering product costs and choosing better performing products over time. The discontinuation of embedded commissions would also eliminate the incentive for representatives to potentially engage in unsuitable leverage strategies. A potential negative impact of the discontinuation of embedded commissions for mass-market households is that some independent fund dealers may choose not to continue to service these households.[116]

Some investors, when presented with the cost of advice may not see value in it and choose to move to another dealer, to an online/discount broker or to an online adviser. We do question though the extent to which this change will occur given that the implementation of the new CRM2 annual report on charges and other compensation will have been completed. It is possible that investors that do not see value from advice, in reaction to the CRM2 disclosures, may have already moved their assets to another dealer, to an online/discount broker or to an online adviser. Where we may see movement is for those investors who want to use mutual funds but do not want to use advice. For investors that move their assets to an online/discount broker, they will no longer bear the cost of full trailing commissions if they make the switch.

It is fair to say that this group of investors is the group most at risk of falling into the "advice gap" – the group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay – today.[117] As was outlined earlier, this is also the group of fund investors

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[116] We note that based on the Ipsos data, an estimated 14% of mass-market households work with an independent/other integrated fund dealer today. About 38% of these households also have a relationship with a deposit-taker or insurer owned dealer.

[117] In the FCA and HM Treasury's *Financial Advice Market Review: Final Report (*March 2016), "advice gap" is similarly defined as situations in which consumers are unable to get advice and guidance on a need they have at a

that are least likely to be receiving advice today and when they do receive advice, the range of services[118] provided tends to be less than for those with higher levels of wealth.[119] Households with little to invest are considered to be the most difficult for the industry to service today given the costs and scalability of existing advice models versus the potential revenue gained. Admittedly, in terms of the number (though not in terms of the share of total wealth) this group makes up the largest share of households.

For a number of reasons alluded to earlier in this section, despite the potential risks, we do not anticipate a significant advice gap in the event that we move forward with our proposals.

First, with respect to the risk of increasing the "advice gap", we note that the majority of mass-market households do not own investment funds and that for the mass-market households that do own investment funds, the majority have tended to purchase them through a deposit-taker or insurer owned dealer. We anticipate that deposit-taker and insurer owned dealers will continue to serve mass-market households if we transition away from embedded commissions. As noted earlier, by virtue of being both vertically and horizontally integrated, many deposit-taker and insurer owned dealers (particularly in the mutual fund dealer channel where we have shown the majority of these households are serviced) have already moved away from traditional grid based compensation that relies on embedded commissions.[120] Their high level of horizontal integration has led these firms to focus less on any one business line (e.g. mutual funds, GICs, mortgages, credit cards etc.) and focus more on gathering assets across all business lines and on directing clients to the appropriate business line.[121]

The discontinuation of embedded commissions by itself will likely have little direct impact on these integrated business models. They will continue to provide a wide array of financial products and services (including mutual funds) to households with little to invest. We have already outlined trends with respect to automation that may actually increase access to advice for

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price they are willing to pay. Based on the experience in other jurisdictions, we note that an advice gap is not a phenomenon that occurs only because of a ban on embedded commissions, but rather it is a function of a number of factors (changes to existing business models, changes to consumer preferences, technological changes etc.) that occur normally in any competitive market for financial services.

[118] Financial services and advice can, but need not always, encompass a broad range of services such as investment recommendations, asset allocation, the setup of systematic savings plans and/or registered plans, the preparation of a written financial plan, tax planning, estate planning, debt management, budgeting cash flows, etc.

[119] As noted earlier when looking at the Ipsos household survey data, the usage and, likely, the breadth of advice tend to increase with household wealth.

[120] For example, see the discussion in MFDA Bulletin #0689-P, supra note 24, regarding the cost disclosure requirements for dealers that do not receive commissions but instead receive transfer payments from affiliates based upon a management agreement with the corporate parent. Also see previous research completed by CSA staff into advisor compensation practices.

[121] For example, to their related branch direct, branch advice, financial advisor, full-service dealer or private wealth management arm.

this group[122] and we have noted the much higher levels of advice coverage and advisor availability in Canada versus other jurisdictions such as the U.K.

With respect to the developments in the advice market in the U.K. post-RDR, it is important to take note of the other factors that have led to the advice gap that are not present in the Canadian context.

In the recent financial advice market review conducted by the Financial Conduct Authority (**FCA**) and HM Treasury in the U.K.[123], they identify that the standards and professionalism in the industry have increased. As well, the move to a direct pay model for advice on retail investment products has improved transparency and significantly reduced certain conflicts of interest. However, they also identified a number of obstacles post-RDR implementation that are limiting accessibility and affordability of advice, including:

- a need for clarity as to when general forms of advice become or are considered "regulated advice" [124];
- a need for clarity on responsibilities when providing guidance that is not "regulated advice" (e.g. online calculators and tools, providing general behavioural nudges to clients);
- a need for clarity on how to tailor suitability assessments when providing narrow forms of advice;
- extending the time new employees can work under supervision while obtaining qualifications in order to provide more flexibility to train a new generation of advisers;
- clarifying the length of time a firm can cross-subsidize the cost of new advice delivery models while still ensuring that over the long-term the charges for their advice service cover the costs of providing that service **(the cross-subsidization rule);** and
- assistance in introducing new technologies to automate advice and to streamline and codify the fact finding process used in traditional advice in order to reduce the cost of suitability assessments.

None of these obstacles limiting access and affordability were found to be related to the removal of embedded commissions but rather they tended to be tied to the particular way in which the FCA chose to raise the standard of care.

The new standard for advisors implemented in the U.K. with RDR has much wider scope, in terms of the types of advice covered and the limitations on business conduct, than is

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[122] See also Accenture, "2016 North American Consumer Digital Banking Survey, Banking on Value: Rewards, Robo-Advice and Relevance," 2016.

[123] Financial Conduct Authority, HM Treasury, *Financial Advice Market Review: Final report*, March 2016.

[124] Advice relating to a particular investment given to a person in their capacity as an investor or potential investor (or their agent) and relates to the merits of them buying, selling, subscribing for, or underwriting (or exercising rights to acquire, dispose of, or underwrite) the investment. See Financial Conduct Authority, *Finalised Guidance FG15/1: Retail investment advice: Clarifying the boundaries and exploring the barriers to market development*, January 2015 (http://www.fca.org.uk/static/documents/finalised-guidance/fg15-01.pdf).

contemplated in CSA CP 33-404. For example, the CSA has not contemplated an equivalent to the FCA's cross-subsidization rule which seems to have played a role in limiting the introduction of new advice delivery models in the U.K. Therefore, we do not anticipate the same obstacles to the development of new lower-cost distribution models in Canada after the discontinuation of embedded commissions.

In addition, as discussed later in Part 5, if the CSA were to discontinue embedded commissions, the CSA would aim for a transition period sufficient to allow market participants time to adjust their business models with the objective of mitigating any investor harm. Finally, as has been the case with the introduction of CRM2 and POS, we anticipate that the industry will find it in its interest to educate and prepare their clients for such a change in order to minimize disruption to its business.[125]

It is possible, however, that the cost of *traditional* advice may rise for this group. 'Bricks and mortar' advice is also likely to decline for this group (although this change may occur anyway for this group over the next few years as account minimums to access advice may continue to increase).

As mentioned in Part 5, the transition to direct pay arrangements and the implementation of other regulatory reforms may lead to an increase in the cost of dealers' operations and compliance, which may lead to an increase in the cost of advice. Some investors may be pushed into online advice relationships, other more simplified forms of advice, or the online/discount brokerage channel even though these services may not meet all their needs and even though they may prefer, but can no longer afford, face-to-face advice.[126]

We do not anticipate that there would be a significant change in the fund products recommended through integrated mutual fund dealer firms although, as we have noted, the cost and performance of those products may change in reaction to new market entrants. There is also the possibility that some representatives may have less of an incentive to service clients after the initial sale were we to move to more widespread use of fee-based arrangements. This may lead to reverse churning.[127]

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[125] James Langton, "MFDA, IFIC help inform investors about pre-sale disclosure", *Investment Executive*, February 25, 2016; Rosemary McCracken, "Talk with your clients about compensation before CRM2 comes into effect", *Insurance & Investment Journal*, November 20, 2015.

[126] We note however that recently released data on the cost of fee-based – percentage of asset fee – charges in the U.K. post-RDR suggest the fees are not too different from the fees charged today in Canada. Initial fees of 1% to 3% with annual ongoing fees of 0.5% to 1% of assets (see Financial Conduct Authority, *Data Bulletin Issue 7,* October 2016, page 11).

[127] Churning typically occurs when a dealer engages in excessive buying and selling of securities in a customer's account chiefly to generate commissions that benefit the dealer. In contrast, "reverse churning" occurs when a dealer places a customer's assets in a fee-based account (or receives some form of asset based compensation) chiefly to collect the fee then subsequently does little for the client, in terms of actual advice, trading or account activity, in exchange for that fee.

As the investor may not be equipped to negotiate the fees or may not fully appreciate that there is a cost to distribution, moving to a fee-for-service model could have the consequence of discouraging some investors from seeking financial advice, particularly where they are indirectly paying for but are not receiving advice (outside of the required suitability assessment) today, as they may be unwilling to pay a fee for such advice.[128] Finally, where representatives choose to offer their services to clients under a transaction-based commission arrangement, they may be incented to churn the account.[129]

ii. Investors with investable assets between $100k and $500k (mid-market)

Similar to investors with modest levels of accumulated wealth, we would expect this group to benefit from lower fund management costs, whether funds are actively or passively managed. We also expect that new players entering the market would tend to target this group and their usage of passively managed funds would likely increase. A transition away from embedded commissions will likely drive a shift in products recommended by representatives and made available on the dealer product shelf toward lower-cost and passively managed funds, which could improve investor outcomes. We expect client engagement with this segment of investors to increase with respect to the services and advice options offered (e.g. full, partial, à la carte options). These different types of service and advice options are likely to give investors more control and more clarity over the advisor/client relationship. This group is also likely to be offered more discretionary advice over time.

Similar to the push toward online advisory services for investors with less than $100,000 to invest, it is possible that some "buy-and-hold" investors may be moved into fee-based accounts when transaction-based fees may be better for their circumstances (we note that this shift is already occurring today). We anticipate that the concept proposals outlined in CSA CP 33-404, if implemented, would limit this potential impact. As outlined above, there is also the potential for reverse churning in these arrangements.

iii. Investors with investable assets above $500k (affluent)

We anticipate that this group of investors will be the least impacted by the discontinuation of embedded commissions as they are the most likely to be using non-embedded forms of dealer compensation today. They would, however, likely benefit from the fund management cost declines outlined above. As with the other two investor groups, representatives at private wealth management firms and representatives at IIROC dealers would likely focus more on recommending lower-cost and passively managed funds to their affluent clients where it is appropriate to do so. Usage of discretionary advice is likely to go up substantially for this group. We anticipate similar potential negative impacts as those anticipated for the other two investor groups. Given that the affluent group of investors is the most sought after by advisors today, we

[128] A recent article questions how much advice is provided to the typical advised client given the number of clients typically serviced by the average advisor (see Dan Hallett, "Advice gap exists now," Investment Executive, Mid-November 2016.

[129] Although churning is something that can typically be detected easily and that self-regulating organizations (**SRO**) and compliance officers routinely check for.

anticipate that they will continue to be provided the most flexibility in terms of payment arrangements and the most number and scope of advice delivery and service offerings.

iv. Do it yourself investors

For DIY investors, the discontinuation of trailing commissions would significantly lower costs as we would expect them to benefit from the decline in fund management costs and the removal of the full trailing commission costs they often pay today. The supply of DIY fund series options may also increase from 493 today to 4,901 options (based on a comparison of the D series and F series available today). These investors will, however, be required to pay transaction-based or asset-based fees directly, to offset the revenue lost from trailing commissions. We do not expect these payments to be any higher than the trailing commissions paid on DIY fund series today – typically 0.25% - which would represent a 75 bps decline from what they would typically pay today.

b. Dealers and investment fund managers

Based on the facts outlined in the previous sections of Part 4, we anticipate that, if we were to discontinue embedded commissions, all industry stakeholders would take the necessary steps to adapt to direct pay arrangements by innovating, segmenting their products and services, and using new technologies, to the extent possible within firm specific resource constraints.

i. Independent investment fund managers

As outlined previously, we expect fund management costs to decline and the share of lower-cost funds and passively managed funds sold in Canada to increase over time. Given that total mutual fund assets have been growing at an average 7.2% per year over the last ten years, we anticipate that a potential increase in the sale of passively managed funds would not necessarily involve a decline in the sale of actively managed funds in Canada nor a decline in the total dollars invested in actively managed funds.

We also estimate that, based on current five year fund alphas, there would be some proportion of actively managed fund assets likely at risk of experiencing redemption pressure. For relatively higher cost active investment fund managers with a large proportion of negative alpha funds and no access to affiliated dealer distribution today, there would likely be more challenges in the event that there is a discontinuation of embedded commissions. These investment fund managers could potentially have fewer options to cross-subsidize across business lines relative to their integrated investment fund manager peers.

We do anticipate, however, that the remaining active investment fund managers are more likely to be high alpha producing firms. For those active investment fund managers that do not pay trailing commissions or pay relatively lower trailing commissions today, it is reasonable to assume that they will have better access to the discount brokerage channel than they do today.[130] The discontinuation of embedded commissions could also provide high alpha generating independent investment fund managers with a better opportunity to access the IIROC channel

[130] Gail Bebee, "Choosing a discount broker", *Morningstar Canada*, April 15, 2014

and the independent MFDA channel than is the case today as we anticipate that fund performance would become a more important driver of fund flows resulting in a shift in market share towards these managers.

While we anticipate increased access to lower-cost fund products in the IIROC and independent MFDA platforms, we also anticipate that independent investment fund managers will still be at a disadvantage as they may not be able to gain access to those firms with closed, proprietary only, product shelves (predominantly deposit-taker and insurer owned MFDA firms). As an alternative, these investment fund managers may be required to set up a direct to client channel and obtain a dealer registration in order to compete in this space or alternatively, access these investors via a third party online advisory service.

ii. Independent mutual fund dealers

We anticipate that independent mutual fund dealers, similar to the situation for investment fund managers, would be required to compete more on their overall level of services and advice in a market that is likely to be transformed significantly by automated solutions and technological change generally over the next few years. Despite the increase in competition, there may be opportunities that arise for these firms as well.

The introduction of more low-cost fund products is likely to allow independent dealers, at least initially, to put pressure on their integrated fund dealer competitors. Representatives at independent firms will be further encouraged to study the product market on behalf of their clients with price and performance in mind which may result in better recommendations and better outcomes for their clients over time. Representatives are also likely to have access to more tools that will allow them to service a wider range of clients than is the case today.[131] It is possible that, similar to the case for independent investment fund managers, these firms could have fewer cross-subsidization options relative to their integrated fund dealer peers.

We anticipate that some independent dealers, if they cannot explain their value proposition, may have trouble maintaining their assets under administration. However, this may already become a trend to a certain degree with the introduction of the annual report on charges and other compensation (CRM2), whether or not embedded commissions are discontinued. Client engagement for the remaining firms will increase as will the service options that can be offered to clients.

There is also a risk that some dealers and representatives that can recommend non-securities products may prioritize their compensation interests over the interests of their clients by

[131] Some established online advisory firms are now offering advisor access to their platforms to help financial advisors better serve small retail investors and reduce the administrative burden related to the administration of smaller accounts. See for example, Tessi Sanci, “Wealthsimple for Advisors readies for launch”, *Investment Executive*, May 11, 2016 (http://www.investmentexecutive.com/-/wealthsimple-for-advisors-readies-for-launch) and Wealthsimple website (https://www.wealthsimple.com/advisors).

inappropriately shifting their clients' assets to non-securities investment products with embedded fees.[132]

All things being equal, following the discontinuation of embedded commissions, it is expected that dealers will compensate for the loss of revenue from embedded commissions with revenue from direct pay arrangements. It is possible that the discontinuation of embedded commissions may disadvantage small-to-medium sized independent mutual fund dealers relative to full-service IIROC dealers because they rely more heavily on embedded commissions than do IIROC dealers.

As at September 2014, trailing commissions represented approximately 27% of the fee revenue and mutual fund commissions represented 16% of annual commission revenue for full-service IIROC dealers.[133] We recognize that this change will represent an important shift in the business model of independent MFDA dealers and, were we to move forward, the method by which we would transition would be key to its success (as outlined in Part 5 of this Consultation Paper).

iii. Integrated financial service providers

We set out below the potential impacts specific to a dealer or an investment fund manager that is part of an integrated financial service provider. The impacts outlined above may also apply to them to a certain degree.

For the asset management arms of integrated financial service providers, we anticipate that new entrants to the market would put pressure on asset management pricing. Integrated investment fund managers would likely need to lower their asset management pricing to compete. They would also likely need to reassess their product pricing and would be encouraged to distribute their low-cost, passively managed fund options. It is important to note however that, given their access to their closed shelf related mutual fund dealer channel, these firms would likely not feel the same pricing and redemption pressure as their independent investment fund manager peers, at least initially.

For integrated dealers that choose to be open shelf, due to the potential introduction of the enhancement to KYP obligations as currently outlined in CSA CP 33-404, representatives may be required to study the market, including the use of non-proprietary funds, on behalf of their

[132] Such recommendations would however have to be in compliance with the requirements of the regime applicable to non-securities products. If an important shift to non-securities products were to happen, we would assume that the SROs and regulators of non-securities products (including some CSA members) would remain vigilant and take any necessary action in the case of non-compliance. Non-securities regulators are increasingly considering regulatory initiatives in order to ensure a harmonized approach with securities regulators on similar products. See Part 3. Also, with the introduction of POS and CRM2, we continue to monitor the potential for regulatory arbitrage. We note the data in Figure 5 above showing assets and growth rates of mutual funds versus other investment funds does not suggest that regulatory arbitrage is occurring today. This is also borne out when we look at net sales and sales rates for these products and advisor dual licensing.

[133] Investor Economics, *Retail Brokerage and Distribution Advisory Service*, Fall 2015 edition.

clients with price and performance in mind which could result in better recommendations and better outcomes over time.

For integrated dealers that choose to offer a closed shelf, as mentioned above, they would not feel the same level of pressure and would, at least initially, still be able to operate mostly as they do today, although as previously mentioned, the cost of the proprietary funds offered may fall. Furthermore, we would anticipate that both the discontinuation of embedded commissions and the potential KYP reforms proposed in CSA CP 33-404 would be unlikely to reverse, and may even increase, the trend toward retaining mid-market and affluent households within the branch network[134] (rather than referring them to their related party open shelf platforms or private wealth management arms). Integrated firms as a whole would have more options, at least initially, to cross subsidize across both securities and non-securities business lines to maintain market share.

Over time however, it is reasonable to assume that even these firms would feel pricing pressure in their closed shelf distribution channels which may incent these firms to embrace new technologies, adopt new pricing strategies and service offerings and rely less on traditional advice (many are already doing so). Furthermore, the potential entrance of low-cost hybrid online adviser models into Canada would likely put further pressure on the integrated fund distribution model.

Now that we have looked at the potential overall and specific market impacts of the discontinuation of embedded commissions, we discuss how this policy change may address our identified concerns.

4. ***How does the discontinuation of embedded commissions potentially address some of the CSA's concerns?***

Eliminating important inherent conflicts of interest

The discontinuation of embedded commissions would eliminate an important inherent conflict of interest that research has shown misaligns the interests of investment fund managers, dealers and representatives with those of investors. Our analysis leads us to believe that discontinuing embedded commissions would increase investment fund managers' focus on fund performance and discourage biased recommendations that may prioritize the maximization of compensation over the interest of the investor. The discontinuation of embedded commissions would also eliminate the incentive for representatives to potentially engage in unsuitable leverage strategies (as explained in Appendix A). The discontinuation of embedded commissions is the clearest and most direct way to address these conflicts of interest. In addition, when combined with certain concepts in CSA CP 33-404, if implemented, the representative-client compensation discussion is more likely to result in a compensation arrangement that is more appropriate for the client's situation.

[134] On the increase in the client wealth "ceiling" within the branch network see, Investor Economics, *Retail Brokerage Report*, Fall 2012, page 10.

The discontinuation of embedded commissions also complements the proposals outlined in CSA CP 33-404. Generally, jurisdictions that have enhanced the advisor's standards and obligations have eliminated embedded commissions at the same time (as outlined in Appendix C) because they have recognized that these payments are one of the main obstacles preventing the advisor from working in the interest of their clients. Research suggests that these payments are a conflict that is very difficult to manage or mitigate, except through avoidance. [135]

Addressing dealer affiliation biases

To a lesser extent, discontinuing embedded commissions may address some dealer affiliation biases directly through the IIROC channel where representatives are paid trailing commissions and indirectly through the mutual fund dealer channel where, despite the focus on proprietary products, asset management fees would need to fall in-line with the rest of the market in order to be competitive on total costs. We recognize that discontinuing embedded commissions does not address all dealer affiliation issues. However the proposals outlined in CSA CP 33-404, if implemented, in conjunction with this proposal may address some conflict issues with respect to internal compensation arrangements at the dealer.[136]

Reducing the number of mutual fund series and the fee complexity that these series create

The fund fee structure has grown increasingly complex due to the growing number of fund series on offer, with each series charging different fees (largely due to differences in dealer compensation). We anticipate that the discontinuation of embedded commissions would significantly simplify the fund fee structure in Canada, facilitate easier product cost and performance comparisons, and incrementally reduce information asymmetry for all market participants (in particular, for retail investors).[137]

Increasing the transparency of dealer compensation costs

We anticipate that eliminating embedded commissions would address fund fee and dealer compensation awareness concerns. Unlike disclosure, which only requires delivery and not understanding, the discontinuation of embedded commissions requires the representative to engage in an in-depth discussion with the client and obtain the client's agreement upfront in order to get paid.[138] More general compensation disclosure such as when a new product is being introduced to the portfolio (fund facts) or more specific compensation disclosure 12 months after engaging the representative (CRM2) serves many purposes and is important, but research

[135] Note that Part 6 of this Consultation paper also explores these issues in the context of why existing reforms may not go far enough.

[136] See CSA CP 33-404, Appendix A.

[137] See for example, Dan Hallett, "Be wary of unmentioned fees in ads for F-Series funds", *Globe and Mail*, May 30, 2016.

[138] The outset of the relationship is arguably when the investor has the highest level of bargaining power as a opposed to 12 months after the engagement of the advisor when they receive their cost disclosure statements and the investor may incur switch costs to make a change.

suggests that this may not be as effective as an upfront discussion and agreement regarding compensation.

Better alignment between the costs paid by investors for financial advice and the services provided to clients by dealers and representatives

The discontinuation of embedded commissions, replaced by an upfront discussion and agreement regarding compensation, also addresses the questions regarding what fees are being paid and more importantly, what they are being paid for. As we have seen already with high net worth client relationships, moving to a direct pay model may allow services and pricing to be more easily tailored to the client's needs.[139]

The discontinuation of embedded commissions would incent investment fund managers, dealers and representatives to be clear about, and to better demonstrate, their respective value propositions. It also allows DIY fund investors to forgo advice and the cost of advice.

In addition, after the discontinuation of embedded commissions, the representative-client compensation discussion is more likely to result in a compensation arrangement that is most appropriate for the client's situation. Transition to direct pay arrangements may also help to increase investors' control over dealer compensation costs and the services provided.

Encouraging new lower-cost fund providers to enter the market

The discontinuation of embedded commissions may encourage new low-cost fund providers to enter the market with a range of passive and actively managed funds. These new entrants will likely service retail investors in all wealth segments as they do today in other jurisdictions in which they compete.

Increasing price competition and decreasing fund management costs

It has been well-documented that one of the things new lower-cost entrants bring to the markets that they enter is significant competitive pressure on incumbents to decrease fund management costs over time.[140] We anticipate that their entrance will encourage the manufacturing and distribution of lower-cost funds. We would expect to see a shift in product recommendations to lower-cost and passively managed products, and a shift in the allocation of capital across active investment fund managers that will ultimately benefit investor outcomes.

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[139] Advisors making the switch to fee-based and other direct pay arrangements today are routinely counselled to make sure that they understand and can communicate their value proposition to their clients before making the change. See for example, Ahmad Hathout, "Transition to fees requires support", *Investment Executive*, June 2016.

[140] See for example, "Index we trust", *The Economist*, June 11, 2016.

Questions

Where possible, we strongly encourage commenters to provide data to support responses.

Addressing the issues

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

Change in investor experience and outcomes

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

    - Will investors receive advice and financial services that are more aligned with the fees they pay?
    - What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?
    - Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?
    - What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?
    - What effect will the proposal have on the cost and scope of advice provided to specific investor segments?

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

    - Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?

17. Do you think this proposal will lead to an advice gap? In particular:

    - Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.

- Do you agree with our definition of an advice gap?
- Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?
- What types of advice or services currently provided today would be most affected by the proposal?
- Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?
- How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?
- Do you think that online advice could mitigate an advice gap? If so, how?
- Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

    - Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

    - Do you see payment options and business models evolving at present?
    - How are they likely to change over time if the CSA were to choose not to move forward with the proposal?

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Potential impact on competition and market structure

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

    - Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?
    - What are the likely impacts on investor outcomes and market efficiency of any

potential consolidation?
- What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?
  - Independent dealers?
  - Independent fund manufacturers?
  - Integrated financial service providers?
  - Mutual fund dealers?
  - IIROC dealers?
  - Online/discount brokers?
- What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?
- What would be the impact on dually-licensed mutual fund dealers and insurance agents?
- Will the proposal lead new, lower-cost entrants to the market? Why and how?
- Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?
- Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?
- Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?
- What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

    - Is there any specific operational or technological impact that we should take into consideration?

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

    - Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?
    - To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:
    - career path;
    - attractiveness of the job;
    - typical profile of individuals attracted to the career;
    - recruitment; and
    - relative attractiveness of careers in competing financial service business lines?

PART 5 – MITIGATION MEASURES

The CSA appreciate that a transition to direct pay arrangements would be a significant policy change that would take considerable time to implement and that may have unintended consequences for both investors and fund industry participants. Therefore, to the extent we may decide to move forward with a rule proposal discontinuing embedded commissions, our goal is to proactively identify and incorporate into our rule proposal various mitigation measures as well as transition options that could help alleviate any negative impacts and facilitate a successful transition to direct pay arrangements.

1. Measures to mitigate potential unintended consequences

In response to our Original Consultation Paper, several fund industry stakeholders submitted that the discontinuation of embedded commissions could have unintended consequences for retail investors and the fund industry,[141]including:

- a reduction in access to advice for lower-wealth investors due to:
    - o substantial changes to dealer business models, and
    - o reticence of investors to pay directly for advisory services;

- the elimination of choice in how investors may pay for financial advice; and

- an uneven playing field among competing products and opportunities for regulatory arbitrage.

a. Access to advice:

The data we consider in Part 4 on Canadian fund investors and the institutions that currently serve them suggests that the discontinuation of embedded commissions is not likely to lead to a significant advice gap for lower-wealth investors in Canada. Nevertheless, we recognize that such a change may (i) impact dealer business models in a way that may reduce the range and affordability of advice and (ii) affect the behavior of certain investors in a way that may reduce their use of advice.

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[141] See CSA Staff Notice 81-323 *Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees*, published on December 17, 2013, which provides a summary of the key comments received on the Original Consultation Paper.

i. Impact to dealer business models

We recognize that a transition to direct pay arrangements would involve substantial changes in current dealer business models. The transition could have the following potential impacts on dealers, among others:

- dealers may incur potentially costly changes in information technology systems, as well as changes in operational and compliance processes, that may increase the cost to provide advisory services[142];

- the transition would require dealers and their representatives to communicate with their clients to inform them of, and obtain their agreement to, the direct pay arrangement;

- going forward, dealers would need to collect their compensation directly from their clients on an individual basis, rather than be compensated on a wholesale basis through trailing commissions; this change would impose new administrative processes which may reduce efficiencies and increase costs; and

- overall revenues may be reduced due to the loss of a form of cross-subsidy from high net worth fund investors to lower-wealth fund investors; this change may increase the cost of servicing lower-wealth investors.[143]

We acknowledge that these potential impacts could be magnified for smaller independent dealers. Some dealers may not be able to adequately compensate with direct pay arrangements their loss of revenue stemming from the discontinuation of embedded commissions and the costs associated with the transition. Some dealers and their representatives may decide to refocus their business on high net worth fund investors and/or charge a fee for advisory services that some investors may not be able to afford, thus increasing the potential for certain investors to lose access to advisory services.

We anticipate that some of these impacts could be alleviated to some extent by innovations in technology, including various forms of online advice, which could be used by dealers and their representatives to automate part of the advice process.[144] The integration of such technology into the business models of dealers and their representatives could potentially add new capabilities

[142] We note these costs would be in addition to those already incurred in connection with the implementation of POS and CRM2 and the costs associated with the potential implementation of any of the CSA CP 33-404 proposals.

[143] Industry stakeholders have submitted that lower-wealth investors in a fund benefit financially from the current embedded commission structure because the cost of providing advice and services to lower-wealth investors is subsidized by the higher-wealth investors in the fund who pay more on account of their larger assets under management. It is reasonable to assume that the mandated use of direct pay arrangements would eliminate this pooling of fees from both higher-wealth and lower-wealth investors and cause the price of servicing lower-wealth investors to increase.

[144] Some Canadian firms are now offering online advice services designed for use by advisors. See note 131.

and deliver efficiencies that could make the provision of advisory services to smaller accounts more viable.

We think they could also be alleviated to a certain extent by our proposal, as discussed in Part 3, to allow investment fund managers to facilitate investors' payment of dealer compensation by collecting payments from the investor's fund investment (for e.g. deductions from purchase amounts or periodic withdrawals or redemptions from the investor's account) and remitting them to the dealer on the investor's behalf.[145]

ii. Impact to investor use of advice

We recognize there are a number of factors, including behavioral factors, which may influence the decision of investors to use financial advice.[146] For example, the requirement for investors to directly pay for advisory services provided by their representative under direct pay arrangements may affect the behavior of certain investors in a way that may reduce their use of advice. Specifically, some investors may consider direct payments less convenient relative to the current embedded commission model, which may accordingly deter them from seeking advisory services.

We also understand that retail investors' varying levels of financial literacy and lack of frame of reference as to what is a reasonable fee for advisory services may reduce their ability to assess the value of such services or to negotiate a fair fee under direct pay arrangements.

In order to address the risk that some investors may be deterred from using financial advice due to the requirement to pay upfront for their representative's services, we would propose, as discussed in Part 3, to allow investors to pay for their representative's compensation through deductions from their purchase amounts or redemptions from their investment fund holdings that would be effected by the investment fund manager and remitted to the dealer on the investor's behalf.[147]

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[145] We recognize that not all investment fund managers may have the capability to offer this service to dealers. Some investment fund managers may need to implement new systems and processes and may therefore incur additional costs to offer this option.

[146] In their *Financial Advice Market Review: Call for input* (October 2015), https://www.fca.org.uk/publication/call-for-input/famr-cfi.pdf, the Financial Conduct Authority and HM Treasury identified eight factors preventing people from seeking financial advice. These factors include: 1) the price of advice; 2) the lack of trust investors have toward financial advisory firms; 3) investors' lack of knowledge of their need for financial advice and how to obtain it; 4) investor overconfidence – believing they do not require help in making financial decisions; 5) investors' access to face-to-face advice; 6) the lack of engagement, where investors who are disengaged with financial services are unlikely to seek financial advice; 7) the lack of skills to use new channels such as the internet if available, and 8) the lack of need for financial advice.

[147] We recognize that periodic redemptions may trigger tax consequences (i.e. capital gains or losses) for some investors. Investors would need to understand the potential tax consequences of this method of payment before agreeing to it.

A factor which may further mitigate the risk that investors may not want to pay upfront for advice is the extent to which the front-end purchase option – where investors may pay both a direct commission at the time of purchase and an ongoing embedded trailing commission – is currently used by investors in Canada. As discussed in Part 4, assets held under the front end purchase option made up 24% of the market ($298 billion) at the end of 2015, growing 93% over the previous five years. Investors who make their fund investments under the front-end purchase option may be more sensitized to upfront fees for advice and may accordingly be less affected by a transition to direct pay arrangements.

As for the issue of low financial literacy potentially hindering investors' ability to assess the value of advisory services or to negotiate fair fees for such services, the CSA anticipate continuing to work on investor literacy initiatives to increase investors' awareness of investing costs and empower them to confidently engage in the negotiation of fees with their representative. We also expect that our recent POS and CRM2 reforms (further discussed in Part 6) will improve investors' awareness and understanding of fund and dealer compensation costs in the lead up to any potential rule proposal discontinuing embedded commissions. This improved awareness and understanding in turn should give investors an initial point of reference from which to gauge the appropriateness of advisory fees under direct pay arrangements.

However, industry participants have submitted that a transition to direct pay arrangements would decrease the transparency of dealer compensation costs as investors would not have any benchmark to help them assess the reasonableness of the fees they are paying for advice. As discussed in Appendix B, the CSA considered the option of making certain enhancements to cost disclosure, including providing certain benchmarking information on product and advice costs. However, we identified certain drawbacks to that option which led us to decide not to further pursue it at this time. If we decide to proceed with the discontinuation of embedded commissions, we anticipate further exploring the potential issue of reduced cost transparency.

b. Choice for investors

Several fund industry stakeholders submit that the discontinuation of embedded commissions will eliminate the ability of investors to choose[148] the payment arrangement they prefer and that is most convenient to them, and force all investors to enter into fee-based arrangements under which they would have to pay a fee that is based on a percentage of their assets under administration.

We recognize that fee-based arrangements may not be suitable for all investors in all circumstances. Accordingly, as discussed in Part 3, we expect that further to the discontinuation of embedded commissions, dealers and representatives would offer their clients a compensation arrangement that suits their particular investment needs and objectives and reflects the level of

[148] Many fund industry stakeholders submit that investors currently have the option of choosing fee-based arrangements by investing in a fee-based series of a fund (for e.g. Series F). In Parts 2 and 4 and Appendix A of this Consultation Paper, we suggest that the fee-based series may not be a true option for all investor segments due to the fact that dealers offering fee-based arrangements typically require a minimum investment amount of $250,000 or more prior to establishing an account.

service desired. Such compensation arrangements could include commissions on trades, hourly fees, a flat fee, a fee-based arrangement, or other suitable arrangement. We would expect representatives to fully inform their clients of the types of accounts available, and the differences between those accounts, both in terms of service and cost. Our expectation is that investors would have more choice in how they may pay for advisory services further to the discontinuation of embedded commissions, not less.

c. Uneven playing field and regulatory arbitrage

Several fund industry stakeholders submit that to require mutual funds to move away from embedded commissions would create an uneven playing field between mutual funds and competing financial products with embedded commissions, including banking and insurance investment products. As discussed in Part 3, we anticipate that any rule proposal we might undertake would discontinue embedded commissions for all types of investment funds and similar products that are governed by securities regulation. The rule proposal would capture not only conventional mutual funds, but also ETFs, non-redeemable investment funds, and structured notes, whether sold under a prospectus or in the exempt market. Accordingly, this would assure a level playing field amongst investment fund and fund-like products that the CSA regulates.

We recognize the potential for regulatory arbitrage in banking and insurance products, and as discussed in Part 3, the CCIR does as well. It is examining potential gaps in the regulatory framework for segregated funds and assessing the risk of regulatory arbitrage by dually-licensed insurance agents and has indicated an intention to act proactively to amend regulation where appropriate to address this risk. The CSA plans to continue to liaise with other regulators to discuss the risk of dealers and representatives prioritizing their compensation interests over the interests of their clients by inappropriately shifting their clients' assets to other investment products with embedded fees.

<u>Questions</u>

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:
    - access to advice for investors,
    - choice of payment arrangements for all investor segments, and
    - a level playing field amongst competing investment products?

28. What other measures should the CSA consider to mitigate the above unintended consequences?

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

    a. Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.

b. To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?

c. What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

a. to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;

b. does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and

c. what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

2. Transition options

We recognize that a transition to direct pay arrangements would require fund industry participants to adopt new business models that would likely entail the use of new systems and the adoption of new processes that would take a significant amount of time to set up and implement. We also recognize that this change would have important implications for investors, and that it would be essential for fund industry participants, including investment fund managers, dealers and representatives, to successfully manage their clients' experience during a transition.

Therefore, to the extent we may decide to move forward with a rule proposal discontinuing embedded commissions, we wish to identify potential transition options that could mitigate possible negative business and client impacts that may result throughout a transition.

With the foregoing in mind, we are currently considering a number of alternative measures that could be used to assist in promoting a successful transition while minimizing any resulting negative impacts. However, before we decide to implement any particular transition option, we want to ensure we have a full understanding of, and carefully consider, each option's potential impacts and consequences.

The following provides a brief discussion of some potential transition options we could consider. We seek your feedback on these options and any other possible options.

Option 1: *Transition to direct pay arrangements within a defined transition period*

One potential option could be to discontinue all embedded commission payments within a certain time period (the **Transition Date**) after the effective date of any final rule implementing such a transition (the **Effective Date**). For greater certainty, such payments would include trailing commissions and other ongoing service fees paid to dealers by an investment fund, investment fund manager or structured note issuer, and internal transfer payments from affiliates to dealers within integrated financial service providers which are directly tied to an investor's purchase or continued ownership of an investment fund security or structured note. The sale of investment funds by means of DSC purchase options would also cease upon the Transition Date.

Under this option, existing redemption schedules set by DSC purchase options (including those entered into before the Effective Date) could either be maintained after the Transition Date until the redemption schedule is completed (i.e. redemption fees could continue to be charged until the schedule expires in its normal course), or discontinued contemporaneously with all other payments at the Transition Date.

In our view, to successfully achieve a transition to direct pay arrangements, dealers would need sufficient time to design and implement direct pay arrangements, and representatives would need to meet with their clients to explain the upcoming changes and their associated impact.

Likewise, investment fund managers and structured note issuers would need sufficient time to modify affected areas of their business. For instance, we anticipate that issuers will likely rationalize the number of purchase options or series options offered for their investment fund products as a result of a transition to direct pay arrangements. Disclosure documentation will also need to be revised to account for changes that may result from the transition (for example, to account for the specific fees that may apply following the transition periods, or to account for any change in the number of purchase and series options).

Investment fund managers, structured note issuers, dealers and representatives would also need time to make necessary system, compliance, procedural and process changes needed to implement the potential transition. Issuers and dealers will also need time to coordinate and cooperate to successfully manage the associated client impact resulting from the transition (for example, to move clients from one series of a fund to another to the extent certain series are no longer offered).

Given what we understand will need to be completed by investment fund managers, structured note issuers, dealers and representatives, we recognize that it will be imperative to provide sufficient time to all affected parties to ensure a successful transition. In this regard, we suggest that a Transition Date of 36 months after the Effective Date could provide sufficient time to complete all required transition steps. We are open to other transition periods and encourage stakeholders to specifically comment on this point.

Option 2: *Transition to direct pay arrangements by account*

An alternate option could be to transition to direct pay arrangements in phases, by phasing in a dealers' account base over multiple periods. This approach would require dealers to transition a certain percentage of accounts by a certain date, a further percentage by a later date, and so on until all accounts have fully transitioned.

Similar to option 1, existing redemption schedules set by DSC and low-load purchase options (including those entered into before the transition) could either be maintained until the redemption schedule is completed (i.e. redemption fees could continue to be charged until the schedule expires in its normal course), or discontinued contemporaneously with all other payments at the Transition Date. Consistent with option 1, we anticipate that if the Transition Date were 36 months after the Effective Date, it could provide sufficient time to transition to the final percentage of accounts, but are open to other transition periods and encourage stakeholders to specifically comment on this point.

We recognize that there may be some logistical and practical constraints in transitioning to direct pay arrangements via a phased-in approach. For example, it may be difficult to coordinate tailored disclosure for investment products with the various time points, and it may also be difficult for issuers to rationalize their series and purchase options. We are therefore interested in your feedback on these potential approaches.

Questions

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.
    - Are there unique costs or challenges to specific businesses?
    - What transition period would be appropriate?
    - Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

PART 6 – RELATED REGULATORY INITIATIVES AND EXISTING TOOLS

In this part, we consider the extent to which related CSA initiatives and existing regulatory tools may help address the market efficiency and investor protection issues we identified in Part 2. The initiatives and tools discussed below include:

1. The POS and the Client Relationship Model (**CRM**) disclosure requirements and enhancements;
2. Compliance review initiatives; and
3. The proposals under CSA CP 33-404.

1. Discussion of Point of Sale & CRM

Overview of POS and CRM reforms

Over the last several years, the CSA have through the POS and CRM reforms, enhanced the disclosure of fund fees and dealer compensation provided to investors at the point of sale, at account opening, and in the account performance reporting process. The POS and CRM reforms aim to improve investors' awareness and understanding of the initial and ongoing costs associated with their investment, including their dealer's compensation, in order to enable them to:

- make a more informed investment decision at the time of the initial sale; and

- assess the cost of the services their dealer and representative provides over the course of the registrant-client relationship.

The fee disclosure enhancements under the POS and CRM reforms are briefly summarized below.

i. Point of Sale

The POS reforms introduced the four page fund facts disclosure document that, as at June 13, 2014, has replaced the lengthier simplified prospectus as the document that dealers are required to send or deliver to investors in connection with a trade in a conventional mutual fund. As at May 30, 2016, the fund facts is required to be delivered to the investor 'pre-trade'; that is, before the dealer accepts an instruction from the purchaser for the purchase of the security.

The fund facts aims to improve fee transparency by disclosing, in summary form, the costs of buying, owning, and selling conventional mutual fund securities. The costs disclosed include:

- the sales charges that an investor may pay at the time of purchase and any deferred sales charges that an investor may pay if the securities are redeemed within a specified period after purchase, each expressed in percentages and in dollars based on a $1,000 investment;

- the commission, expressed on a percentage basis, that the investment fund manager pays to the dealer for purchases made under the DSC option;

- the range of the trailing commissions paid by the investment fund manager to the dealer for each purchase option, expressed both in percentages and in dollars based on a $1,000 investment; and

- the management expense ratio, trading expense ratio, and fund expenses, expressed in percentages. The fund expenses are also expressed in dollars based on a $1,000 investment.

To alert investors to the conflict of interest created by embedded compensation such as trailing commissions, the foregoing cost disclosure is required to be prefaced by a statement that “higher commissions can influence representatives to recommend one investment over another”. The disclosure also includes a general description of what trailing commissions pay for.

While the fund facts document currently only applies to conventional mutual fund securities, the CSA will, at the time of publication of this Consultation paper, have published final rules introducing a similar summary disclosure document for exchange traded funds, called “ETF Facts”.

ii. <u>CRM</u>

The CRM reforms, which have been implemented in phases over the last several years, introduced new requirements in a number of areas related to a client’s relationship with a registrant. The first phase of CRM introduced relationship disclosure information delivered to clients at account opening (by explaining, for example, the types of products and services provided by the registrant), and comprehensive conflicts of interest requirements. CRM2 introduced new disclosure requirements relating to investment performance at the account level and the commissions and other amounts paid to dealers. A particular objective of this second phase was to increase mutual fund investor’s awareness of trailing commissions paid to dealers. CRM2 was not intended to address product costs. Generally, the CRM reforms apply broadly to all types of securities held by a client.

As a result of the CRM reforms, at account opening, clients are now provided with more fulsome information on charges, including transaction charges, which they may expect to pay in connection with their investment. Where the investment is in mutual funds, for example, the information should include:

- the management fee paid by the fund;

- the initial sales charge and DSC options available to the client (along with an explanation of how such charges work); and

- any trailing commissions or other embedded fees paid in connection with the investment.

Following a transaction, clients are provided with a trade confirmation that includes disclosure of each transaction charge, deferred sales charge or other charge applying to a transaction, and the total amount of all charges. Thereafter, on an annual basis, the report on charges and other compensation now provides a summary of all charges incurred by the client and all compensation received by the dealer that relates to each account the client holds with the dealer, including:

- the total dollar amount of each type of transaction charge related to the purchase or sale of securities paid by the client during the period covered by the report, and the total amount of those charges;
- the total dollar amount of each type of payment, other than a trailing commission, that is made to the dealer or any of its representatives by a securities issuer or another registrant (e.g. an investment fund manager) in relation to registerable services to the client – this amount captures upfront commissions that investment fund managers pay to dealers for sales made under DSC arrangements; and
- the total dollar amount of trailing commission received by the dealer in connection with securities held in the client's account, accompanied by a statement advising the client that the trailing commission is paid by investment fund managers, that its amount varies depending on the purchase option selected, and that these fees affect the client because they reduce the amount of the fund's returns.

The client's annual investment performance report for each account held with the dealer also includes the following information to better enable the client to evaluate how their investments have performed:

- a detailed breakdown of all deposits into and withdrawals out of the account;
- the change in market value of the account (in dollars); and
- the annualized total percentage return of the account for the previous year, as well as the previous three, five, and ten years.

How POS and CRM may address the identified issues

The CSA will monitor the impact of the POS and CRM.[149] While we expect it will be a number of years before these impacts may be fully evaluated, generally, we expect the reforms to appreciably improve investors' awareness and understanding of mutual fund costs and performance, and make them more informed consumers of investment fund products and advice services. We anticipate that these improvements will partially address the key issues we have identified.

[149] The CSA recently began a multi-year research project to measure the impacts of CRM2 and POS on investors and the industry. The research will measure outcomes related to investor knowledge, attitude and behavior, registrant practices, and fund fees and product offerings. It will cover activity from 2016 through 2019 and is expected to be completed in 2021.

The following discussion provides further analysis for each of the key issues:

- Issue 1 – Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

We anticipate that the enhanced disclosure required at the time of sale (by the POS reforms), at account opening and annually thereafter (by the CRM reforms) will lead to increased transparency of fund costs and dealer compensation. The increased transparency should better enable investors to compare the costs of investing in one mutual fund over another, which should equip investors with better tools to manage the impact of fund costs on their returns.

The introduction of account performance reporting coupled with the heightened transparency of fund costs and dealer compensation (and in particular trailing commissions) may also cause investors to question the services that their representatives provide and allow investors to better assess the true costs and value of the services they receive. This awareness in turn may, over time, lead to changes in the consistency and level of services provided by dealers and representatives to investors, and the selection of lower-cost funds and, possibly, better performing funds. To the extent this occurs, we anticipate that investment fund managers may respond to dealers' different product demands by producing lower-cost funds and focusing more on performance, thus potentially increasing competition and market efficiency. The investment fund manager response may be further shaped by the extent to which the POS and CRM reforms may cause clients to also question the cost of the investment fund manager.

Overall, these potential positive effects of enhanced disclosure on the registrant-client relationship and investment fund manager behavior may combat some of the harms resulting from Issue 1. However, we believe disclosure alone may fall short of fully addressing the inherent conflicts of interest under Issue 1 for the reasons below:

i. The research we have reviewed (see Part 2 and Appendix A) suggests that, as long as product embedded commissions continue to be permitted,

    a. the compensation bias in such commissions may continue to incent dealers and their representatives to recommend to investors products that give priority to maximizing revenue over the interests of clients – potentially impairing investor outcomes and market efficiency; and

    b. investment fund managers will continue to be incented to compete for sales on the basis of the compensation they pay dealers, reducing the likelihood that they will compete on the basis of performance and skill – potentially disadvantaging skilled fund managers who do not pay higher than standard trailing commissions or who do not pay any trailing commissions. As discussed in Part 2, this incentive can drive up fund costs overall and limit the availability of low-cost and passively managed funds, thus impairing competition and market efficiency;

ii. Research has shown that disclosure alone may not be an effective remedy at addressing conflicts of interest in an advisor-client relationship. Specifically, research suggests that advisors provide more biased advice when a conflict of interest is disclosed than when it is not, and that advisees may not sufficiently discount the advice to counteract the increased bias.[150] Further research also suggests that disclosure of a conflict of interest can have unintended, perverse effects such as advisees being more likely to follow conflicted advice.[151] To the extent such effects occur in the advisor-client relationship as a result of the disclosure, advice and decision making may be suboptimal leading to poor investor outcomes and decreased market efficiency; and

iii. Investors' high level of trust and reliance on their advisors for investment decisions may cause them to not thoroughly review disclosure documents and reports, and thus limit the benefits to be derived from disclosure. For example, a recent study conducted by the British Columbia Securities Commission (**BCSC**) found that, among other things, 89% of respondents described their existing level of trust in their investment representative as strong or very strong. This trust led some clients to place less importance on reading their account statements because they were confident that their representative was taking care of their investments.[152] Similarly, a recent survey conducted by the CSA shows that investors' primary source of investment information is their advisors, with 43% of investors classified as exclusively relying on their advisor.[153] To the extent that clients do not rely on disclosure for their investment decisions, the resulting benefits of the disclosure may be limited as they may not be fully informed with respect to all account fees and performance, and may not fully or effectively question or assess the services provided.

- Issue 2 – Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

As discussed in connection with Issue 1 above, the enhanced and more prominent disclosure of fund fees, including embedded dealer compensation, should increase an investor's awareness and understanding of such costs and better equip them to manage the impact of those costs on their investment returns.

However, to the extent dealer compensation continues to be paid out of fund management fees, we think the POS and CRM reforms may only partially address Issue 2 for the reasons below:

i. The fund fee structure will remain relatively complex which, as discussed in Part 2, may continue to impede investors' understanding of dealer compensation costs and fund fees;

[150] Daylain M. Cain, George Loewenstein and Don A. Moore, "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest", *The Journal of Legal Studies*, Vol. 34, No. 1 (January 2005), pp. 1-25, http://www.arts.uwaterloo.ca/~dkoehler/ACC784/CainLoewensteinMoore2006.pdf.

[151] Sunita Sah, "The Paradox of Disclosure", *The New York* Times, July 8, 2016, http://nytimes.com/2016/07/10/opinion/sunday/the-paradox-of-disclosure.html?_r=0.

[152] BC Securities Commission, National Smarter Investor Study, Public Opinion Research (November 2015), https://investright.org/wp-content/uploads/2016/09/Smarter-Investor-Study-FULL-REPORT-1.pdf.

[153] The CSA Investor Education Study 2016, https://www.osc.gov.on.ca/documents/en/About/csa_investor-education-study.pdf.

ii. Investment fund managers will continue to determine the compensation paid to the dealer without any direct involvement of the client. This current arrangement limits a client's engagement in the dealer compensation process and consequently limits their awareness and control over that compensation.

Discontinuing embedded commissions would remove the investment fund manager from the dealer compensation process and enable the direct involvement of the client with their representative over the compensation paid. This involvement in turn may lead to greater fee awareness, as well as create opportunities for a client to negotiate, and have greater control over, the ultimate compensation paid.

- Issue 3 – Embedded commissions paid generally do not align with the services provided to investors

As noted in Issue 1 above, the increased performance reporting coupled with the increased saliency of fund costs and dealer compensation should cause investors to question the services provided by their representative. To the extent that investors respond to fund fee disclosure under CRM2 by either questioning the overall level of services and advice they are receiving from their representative or switching to lower-cost alternatives, we would expect the representative to respond by demonstrating their value proposition and reviewing the level of services provided. To the extent this change occurs, these disclosure reforms may improve the alignment between the embedded dealer compensation paid and the services provided to investors and therefore assist in addressing Issue 3. Nevertheless, embedded commissions will remain a "one-size-fits-all" fee that may not align well with the services and advice actually provided to individual investors in accordance with their specific needs, expectations and preferences. This misalignment in turn may cause some investors to pay more fees than necessary relative to the services received, thus impeding investment returns.

2. Discussion of Compliance Review Initiatives

Overview of the compliance review initiatives

Some CSA members are completing various compliance review initiatives on sales incentives that may give rise to conflicts of interest when distributing investment funds. In certain cases, the compliance initiatives are also being coordinated with the MFDA and IIROC.

While some reviews are completed and others are ongoing, the reviews include an examination of, among other things, practices that are designed to influence the selection of investment funds for distribution by a representative to clients. For example, in early 2016, the Ontario Securities Commission (**OSC**) completed a focused review of mutual fund sponsored conferences organized and presented by investment fund managers to assess compliance with NI 81-105. The OSC and the Autorité des marchés financiers (**AMF**) have also issued a survey requesting information from a sample of investment fund managers relating to management fee discounts that are based on total assets held by a dealer.

How the compliance review initiatives may address the identified issues

The CSA will monitor the results of the compliance reviews to determine the full extent to which the review addresses each of the market efficiency and investor protection issues identified. While the full effect of the reviews remains to be determined, the CSA do not at this time anticipate that the initiatives will, on their own, materially address the identified key issues.

The following discussion provides further analysis for each of the key issues:

- Issue 1 – Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

The CSA expect that the reviews may reduce the incidence of inappropriate practices designed to drive sales. To the extent inappropriate practices designed to drive sales are reduced, the CSA anticipate a reduced incentive for products to be recommended on the basis of inducements received by the representative – potentially leading to a shift in recommendations from funds that were inappropriately favored to those that may be more suitable for an investor. If these funds are better performing funds, the shift in recommendations may reward better performing investment fund managers with an increase in market share, which should in turn lead to greater competition in the marketplace and efficiency in general (as investment fund managers would face increasing pressure to compete on the basis of performance, and not on incentives they offer to dealers).

Given the foregoing, the CSA expect that the review may partially assist in addressing Issue 1. However, we do not anticipate that the review will fully address Issue 1 primarily because the payment of trailing commissions and other forms of embedded compensation will continue to be permitted. As a result, the conflicts of interest facing dealers and representatives will continue to be present, which may continue to encourage investment recommendations that may impair investor outcomes. Additionally, the continued presence of embedded commissions will not address the conflicts that exist at the investment fund manager level, maintaining the potential for underperformance and higher-costs overall.

- Issue 2 – Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

The CSA do not expect the outcomes of the review to address Issue 2. As this initiative will be focused on incentives provided to dealers and representatives and is not disclosure or client focused, it is not expected to increase investors' overall awareness, understanding and control of dealer compensation costs and fund fees. Additionally, we do not anticipate the review having any impact on reducing the complexity of the mutual fund fee structure or on the industry generally.

- Issue 3 – Embedded commissions paid generally do not align with the services provided to investors

The CSA also do not expect the outcomes of the review to address Issue 3. Similar to Issue 2, as this initiative will be focused on incentives provided to dealers and representatives and is not disclosure or client focused, there are no aspects of this review that are expected to directly increase the alignment between embedded commissions and services provided to fund investors.

3. Discussion of the proposals to enhance the obligations of advisers, dealers and representatives toward their clients outlined in CSA Consultation Paper 33-404

Overview of CSA Consultation Paper 33-404

On April 28, 2016, the CSA published CSA CP 33-404 seeking comment on proposed regulatory action aimed at enhancing the obligations and duties of advisers, dealers, and representatives toward their clients. The proposals, which are in response to issues the CSA identified in the client-registrant relationship, include measures to:

- better align the interests of registrants to the interests of their clients;
- clarify the nature of the client-registrant relationship; and
- improve outcomes for clients.

The concept proposals outlined in CSA CP 33-404 introduce a number of targeted reforms to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that include, among others, proposals to strengthen the regulation of conflicts of interest, the know-your-client (**KYC**) and KYP requirements, the suitability obligation, proficiency of representatives, and the use of titles.

For example, with respect to the regulation of conflicts of interest, dealers and representatives would be required to respond to each identified material conflict of interest in a manner that prioritizes the interests of the client ahead of their own. Moreover, any disclosure given to a client about a conflict of interest would need to be prominent, specific, and clear. Importantly, the disclosure should be meaningful to the client to allow the client to fully understand the conflict, including the implications and consequences of the conflict for the client. CSA CP 33-404 states that disclosure alone is a generally inadequate mitigation mechanism because of its limited impact on a client's decision-making process.[154] That consultation paper also provides guidance on specific conflict of interest situations related to compensation practices.

The KYC process would also be improved to ensure it results in a thorough understanding of the client, and as a result would require a representative to gather more client-centered information relating to the client's investment needs and objectives, financial circumstances, and risk profile.

Amendments to the KYP process would explicitly require representatives to have sufficient knowledge of a product, together with the KYC analysis, to support a proper suitability analysis. Ultimately, this process would require representatives to thoroughly consider, among other things, the product strategies, features, costs and risks of each security on the firm's product list. Moreover, representatives would be required to understand and consider how a product being

[154] See CSA CP 33-404, Appendix A.

recommended compares to other products and how the recommendation would fit within the client's account and overall strategy.

Dealers would be required to identify whether they have a proprietary or mixed/non-proprietary product shelf. Dealers with a mixed shelf would be required to undertake a fair and unbiased market investigation of a reasonable universe of products to satisfy themselves they have a range of products that are most likely to meet the investment needs and objectives of its clients based on its client profiles.

The suitability analysis would also be reinforced to ensure that recommendations satisfy the following three broad elements: basic financial suitability, investment strategy suitability, and product selection suitability. Of note, the product selection suitability determination would need to take into account the impact on the performance of the product of any compensation paid to the registrant by the client or a third party in relation to the product.

The proposals would also introduce new requirements aimed at increased proficiency for representatives, including increased proficiency of how product costs and investment strategies (such as active and passive) can impact investment outcomes for clients.

In addition to the targeted reforms discussed above, all of the CSA jurisdictions other than the BCSC are consulting on a regulatory best interest standard, accompanied by guidance, that would form both an over-arching standard and governing principle against which all other client-related obligations would be interpreted. Generally, a regulatory best interest standard would require that a registered dealer and its representatives deal fairly, honestly, and in good faith with its clients and act in its clients' best interests. Several CSA members have expressed strong reservations relating to the adoption of a regulatory best interest standard.

If the potential reforms outlined in CSA CP 33-404 are implemented, they would cover a broad spectrum of obligations for registrants and apply to all advisers, dealers and representatives, including those who are members of IIROC and the MFDA. Ultimately, these potential reforms are intended to work together to improve the overall client-registrant relationship.

How the CSA CP 33-404 proposals may address the identified issues

It is important to note that the concept proposals discussed in CSA CP 33-404 are not specifically designed to address the key investor protection and market efficiency issues identified in this Consultation Paper. The CSA will however monitor the development of those proposals over the consultation process and continue to evaluate the extent to which they may address our key issues. We consider that the potential reforms discussed in CSA CP 33-404 may, to the extent they are adopted in their current form, better align the interests of registrants with the interests of their clients, clarify the nature of the client-registrant relationship and improve outcomes for investors overall. The CSA expect that these potential reforms may assist in addressing, to a partial extent, the investor protection and market efficiency issues we have identified in this Consultation Paper.

The following discussion provides further analysis for each of the key issues:

- <u>Issue 1 – Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors</u>

The CSA anticipate that the potential reforms discussed in CSA CP 33-404 would, if implemented, lead to better conflict of interest management that may, in turn, assist in mitigating the conflict of interest that embedded commissions raise for dealers and representatives. We are of this view for several reasons, including because representatives would be required to respond to conflicts of interest in a manner that prioritizes the interests of the client ahead of their own. With respect to dealer compensation, for example, dealers would need to assess whether any remuneration could reasonably be expected to inappropriately influence how representatives interact with their clients. To the extent that the compensation gives rise to a conflict, firms would need to ensure that there are adequate controls and oversight in place to mitigate the conflict. Importantly, if the conflict cannot be managed, it must be avoided.

We are also of the view that the CSA CP 33-404 proposals would lead to better conflict of interest management because dealers and representatives would specifically be required to consider the impact of their compensation on performance as part of the suitability analysis. To the extent a product is recommended because it benefits the dealer or representative, but there is another equally suitable product on the dealer's product list that would be less costly for the client, such recommendation would not comply with the suitability obligation or the dealer's general duties to their client.

As a result of the foregoing, the CSA anticipate that tied forms of compensation may play less of a role in product recommendations. Combined with the enhancements to KYC, KYP, suitability, and proficiency, the CSA anticipate that representatives' recommendations may shift to more suitable products that may be lower-cost and, possibly, better performing products. To the extent that the CSA CP 33-404 proposals result in shifts in product recommendations toward lower-cost and better performing products, we anticipate that those proposals may also have an indirect effect over time on investment fund managers as they may respond to these shifts by producing lower-cost funds and placing a greater emphasis on performance. This shift would potentially reward better performing investment fund managers with increased market share, thereby improving competition and market efficiency.

Given the apparent benefits of the foregoing, the CSA expect that the concept proposals outlined in CSA CP 33-404 (if adopted in its current form), in combination with the POS and CRM reforms as well as the compliance review initiatives, may address Issue 1. For the following reasons, we are nevertheless considering whether discontinuing embedded commissions may also be necessary.

Firstly, the proposals were not developed to address the conflict that embedded commissions raise at the investment fund manager level. As a result, the anticipated positive effects of the proposals on investment fund manager behavior (i.e. production of lower-cost funds and increased focus on performance), as well as the consequential positive effects on competition and market efficiency, are dependent on the effect the proposals have on representatives' recommendations. While the extent to which representatives' recommendations would shift remains to be determined, there are certain aspects of the proposals that may lessen its ultimate impact on investment fund manager behavior, competition and market efficiency generally.

Until such time as dealer recommendations shift to the degree necessary to trigger change at the investment fund manager level (if at all), investment fund managers may continue to be incented to rely more on the payment of embedded commissions rather than on skill to sell their products and gain market share. As discussed in Part 2 above, the payment of embedded commissions can reduce a manager's focus on performance and lead to underperformance.

Secondly, the payment of embedded commissions is not addressed under CSA CP 33-404. Embedded commissions may continue to create a barrier to entry that may reduce the likelihood of lower-cost providers entering the market. As discussed in Part 4, the entrance of lower-cost providers may place competitive pressure on fund costs and encourage the manufacturing and distribution of lower-cost funds. Embedded commissions may also dampen the extent to which independent investment fund managers are able to access the IIROC and independent mutual fund dealer distribution channels. Taken together, these effects may limit price competition and market efficiency.

Finally, in our view, a potential discontinuation of embedded commissions may complement the concepts outlined in CSA CP 33-404. We are of this view because a discontinuation may remove the conflict of interest that embedded commissions raise for dealers, representatives and investment fund managers and may better align their interests with those of investors.

- Issue 2 – Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

CSA CP 33-404 was not designed to address Issue 2. While transparency of fees may increase to the extent embedded dealer compensation arrangements are disclosed as part of the conflict of interest mitigation process, investment fund managers would still continue to determine the compensation paid to dealers without any direct involvement of the client. The lack of direct client involvement in the dealer compensation process may limit fee awareness, as well as the level of control a client has over the compensation ultimately paid to their dealer and their representative for the services provided. Moreover, the presence of embedded compensation may continue to make the fee structure more complex, which may continue to inhibit investors' understanding of such costs.

- Issue 3 – Embedded commissions paid generally do not align with the services provided to investors

CSA CP 33-404 was also not designed to address Issue 3. The CSA expect that the enhancements to KYC, KYP, suitability, and proficiency requirements, along with improved conflict of interest mitigation, may encourage the provision of advice and services to investors that better meet their needs and objectives. However, embedded commissions will still remain a "one-size-fits-all" fee that may not align well with the services and advice actually provided to individual investors in accordance with their specific needs, expectations and preferences. This misalignment may cause some investors to pay more fees than necessary relative to the services received, thus impeding investment returns.

Questions

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

    - address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and

    - address or not address any additional harms or issues that you have identified.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

PART 7 – COMMENT PROCESS AND NEXT STEPS

The issues addressed in this Consultation Paper are important ones which affect all participants in the Canadian capital markets. Due to the broad impact of the policy option discussed in this Consultation Paper, the contribution of stakeholders is important. We invite all interested parties to make written submissions.

Some CSA jurisdictions will hold in-person consultations in 2017 to facilitate additional feedback and further our consideration of the issues discussed in this Consultation Paper. The details of any in-person consultations will be announced.

Once we have considered the feedback received through the written comment process and any in-person consultations, we will decide on the appropriate policy response, if any, communicate our policy direction and propose any necessary rule changes to implement the policy. Any rule proposal would be published for comment in accordance with the regular rule-making process.

Please submit your comments in writing on or before **June 9, 2017**. You may provide written comments in hard copy or electronic form. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Certain CSA regulators require publication of the written comments received during the comment period. We will publish all responses received on the websites of the Autorité des marchés financiers (www.lautorite.qc.ca), the Ontario Securities Commission (www.osc.gov.on.ca), and the Alberta Securities Commission (www.albertasecurities.com). Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Please address your submission to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA regulators.

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APPENDIX A
EVIDENCE OF HARM TO INVESTOR PROTECTION AND MARKET EFFICIENCY FROM EMBEDDED COMMISSIONS

Issue 1: Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

i. Embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance

Trailing commissions and DSC arrangements may influence fund flows and negatively impact fund performance:

Research by Douglas Cumming et al[155], examining whether sales and trailing commissions influence fund sales and using fund level data provided by Canadian investment fund managers, finds that trailing commissions insulate the investment fund manager by reducing flow sensitivity to past performance, evidencing the misalignment of interests associated with embedded commissions. Key findings from the research included:

- All flows, with the exception of flows originating from affiliated dealers of the investment fund manager, are sensitive[156] to past performance. Funds that outperform receive more sales, while funds that underperform receive less sales;

- The sensitivity of fund sales to past performance is considerably reduced when:

  a. investment fund managers pay embedded commissions to dealers/representatives – the greater the payment, the greater the level of net flows that is indifferent to past portfolio manager skill (i.e. alpha). At a 1% trailing commission – the amount typically paid by front end equity/balanced funds and funds-of-funds in Canada today – the investment fund manager could expect inflows to increase by 0.3% of assets per month or 3.7% per year, regardless of past performance. Similarly, a 1.5% trailing commission was found to increase the average monthly flows by 0.45% of assets under management each month or 5.4% per year regardless of past performance. On the converse, the research found that fund flows for mutual fund series that do not pay embedded commissions (fee-based series) are more sensitive to past performance; and

[155] Douglas Cumming et al., supra, note 3.

[156] 'Sensitivity' is referring to the relationship between past risk-adjusted outperformance and future fund flows after controlling for all other product specific factors (e.g. fund type, risk classification, series type, etc.) that may provide a reason for investors and their dealers/representatives to select the product.

b. investors are invested under the DSC option. Investments under that option show the lowest sensitivity to past performance out of all purchase options, which reflects the impact of the redemption fee on investor behavior; it may deter investors from redeeming even in the face of consistently poor performance.

- The payment of trailing commissions impacts the relationship between performance and fund sales such that, for any increase (decrease) in performance, inflows (outflows) are 15% less than what they would be in the absence of trailing commissions.

- Reduced sensitivity to past performance also impacts future fund performance and this result applies to funds that pay embedded commissions, funds sold under DSC arrangements and funds that receive affiliated dealer flows. For example, an increase in trailing commissions and sales commissions under the DSC by 1% is indirectly associated with a reduction in future outperformance before fees by 1.4% and 0.6% respectively, relative to the average monthly performance. This finding potentially suggests that investment fund managers who pay trailing commissions to dealers, understanding that outperformance may not be rewarded with additional inflows, may have a tendency to cease trying to outperform.

Consistent with the Cumming et al. research, a *study by Susan Christoffersen et al*[157] which examined fund flows between 1993 and 2009 among U.S. mutual funds with loads or revenue-sharing found that higher payments to fund brokers lead to higher inflows and that net returns are approximately 50 basis points lower for every 100 basis points of loads.

In contrast to the above research, a *study by Investor Economics for the Investment Funds Institute of Canada*[158] argues that no single factor can satisfactorily explain the volume of mutual fund sales and redemptions into a specific fund at a given point in time. Rather, their study asserts that the flow activity in and out of Canadian mutual funds reflects the interplay of more than 40 factors, of which they argue the following three to be the most relevant:

i. macro-economic and demographic factors;

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[157] Susan Kerr Christoffersen, Richard B. Evans and David K. Musto, "What do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives", *The Journal of Finance*, Vol. 68, Issue 1, (February 2013), pp. 201-235, available on SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1393289.

[158] Investor Economics, *Analysis of Factors Influencing Sales, Retention and Redemptions of Mutual Fund Units*, September 2015 Study for The Investment Funds Institute of Canada, https://www.ific.ca/wp-content/uploads/2015/12/Investor-Economics-Analysis-of-Factors-Influencing-Fund-Flows-September-2015.pdf/12353/

ii. individual fund investment return characteristics; and

iii. preferred access to distribution, via either direct affiliation or strategic alliance.

Funds that pay commission tend to underperform those that do not:

The *Mutual Fund Fees Research by the Brondesbury Group*[159], evaluating the extent to which the use of fee-based versus commission-based compensation changes the nature of advice and impacts investment outcomes, while not finding evidence that fee-based arrangements produce better outcomes for investors, finds conclusive evidence that commission-based compensation creates problems that must be addressed. They find, among other things, that funds that pay a commission (sales loads and trailing commissions) underperform those that do not, whether looking at raw, risk-adjusted or after-fee returns.

A *study by Jonathan Reuter*[160] similarly finds evidence that the payment of dealer compensation impairs fund performance. Specifically, this study finds over a 10-year period that when actively managed non-specialized U.S. equity mutual funds are sold through brokers, they underperform similar actively managed funds sold directly to investors (i.e. sold without the intermediation of a dealer) by an average of 0.65% on a risk-adjusted basis. When performing the comparison without 12b-1 fees (i.e. the U.S. form of trailing commissions), the average 10-year return for direct-sold funds held a 0.42% point advantage over broker-sold funds, using a value-weighted comparison.

Embedded commissions may increase flow volatility and decrease gross returns:

A *study by the Office of Economic Analysis of the U.S. Securities and Exchange Commission* (**SEC**)[161] that empirically tests the benefits to fund shareholders of 12b-1 fees (i.e. the U.S. equivalent of trailing commissions) finds no apparent benefits accruing from such payments to fund unitholders. Overall, while funds with 12b-1 fees attract higher flows and accordingly grow faster than funds without them[162], they appear to increase flow volatility[163] and decrease gross returns. The SEC notes that the results of the research

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[159] The Brondesbury Group, supra, note 3.

[160] Jonathan Reuter, Boston College - Department of Finance, National Bureau of Economic Research (NBER), “Revisiting the Performance of Broker-Sold Mutual Funds”, November 2, 2015, available on SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685375.

[161] Lori Walsh, SEC Office of Economic Analysis, *The Costs and Benefits to Fund Shareholders of 12b-1 Plans: An Examination of Fund Flows, Expenses and Returns*, April 26, 2004, https://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf.

[162] Ibid, at page 10, the SEC Office of Economic Analysis states: “[F]unds with 12b-1 plans obtain significantly higher annual net flows than do funds without 12b-1 plans. Fund portfolios with a weighted-average 12b-1 fee of 0.34% had 4% higher flows than similar non-12b-1 funds. This is significant considering that the average net flow is 8% annually. Funds with 12b-1 fees thus have grown more quickly than funds with no 12b-1 fund fees.”

[163] ‘Flow volatility’ means the volatility of fund purchase and redemption flows which may increase liquidity costs.

highlight the conflict of interest that 12b-1 plans create – investment fund managers use fund unitholder money to pay for asset growth from which the investment fund manager is the primary beneficiary through the collection of higher fees and the unitholders are not obtaining the benefits they should from the payments of 12b-1 fees.

ii. Embedded commissions can encourage dealers and representatives to make biased investment recommendations which may negatively affect investor outcomes

Commissions encourage biased representative recommendations:

The *research by Douglas Cumming et al*[164] referenced above showed that a rise in trailing commissions reduces the sensitivity of fund flows to past risk adjusted performance (i.e. portfolio manager skill), suggesting that these payments bias dealers/representatives toward funds that pay higher trailing commissions, and away from funds that do not pay industry standard trailing commission rates, regardless of their performance;

The *study by Susan Christoffersen et al*[165] referenced above found that higher payments to U.S. fund brokers led to higher inflows, suggesting that brokers' recommendations are biased by the payments they receive;

A *study by Daniel Bergstresser et al.*[166] examining broker-sold and direct-sold funds in the U.S. from 1996 to 2004 found "that flows in broker-sold funds are positively related to distribution fees, suggesting that sales in the broker sector might reflect broker compensation incentives.";

The *Mutual Fund Fees Research by the Brondesbury Group*[167], referenced above found that:

- higher embedded commissions drive mutual fund sales;
- financial advisor recommendations are sometimes biased in favour of higher commission generating products; and
- commissions affect the effort made by financial advisors to overcome investor behavioral biases, including biases that may lead to sub-optimal returns;

[164] Douglas Cumming et al. supra, note 3.

[165] Susan Kerr Christoffersen et al, supra, note 157.

[166] Daniel Bergstresser, John Chalmers and Peter Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," *Review of Financial Studies*, Vol. 22, (2009), pp. 4129-4156, at p.4131, https://pdfs.semanticscholar.org/192b/4d9cde7f484200b037ffbdadabef1b90b800.pdf.

[167] The Brondesbury Group, supra, note 3.

A *study by John Chalmers and Jonathan Reuter*[168] studying the impact of financial advisors on the retirement portfolios of a large sample of U.S. public college and university employees finds empirical evidence that commissions, rather than the suitability of financial products, drive sales. Chalmers and Reuter conclude in their analysis that "funds paying higher broker fees receive economically and statistically significantly higher retirement contributions from broker clients. Our evidence that broker incentives influence broker recommendations highlights the agency conflict that can arise when financially unsophisticated investors seek advice from intermediaries."[169]

A *study by Sendhil Mullainathan et al*[170]**,** using an audit methodology where trained auditors met with U.S. retail commission-based financial advisors and presented different types of portfolios, examined whether advisors reinforce investor biases that help further the advisor's own economic interests. The study found that financial advisors fail to de-bias their clients and often reinforce biases that are in the advisor's interests. Financial advisors encourage returns-chasing behavior and push for actively managed funds that have higher fees, even if the client starts with a well-diversified low-fee portfolio. The researchers state that "[t]he evidence suggests that most of the interaction is driven by the need to generate fees rather than to respond to the client's rebalancing needs."[171]

Embedded commissions incent unsuitable use of DSC arrangements:

In addition to embedded trailing commissions, there is evidence that embedded commissions paid by investment fund managers to dealers/representatives on sales made under the DSC option can similarly incent unsuitable recommendations. A recent *MFDA compliance review* completed in December 2015[172] uncovered instances of the inappropriate use of the DSC option. The MFDA examined the use of that option, particularly with senior clients, and dealers' supervision, suitability assessment, and disclosure practices in this area. The review covered 12 firms of various sizes with assets totalling $140 billion (30% of all mutual fund dealers) and employing 24,650 approved persons (30% of all approved persons).

The review uncovered several problematic practices, including:

- clients over age 70 that were sold funds under DSC arrangements;

[168] John Chalmers and Jonathan Reuter, "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?", NBER Working Series/Working Paper 18158, (09 June 2012), https://www2.bc.edu/jonathan-reuter/research/NBER_WP18158.pdf.

[169] Ibid, page 4.

[170] Sendhil Mullainathan, Markus Noeth and Antoinette Schoar , "The Market for Financial Advice: An Audit Study", NBER Working Paper 17929, (2012) http://www.nber.org/papers/w17929.

[171] Ibid p. 16.

[172] MFDA Bulletin #0670-C, *2015 DSC Sweep Report*, December 18, 2015.

- clients who were sold funds with DSC redemption schedules that are longer than their investment time horizon; and

- evidence of poor disclosure of the redemption fees at certain firms and poor suitability assessment and supervision of sales under the DSC option.

In a recent *MFDA Review of Compensation, Incentives and Conflicts of Interests*, the MFDA identified compensation and incentive practices that increased the risk of mis-selling funds under the DSC option.[173]

Further analysis of *MFDA enforcement files* show that the DSC option can attract dealers/representatives promoting unsuitable leverage strategies on their clients or churning the client accounts.[174] Recommendations that clients borrow to invest in funds on a DSC basis enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction.

The *Inspections Branch of the AMF* also issued a compliance notice in July 2015 that reported that the AMF found some important risks of non-compliance with the KYC rules among mutual fund dealers in Québec. In particular, certain dealers' compliance systems permitted the sale of funds with DSC redemption schedules to investors with short investment horizons.

These findings suggest that the DSC option remains an attractive option for dealers and their representatives because it offers a guaranteed initial commission of up to 5% of the purchase amount (paid by the investment fund manager rather than the investor), plus the ongoing trailing commission.

The DSC option may have a significant impact for the investor, being the redemption fee payable on investments that are redeemed within a certain number of years of purchase (typically up to 6 years from the date of purchase) where an investor wishes to redeem its investment from the firm. This penalty, which aims to discourage redemptions in order to preserve assets under management, has progressively reduced the popularity of the DSC option with investors.

Recent market data suggests that the use of the DSC option in Canada remains in stark contrast to its very limited use in other jurisdictions. As at the end of 2015, 19% of the Canadian fund assets totalling $234 billion were held in DSC options.[175]The latest data from

[173] MFDA Bulletin #0705-C, *Review of Compensation, Incentives and Conflicts of Interest*, December 15, 2016.

[174] See for example, the cases against Enzo DeVuono, George William Popovich, Michael Darrell Harvey, Tony Siu Fai Tong, Jacqueline De Backer, Carmine Paul Mazzotta and David John Ireland.

[175] Investor Economics, *Insight Monthly Update*, May 2016. The 19% figure includes DSC (14.4%) and low load (5.1%).

the U.S. and Europe shows that less than 1% of assets in each jurisdiction are invested under the DSC option (0.71% for the U.S. and 0.49% for Europe).[176]

We note that an important Canadian group of mutual funds has announced that it will discontinue the DSC purchase option effective January 1, 2017.[177]

Conflicted advice may negatively affect investor outcomes:

A *study by the Executive Office of the President of the United States*[178] examined the evidence on the cost of conflicted investment advice and its effects on Americans' retirement savings. It found that conflicted advice leads to lower investment returns. Savers receiving conflicted advice earn returns roughly 1 percentage point lower each year (for example, conflicted advice reduces what would be a 6 percent return to a 5 percent return).

A similar *study by John Chalmers et al*[179] examined whether conflicted advice yielded better investment outcomes than no advice. Researchers examined account-level data for participants in a defined contribution plan over time, allowing them to compare the portfolios of advised and non-advised clients with similar attributes over time and to compare advisor recommendations against a simple default option – a target date fund[180]. They found that:

- investors that used the services of a broker earned annual after-fee returns that were 2.98% lower than they would have earned investing in a target date fund - offering similar levels of risk;
- brokers are significantly more likely to place their clients in funds that pay them higher fees.

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[176] U.S. – Morningstar Direct Non-Institutional B Shares with minimum investment below $25,000 USD at February 2016; Europe – Morningstar Direct Non-Institutional series Open-End and SICAV with minimum investment below 25,000 (base currency) at February 2016.

[177] Investors Group website: https://www.investorsgroup.com/en/media-releases/deferred-sales-charge-purchase-optionto-be-discontinued.

[178] Executive Office of the President of the United States, "The Effects of Conflicted Investment Advice on Retirement Savings" (2015), https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[179] John Chalmers and Jonathan Reuter, "Is Conflicted Advice Better than No Advice?", NBER Working Paper 18158, (2012), http://www.nber.org/papers/w18158.

[180] A "target date fund", also known as a "lifecycle fund", is designed to provide a simple pre-packaged investment solution through a portfolio whose asset allocation mix becomes more conservative as the target date (usually retirement) approaches. These funds relieve the dealer and their representative from performing any asset allocation and rebalancing for the investor as this occurs automatically within the fund's portfolio as time progresses and the investor nears the target date.

In Canada, a *study by Stephen Foerster et al*[181] analyzing the value of advice by tracking account level data from three mutual fund dealers covering 581,044 investors and 5,920 representatives over a 14 year period reached similar results. Researchers found that:

- representatives encourage increased risk taking among their clients, allocating as much as 30% more to higher risk mutual funds (with higher fees/dealer compensation) than non-advised clients. The higher expected return (i.e. the equity risk premium) that should be generated as a result of greater risk taking is completely nullified by the higher costs borne by clients in high fee mutual funds. For the average investor, it is the representative and mutual funds who capture all of the additional returns from the increased risk taking;

- variation in client attributes tended not to result in a variation in client portfolios. Client portfolios tend to resemble the representative's own portfolio over time, independent of their clients' risk preferences and stage in the life cycle. Investor characteristics including risk tolerance and point in the lifecycle explain only 13% of the variation in risky share across clients; and

- the costs of advice are economically significant given the lack of customization. The average advisor generated a yearly negative alpha of -3.34%, reflecting the average fees borne by the clients each year (nearly 2.7% on average) and the underperformance of the advised portfolio on a before-fees basis, compared to using low-cost passive index funds. Investors' net underperformance therefore equals (or exceeds) the fees that they pay.

Foerster et al. concludes that for the average investor, "investment advice alone does not justify the fees paid to advisors".[182]

Finally, a *study by Daniel Bergstresser et al.*[183] sought to measure the benefits that advised investors enjoy in exchange for the distribution costs they pay. Their research, which studied "broker-sold" and "direct-sold" funds from 1996 to 2004 in the U.S. market, failed to find that brokers deliver substantial tangible benefits. In comparison to investors in direct-sold funds, they found that clients of brokers, on average, purchase funds that deliver lower risk-adjusted returns (on a pre-distribution fee basis) and pay substantial distribution charges, and that the broker channel displays no obvious asset allocation skills that help their investors time the market.

[181] Stephen Foerster, Juhani Linnainmaa, Brian Melzer and Alessandro Previtero, "Retail Financial Advice: Does One Size Fit All?", NBER Working Paper 20712, (2014), http://www.nber.org/papers/w20712.

[182] Ibid, at page.27.

[183] Daniel Bergstresser et. al., supra, note 166.

iii. Embedded commissions encourage high fund costs and inhibit competition by creating a barrier to entry

Certain research finds that price formation in retail financial markets runs counter to classic microeconomic theory telling us that more competition leads to lower prices. This research suggests that the prevalence in Canada of mutual funds with higher fees is largely due to financial product providers relying on intermediaries to distribute their product and paying them incentives to promote their collective profit maximization aims. The pursuit of these mutual goals serves to entrench higher fee arrangements and to curb the growth of less costly alternatives.

Commissions tend to drive up retail prices for financial service products:

A *paper by Mark Armstrong* on the economics of consumer protection states that commissions drive up retail prices for financial service products. The increase in price is "due to competition between firms to offer high sales commissions to have their product promoted, which artificially inflates the marginal cost of selling a product".[184]

Intermediaries are incented to promote high fee arrangements:

Research by Kathryn Judge examining the influence of intermediaries in financial markets finds that the continued prevalence of higher-cost institutional arrangements despite the presence of more efficient alternatives is due to the influence of intermediaries that use positional and informational advantages to promote self-serving high-fee arrangements in order to maximize their revenue. She also finds that intermediary influence has a distorting effect on the allocation of capital as it may cause certain firms to receive more capital than may be warranted. Her research also shows that the intermediary's influence helps to

[184] Mark Armstrong, "Economic Models of Consumer Protection Policies", MPRA/Paper No.34773 (16 November 2011), p.14, https://mpra.ub.uni-muenchen.de/34773/1/MPRA_paper_34773.pdf. At pages 15 and 16, Armstrong goes on to state:

> "This section has described a model where firms attempt to influence a salesman's marketing efforts by means of per-sale commission payments. The salesman gives prominence to the product which pays the highest commission, and in equilibrium this entails steering uninformed consumers toward the more expensive products. Competition between sellers to set the highest commission means that the marginal cost of supply is inflated and equilibrium retail prices are high. Therefore, the outcome for consumers, both informed and uninformed, is poor: worse than the situation without commission payments where the uninformed shop randomly, and far worse than the situation in which consumers pay directly for advice. This model therefore gives some support to consumer policies which restrict the use of commission payments as a marketing tactic."

explain an array of observable trends such as the growth and increasing complexity of the financial sector.[185]

Pricing complexity and incentive contracts tend to maintain high prices in retail financial markets, even as more firms enter:

Research by Bruce Ian Carlin examining pricing in retail financial markets finds that, despite the large number of firms in the market, prices remain above marginal cost and may even rise as more firms enter. He finds that these anomalies arise when product providers (i) add complexity to their price structures which affects consumer literacy about prices, thereby preserving market power and corporate profits, and (ii) align themselves with the advice channel and sign incentive contracts that are mutually profitable. These incentive contracts make it more profitable for the advice channel to hold back information from consumers and preserve industry profits.[186]

The findings from the above research may offer an explanation for why the embedded dealer compensation model remains predominant in Canada, despite the availability of alternatives, and why high fund fees continue to persist in Canada.

Mutual fund fees in Canada are consistently among the highest in the world:

The persistence of high fund fees in Canada has been observed by a number of research studies published over the last 13 years which, when comparing mutual fund ownership costs globally, consistently conclude that Canadian mutual fund fees are among the highest in the world.[187]

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[185] Kathryn Judge, "Intermediary Influence", *University of Chicago Law Review*, Vol. 82, Issue 2, Article 1, (2015), pp. 573-642, http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=5853&context=uclrev. At page 629, Judge states:

> "Intermediary influence may also distort the allocation of capital in systematic ways. When intermediaries earn greater fees from particular types of transactions, they tend to use their influence to favor that transaction type. The greater the influence an intermediary enjoys, the greater the resultant distortion in the mix of transactions actually consummated, that is, the greater the fee effects. Thus, when intermediary influence results in institutional arrangements that make parties more reliant on a particular type of intermediary, greater fee effects generally result. And, when certain firm types or sectors of the economy receive capital through pathways that are particularly profitable for financial intermediaries, greater fee effects result in greater capital being allocated to those firms and sectors than is socially optimal. At the extreme, asset bubbles can result. A closely related effect is that when firms or sectors are funded in ways that are less profitable for intermediaries, those firms or sectors may receive less capital than is socially optimal."

[186] Bruce Ian Carlin, "Strategic Price Complexity in Retail Financial Markets" (December 4, 2006). Available on SSRN: http://ssrn.com/abstract=949349.

[187] Examples of such studies include: B.N. Alpert et al., "Morningstar Global Fund Investor Experience Study (June 2015); B.N. Alpert et al., "Morningstar Global Fund Investor Experience", 2013 Report; B.N. Alpert et al., "Morningstar Global Fund Investor Experience 2011" (March 2011); J. Rekenthaler et. al., "Morningstar Global

In response to these studies, a *study by Investor Economics and Strategic Insight for The Investment Fund Institute of Canada*[188] proposed an analytical framework[189] to enable comparisons of the total cost of mutual fund ownership by mutual fund investors in the United States and Canada as well as other countries. The framework identifies and highlights the impact of structural differences between the U.S. and Canadian mutual fund industries, including differences in taxation of management fees, economies of scale in mutual fund distribution and investment management, and the manner in which advisory fees are charged, as being among the factors that combine to explain the differences in the level of the cost of ownership of funds in the two countries and make it difficult to make detailed comparisons between the two jurisdictions. Beyond these differences, the study suggests that the cost of ownership of funds in advised relationships in Canada – both commissions and fee-based – is at a comparable level to the average cost of ownership incurred by a typical fee-based investor in the U.S. On a tax-adjusted basis, through the elimination of the impact of Canadian taxes on management fees, the asset-weighted cost of ownership in Canadian advice channels is estimated to be 2.02% of invested assets compared to the level of approximately 2% in the U.S.

According to recent *Investor Economics* data, the average asset-weighted fund industry MER for long term funds has fallen from 2.01% in 2004 down to 1.95% in 2015.[190] Management fee reductions by several investment fund managers are responsible for the bulk of the six basis point MER decline during this period.

Fund Investor Experience 2009 (May 2009); A. Khorana et al., "Mutual Fund Fees Around the World" (July 23, 2007); and K. Ruckman, "Expense Ratios of North American Mutual Funds", *Canadian Journal of Economics* (February 2003) p. 192-223.

[188] Investor Economics and Strategic Insight, "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada – U.S. Perspective", November 2012, a study for The Investment Funds Institute of Canada. This study was subsequently updated in: Investor Economics and Strategic Insight, "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canada – U.S. Perspective, 2015 Update", May 2015 Update to the 2012 study by Investor Economics and Strategic Insight For The Investment Funds Institute of Canada.

[189] These findings are based on the assumption that investment choices (i.e. the usage of actively managed mutual funds) remain the same whether the advisor uses a fee-based or commission-based arrangement and reflect the fact that large low-cost fund providers in the U.S. were not included in the cost comparisons. The total cost of ownership in the U.S. would otherwise be lower if this assumption was relaxed and if the sample were changed. In addition, as highlighted by Investor Economics at page 17 of their separate report on the Canadian fund market (Investor Economics, *Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives*, September 2012), the total cost of ownership in Canada would be lower if the switch to fee-based compensation led to higher usage of ETFs and index funds.

[190] Investor Economics, *Investor Economics Insight*, July 2016. Investor Economics looks at the average asset-weighted fund industry MER for long term funds which excludes money market funds, funds with performance fees, funds with management fees charged at the account level and labor-sponsored funds.

Low availability of low-cost passively-managed index funds in Canada:

Passively-managed index mutual funds in Canada typically:

- bear a substantially *lower management fee* – usually no more than 0.50% compared to the more typical 1.5 to 2% charged on actively managed equity funds; and
- pay a substantially *lower trailing commission* to dealers – usually between 0.10% and 0.25%, compared to the more typical 1% trailing commission paid on actively managed equity funds.

The lower cost of passively managed index mutual funds suggests that these funds are substantially less profitable for both investment fund managers and dealers, which in turn reduces the incentive to manufacture and distribute these lower-cost products.[191]

At June 2015, low-cost passively-managed mutual funds (excluding ETFs) in Canada made up only 1.5% of mutual fund total assets under management - a level that has remained essentially unchanged over the last 10 years - while the remaining 98.5% of mutual fund assets is actively managed. By comparison, passively-managed mutual funds comprise 15.3% of the U.S. market and 11.2% of the U.K. market.[192]

The low availability of low-cost passively managed mutual funds persists in Canada despite the volume of research finding that most actively-managed funds generally tend to not perform sufficiently well to justify their higher fees[193] and tend to underperform their passive counterparts on a net of fees basis.[194]

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[191] Morningstar Canada discusses the reasons why index funds have not grown in popularity in Canada. See C. Davis, "Why hasn't indexing taken root in Canada", *Morningstar Canada*, November 23, 2016.

[192] Source: Based on data from Investor Economics and internal OSC analysis.

[193] Eugene F. Fama and Kenneth R. French, "Luck Versus Skill in the Cross Section of Mutual Fund Returns", *Journal of Finance*, Vol. 65, (2010), pp. 1915-1947 (at p. 1916 finding that the evidence regarding the value of actively managed funds is "disheartening". They find "that few active funds produce benchmark adjusted expected returns that cover their costs," indicating that "if many managers have sufficient skill to cover costs, they are hidden by the mass of managers with insufficient skill."); Mark Carhart, "On Persistence in Mutual Fund Performance", *Journal of Finance*, Vol. 52, (1997) pp. 57-82 (at p.80 finding that "[a]lthough the top decile mutual funds earn back their investment costs, most funds underperform by about the magnitude of their investment expenses. The bottom-decile funds, however, underperform by about twice their reported investment costs."); Martin J. Gruber, "Another puzzle: The growth of actively managed mutual funds", *Journal of Finance*, Vol. 51, (1996), pp. 783-810 (at page 789 finding that actively managed "mutual funds underperform an appropriately weighted average of the indices by about 65 basis points per year" because even though "active management adds value, . . . mutual funds charge the investors more than the value added"). We note however certain research finding that some actively managed mutual funds perform sufficiently well to justify the associated fees, but such funds are the minority and they do not perform sufficiently well to justify the average actively managed fund. For example, Malcolm Baker et al., "Can Mutual Fund Managers Pick Stocks? Evidence from Their Trades Prior to Earnings Announcements", *Journal of Financial and Quantitative Analysis*, Vol. 45, (2010) pp. 1111-1131, (at p. 1119 finding that "the average mutual fund . . . does not appear to possess stock picking ability," but that some funds do outperform the market); Robert

A similar trend may generally be observed with ETFs. Most Canadian ETFs are passively managed (86.2%) and typically do not pay embedded commissions.[195] Most ETFs bear lower management fees – 88.3% of Canadian ETFs pay management fees of less than 0.75%. However, ETF assets under management have increased significantly over the last few years. As at June 2016, ETFs made up 7.3% of investment fund total assets under management. By comparison, ETFs represented a total of 11.6% of the U.S. investment company total assets.[196]

Countries with low levels of index funds may experience poor price competition:

A recent *study by Martijn Cremers et al*[197] suggests that countries with low levels of explicitly indexed funds (i.e. passive index tracking investment funds that are advertised as

Kosowski et al., "Can Mutual Fund "Stars" Really Pick Stocks? New Evidence from the Bootstrap Analysis", *Journal of Finance*, Vol. 61, (2006), pp. 2551-2595 (at p. 2553 finding that "while most funds cannot compensate for their expenses and trade costs, a subgroup of funds exhibit stock-picking skills that more than compensate for such costs").

[194] Morningstar Canada Research, "Have Active Canadian Equity Fund Managers Earned Their Keep?", May 7, 2015 (finding that fund fees gobble up most of Canadian equity funds' excess returns: Just 18% of funds in the category outperformed the passive alternative on a net-of-fees basis over the 10-year period); Morningstar Manager Research, "Morningstar's Active/Passive Barometer: A new yardstick for an old debate", June 2015 (finding that U.S. actively managed funds have generally underperformed their passive counterparts, especially over longer time horizons and experienced mortality rates (i.e. many merged or closed). In addition, the report finds that failure tended to be positively correlated with fees (i.e. higher cost funds were more likely to underperform or be shuttered or merged away and lower-cost funds were likelier to survive and enjoyed greater odds of success) and that fees matter as they are one of the only reliable predictors of success.); Vanguard Research by Christopher B. Philips et al., "The Case for Index-Fund investing for Canadian Investors", April 2015 (finding that low-cost index funds have displayed a greater probability of outperforming higher-cost actively managed funds, even though index funds generally underperform their targeted benchmarks); Richard A. Ferri and Alex C. Benke, "A Case for Index Fund Portfolios: Investors holding only index funds have a better chance for success", June 2013 (finding that diversified portfolios of index funds consistently outperform portfolios of actively managed funds – specifically, when comparing a ten-fund index fund portfolio to a portfolio consisting of ten randomly selected actively managed funds using identical asset class categories and weightings, the ten-fund index fund portfolio beat actively managed portfolios 90% of the time over a 10 year period running from 2003 to 2012).

[195] There are currently 93 ETFs that offer advisor class shares for which the investment fund manager will pay an ongoing commission (usually called "service fee") to the dealers. These ETFs represent less than 1% of Canadian ETF assets under management.

[196] Based on data from Investor Economics and the 2016 Investment Company Fact Book, 56th edition, Investment Company Institute, https://www.ici.org/pdf/2016_factbook.pdf.

[197] Martijn Cremers, Miguel A. Ferreira, Pedro P. Matos and Laura T. Starks, "Indexing and Active Fund Management: International Evidence", *Journal of Financial Economics, Forthcoming*; Darden Business School Working Paper No. 2558724, (February 1, 2015). Available on SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2558724.

such) experience poor price competition and thus higher fees. The study examined the relation between indexing and active management in the mutual fund industry worldwide. They found that actively managed funds are more active and charge lower fees when they face competitive pressure from low-cost explicitly indexed funds. Moreover, the average alpha generated by active management is higher in countries with more explicit indexing and lower in countries with more closet indexing.[198] Overall, the evidence from the study suggests that explicit indexing improves competition in the mutual fund industry. Canada was found to have low levels of explicit indexing with explicit indexing ETFs and mutual funds collectively making up only 7% of the market.

'Direct-to-client' funds may have difficulty competing on an equal basis in Canada:

Lower-cost mutual funds that are sold under the 'direct-to-client' model[199] (i.e. without the intermediation of a third party dealer) and that do not pay any dealer compensation make up only 2.8% of assets under management in Canada. Assets in the 'direct-to-client' channel have remained flat, with no increase in market share over the last several years.[200] The investment fund managers of these funds must rely strictly on the performance and attributes of their product to attract sales rather than the payment of compensation to dealers.

New low-cost providers may have difficulty entering the Canadian market:

The slow growth of the 'direct-to-client' model in Canada may have discouraged new low-cost providers from entering the market in Canada. Specifically, when Vanguard, one of the largest U.S. 'direct-to-client' mutual fund and ETF manufacturers, entered the Canadian fund market in 2011, it did so with its ETFs only, and not with its 'no trailing commission' mutual funds that are widely distributed in the U.S. Vanguard Investments Canada stated that the barrier to entry in Canada was the requirement to pay for distribution.[201] This

[198] "closet indexing" refers to an investment fund that purports to be actively managed but actually follows more or less a benchmark index.

[199] There exist only a handful of Canadian fund companies that sell directly to the public. In those cases, the investment fund manager or a related party is registered as a mutual fund dealer and sells its funds directly to the public.

[200] Source: Investor Economics (various surveys).

[201] See transcript of OSC Roundtable Re Discussion Paper and Request for Comment 81-407 Mutual Fund Fees (June 7, 2013) , supra, note 2, at p.98 - Question from Commissioner Deborah Leckman to Atul Tiwari, Managing Director/Head of Canada for Vanguard Investments:

> "COMMISSIONER LECKMAN: So I have a final question for Atul, and then maybe there will be some more questions from either the panelists or from the audience. You came into Canada and chose only to use ETFs. What was the business reason you chose not to offer your conventional mutual funds that don't pay trailers in Canada?
>
> MR. TIWARI: Good question. Well, Vanguard actually looked at coming into Canada for well over 20 years; I'm told this was the seventh business plan that had been put together. We are a pretty prudent and

statement suggests that the payment of trailing commissions may essentially be the 'price of admission' to the Canadian market and that low-cost investment fund providers that do not pay any or low trailing commissions may not be able to access major fund distribution channels. This barrier to entry inhibits effective price competition in our market.

Issue 2: Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

i. The lack of saliency of embedded commissions reduces investors' awareness of dealer compensation costs

Investors tend to understand 'visible' fees the most:

A *report by the Brondesbury Group on performance reporting and cost disclosure*[202] found that:

- The fees that investors understand the most appear to be those that are most visible, such as transaction-based commissions and account fees, which were understood by two-thirds of investors who participated in the study;
- only 4 out of 10 respondents indicated they understood DSCs;
- only one-third of respondents indicated they understood trailing commissions; and
- only half of respondents reported that they discussed costs with their advisor.

Investors are generally more apt to attempt to control salient fees:

A *study by Brad Barber et al.*[203] found that investors are less apt to control the impact of fees paid from fund assets. It found that mutual fund investors are more sensitive to salient, upfront fees, like front-end loads and direct commissions, than a fund's operating expenses. This study analyzes U.S. mutual fund flows over a period of 30 years and, when assessing how investors respond to expenses while investing in mutual funds, finds that investors treat

deliberate organization, to say the least. The original barriers all had to do with paying for distribution. Again, Vanguard doesn't pay for distribution. So when you look at the structure of the market in Canada, it would be a tough slog to kind of come in and have a business proposition that's based around trying to sell mutual funds without a trailer."

[202] The Brondesbury Group, "Report: Performance Reporting and Cost Disclosure", prepared for: Canadian Securities Administrators (September 17, 2010), at p.15-16, http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt_20110622_31-103_perfomance-rpt-cost-disclosure.pdf.

[203] Brad M. Barber et al., "Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows", *The Journal of Business*, Vol. 78, no 6 (2005), pp. 2095-2120, http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/Out%20of%20Signt.pdf

front-end loads and fund expenses differently. It finds a negative relation between flows and front-end loads, but finds no relation between operating expenses and flows. This research suggests that investors are more apt to attempt to control visible fees which they must pay directly, but remain passive about ongoing fund fees paid out of fund assets.

Canadian investors are generally not aware of what they pay for financial advice or that they pay for financial advice at all:

The fund industry's latest *Pollara opinion survey*[204] found that only:

- 27% of investors could say they "definitely" believe that part of the fees charged within mutual funds are used to compensate their financial advisor, while 45% replied "I think so". Another 21% do not believe they pay for financial advice through embedded fees, while the remaining 10% indicated they "don't know";

- 56% of investors recalled that their advisor discussed his/her compensation when they last purchased a mutual fund;

- 62% of investors recalled that their advisor discussed mutual fund fees such as front-end sales charges and DSCs; and

- 57% of investors recalled that their advisor discussed MERs;

A *BCSC National Smarter Investor Study*[205] finds that 23% of Canadians do not know how their advisor is paid. Over half (53%) do not know how much they paid to their advisor in the last 12 months;

The *OSC Mystery Shop report*[206] found that while 56% of the investors were told about fees for products, just 25% were told about how the advisor would be compensated;

A *study by PMG Intelligence*[207] found that:

- investors are confused about fees (whether they are disclosed or not, whether they pay them or not, whether they are discussed or not); and

- most investors aren't sure how much they pay for advice and what fees they pay for

[204] POLLARA Inc., "Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry" (2016), Report Prepared For: The Investment Funds Institute of Canada, https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/.

[205] BC Securities Commission, supra note 152.

[206] OSC Staff Notice 31-715 – *Mystery Shopping for Investment Advice*, September 17, 2015, http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf .

[207] PMG Intelligence, "The Value and Price of Advice – A Benchmark Study 2014 Edition".

but acknowledge some form of disclosure;

A recent *survey by Tangerine Investments*[208] found that:

- although the majority of investors surveyed (89%) describe themselves as either "very knowledgeable" or "somewhat knowledgeable" when it comes to their investments, many were unaware of the associated fees – 36% of those surveyed claimed they do not pay any fees, and another 11% were unsure if they pay fees at all;

- when the survey narrowed in on the 67% of investors who use a financial advisor, 24% of those surveyed said they do not pay fees or commissions for their advisor's services, and another 13% were unsure; and

- of those who were aware of fees for their advisor's services, when asked how well they understood the fee structure, nearly 40% said "not very well" or "not at all".

A *report by the Brondesbury Group on advisor relationships and investor decision-making*[209] found that investors have minimal knowledge of mutual fund fees and what affects them, including how their advisors can get paid. Specifically, they found that:

- unless investors are told what affects the amount of fees they pay, they are unlikely to reach an accurate conclusion on their own. Even when the full range of fees and what affects them are identified, it is difficult for investors to assess the implications of what they have learned;

- only one third of investors were able to recognize several common compensation arrangements and one-third indicated they were aware of trailing commissions; and

- out of the one-third who indicated they were aware of trailing commissions, about 4 out of 10 respondents agreed that the amounts of these commissions may vary depending on the type of mutual fund and the mutual fund manufacturer that offers the fund.

This same study assessed respondents' knowledge about how advisors were paid by presenting them with five statements to agree or disagree with. The percentage agreement

[208] Tangerine Investments conducted an online survey from June 29 to July 4, 2016 among 1,003 randomly selected Canadian adults. The results are discussed here: http://www.newswire.ca/news-releases/many-canadian-investors-unaware-of-fees-theyre-paying-to-invest-586603691.html.

[209] The Brondesbury Group, "Investor behavior and beliefs: Advisor relationships and investor decision-making study", a report prepared for the Investor Education Fund, 2012, http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

was so similar across all five statements that the authors concluded that "the results demonstrate that investors have little or no idea about how advisors can get paid."[210]

Costs do not figure significantly into investor-decision making:

According to the same *report by the Brondesbury Group on advisor relationships and investor decision-making*[211], costs do not figure significantly into investor decision-making due largely to investors' lack of awareness and/or understanding of fund fees, as highlighted above. The cost of buying is a factor for only 2 out of 10 investors, but almost never a decisive factor. Management fees are treated similarly. Costs may deter 1 out of 6 of buying.

This study also found that most investors do not consider information in fund disclosure documents to make their investment decision, preferring instead to rely on their advisor for their investment decision. For 8 out of 10 investors, the advisor's opinion dominates all other sources as a factor in buying decisions. Investors trust their advisor to provide advice that benefits the client first.

ii. Embedded commissions add complexity to fund fees which inhibit investor understanding of such costs

Embedded dealer compensation results in numerous fund series that adds complexity to fund fees:

The fund fee structure has grown increasingly complex over the last several years due to the growing number of fund series on offer, with each series having different fees. The numerous fund series available today on most funds has effectively resulted in an '*alphabet soup*' of fund series[212] that can be confusing to investors and overwhelm their ability to understand the fees that apply to their investment.

Mutual funds typically offer various series of their securities which may be designed for:

ii. specific types of dealer business models and the investors they serve (for example, retail, higher-net-worth, institutional, fee-based, DIY/discount brokerage), or

iii. a specific purpose (for example, hedged series or 'tax-advantaged' series paying fixed distributions that include a portion of return of capital).

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[210] Ibid. page 25.

[211] Ibid.

[212] The following news articles acknowledge the complexity of the Canadian mutual fund series "alphabet soup". See John Heinzl, "What do all those letters mean after mutual fund names?", *Globe and Mail*, August 16, 2013, http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/what-the-f-the-abcs-of-mutual-funds/article13816786/; Bryan Borzykowski, "Decoding the mutual fund alphabet soup", *Money Sense*, August 16, 2012, http://www.moneysense.ca/save/investing/mutual-funds/decoding-the-mutual-fund-alphabet-soup/.

Some Canadian investment fund managers may offer in excess of 30 different series of their funds. Each series is denoted with a different letter, but there is no official standard governing how investment fund managers use letter designations for their fund series. Each series may:

- have different eligibility requirements (e.g. specified investment thresholds);
- have different management fees (typically, the higher the investment threshold, the lower the management fee);
- be sold under various sales charge options (front-end load, low-load, DSC, fee-based, no-load); and
- pay different compensation (trailing commissions and other embedded sales commissions) to the dealer.

As at the end of June 2016, taking into account underlying purchase options, there were 39,848 unique mutual fund series/purchase option combinations available in Canada[213] in which were invested a total of $1.3 trillion[214].

Further adding complexity is the fact that trailing commissions payable on various fund series may vary based on:

- the investment fund manager – they may differ between similar funds and fund series managed by different investment fund managers, i.e. some investment fund managers may pay more/less than others;
- the asset class of the fund - they are typically highest on equity funds, lower on fixed income funds and lowest on money market funds;
- the main investment strategy – they are typically higher for actively managed funds and lower for passively managed funds;
- the purchase option selected - they are typically higher on fund investments made under the front-end load and low-load options and lower on fund investments made under the DSC option; and

[213] Source: FundSERV – mutual fund and wrap products. By contrast, there were 32,555 unique mutual fund series/purchase option combinations available in the United States (source: Morningstar Direct) at the end of June 2016 in which were invested a total of $15.9 trillion USD (source: Investment Company Institute).

[214] Source: Investor Economics.

- the length of time the investment is held - for example, they may:
  - in some cases increase in steps with each year the investor continues to hold the investment, reaching a specified maximum after a certain number of years; or
  - where the investment has been made under the DSC option, double at the expiration of the redemption schedule (6 years on average).

The wrong choice of fund series may subject an investor to excess fund fees:

The complexity of fund fees created by the plethora of series on offer requires dealers to maintain robust systems of controls and supervision to ensure that investors are being invested in the fund series that is right for them. The failure to have such systems can result in investors holding the wrong fund series securities and paying excess fees as a result. In *recent no-contest settlements*[215], OSC staff alleged that certain dealers had inadequacies in their systems of controls and supervision which formed part of their compliance systems which caused clients to not be invested or switched into a lower-fee series of a fund for which they were eligible (further to having met the minimum investment threshold for investment in the series). OSC staff further alleged that these inadequacies resulted in clients paying excess fund management fees. These settlements were concluded after the dealers self-reported to the OSC. As part of the settlement agreements, the dealers undertook to pay compensation to affected clients and former clients.

Disclosure generally does not help investors identify the best fund series based on compensation:

The *Brondesbury Group Mutual Fund Fees Research*[216] finds that:

- most investors are unable to understand and assess different forms of compensation. They cannot make the economic assessment due to the complexity of calculations and the difficulty of choosing the right underlying assumptions, nor can they assess the implications of compensation arrangements for creating potential conflicts of interest in the advice that advisors give them; and
- in a commission-based environment, disclosure does not help investors identify either the best advisor or the best fund series based on compensation. The end result

[215] See the no-contest settlements in the matters of *TD Waterhouse Private Investment Counsel Inc.* (http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20141113_td-waterhouse-private-investment.pdf), *Quadrus Investment Services Ltd.* (http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20151106_quadrus.pdf), *Scotia Capital Inc.* (http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20160725_scotia-capital.pdf), *CIBC World Markets Inc.* (http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20161024_cibc.pdf) and *BMO Nesbitt Burns Inc.* (http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20161209_bmo.pdf).

[216] The Brondesbury Group, supra, note 3, at pages 46 to 48.

is that the advisor will propose the fund series and it will be advantageous to them.

The complexity of fund fees may discourage investors from asking about dealer compensation – investors trust the compensation is fair and reasonable:

The *BCSC National Smarter Investor Study*[217] finds that:

- the complexity of fund fees is intimidating to investors and discourages investors from asking about their dealer/representative's compensation. Specifically, the study finds that 23% of Canadians have never asked their advisor what fees they pay. Of these individuals, 37% agreed that they would ask about compensation more often if they had a better understanding of how fees and commissions for advisors worked;

- for Canadians who invest with an advisor but say they do not always ask about compensation, trust was the key reason they do not ask more often – 72% indicated that they trust that their advisor's compensation is fair and reasonable.

Complexity in fund pricing can increase investors' reliance on dealer/representative's advice:

Research by Kathryn Judge suggests that complexity in financial products is deliberate to ensure investors' reliance on intermediaries for investment decisions and assure intermediaries' long-term returns. She states that: "[G]reater complexity can make an investor more reliant on an intermediary's guidance and other services. This increases the probability that the investor will continue to use that intermediary's services in the future, increasing the intermediary's long-term expected returns. Complexity can also make it more difficult for any of the parties involved to see the full range of fees an intermediary is earning on a transaction. To the extent that salience affects a party's inclination to push for a lower fee, intermediaries may prefer less transparent, and hence more complex, transactions and market structures." [218]

Retail financial product providers may strategically use price complexity to limit awareness of fees:

Research by Bruce Ian Carlin[219] suggests that product providers in retail financial markets strategically add price complexity to their product to maintain consumer ignorance about prices, which in turn preserves the provider's ability to gain market power and earn corporate profits. This complexity ultimately leads to failure of competition, despite the large number of firms in retail financial markets. He finds that: "increased competition always leads to higher industry complexity. When more firms compete for market share,

[217] BC Securities Commission, supra, note 152.

[218] Kathryn Judge, supra note 185 at page 627.

[219] Bruce Ian Carlin, supra note 186 at page 4.

the probability that they receive demand from the informed consumers decreases. To maximize expected profits, the firms tend to increase complexity in order to optimize the revenues they receive from uninformed consumers. Increased complexity and higher cognitive load makes it harder for consumers to become informed. If a larger fraction of consumers remain uninformed when more firms are present, then prices rise."

iii. The product embedded nature of dealer compensation restricts investors' ability to directly control that cost and its effect on investment outcomes

Dealer compensation charged at the fund level may cause cross-subsidization:

Embedding dealer compensation costs into fund management fees charged to a mutual fund rather than charging and collecting such compensation at the account level can cause some investors to subsidize the cost of certain commissions or other services that are not attributable to their specific investment in the fund. This cross-subsidization of dealer compensation costs can result in some investors indirectly paying excessive fees beyond their control.

One example of such cross-subsidization is the subsidization by front-end load investors of the specific distribution costs attributable to DSC investors. Specifically, investment fund managers may use part of the management fees they earn on a fund to fund the payment of upfront sales commissions to dealers on sales made under the DSC option.[220] The cost of these embedded sales commissions is allocated to the fund as a whole, and therefore to all investors in the fund, irrespective of the purchase option under which they made their fund investment. As a result, even though these costs are unique to the DSC option, investors who purchase under the front-end load option (under which the investor may have already paid a sales charge directly to their dealer or representative at the time of purchase) bear the same 'higher' management fee as, and therefore subsidize, those investors who purchase under the DSC option.

Less than a handful of Canadian investment fund managers have addressed this type of cross-subsidization by offering a different series or class of their funds for each of the various purchase options, with each bearing a different management fee reflecting the different costs associated with the different purchase options. In these cases, the management fee of the front-end load series is typically 15 basis points lower than the management fee of the DSC series.

We note that in the U.S., mutual funds offer separate classes of securities for each purchase option. The A share class is the front-end load purchase option and the B share class is the DSC purchase option. The B share class expenses are typically 0.60 to 0.75 percent higher each year than on class A shares.[221]

[220] See note 6 for a description of the DSC option.

[221] The difference in expenses is observable by reviewing fee disclosure in U.S. mutual fund prospectuses. See also FINRA Investor Alert: "Class B Mutual Fund Shares: Do They Make the Grade?", http://www.finra.org/investors/alerts/class-b-mutual-fund-shares-do-they-make-grade.

Discount/DIY series not widely available:

Some investment fund managers offer a discount series (e.g. series D) of their funds for DIY investors whose lower management fees reflect a reduced embedded trailing commission of typically no more than 0.25%. However, those investment fund managers that do offer a discount series typically offer it on only a portion of their fund lineup rather than all their funds[222]and their accessibility is limited. Discount series are typically available only online through certain discount dealers. Industry data shows that:

- only 1% of Canadian mutual fund assets is held in a discount/DIY series;[223]and
- the bulk (roughly 84%)[224] of mutual fund assets held in the online/discount brokerage channel remain invested in the regular retail fund series paying full unreduced trailing commissions to the discount broker.

Fee-based option not a true choice for everyone:

Many investment fund managers offer a fee-based series (e.g. series F) for investors in fee-based arrangements with their dealer/representative whose reduced management fees reflect the absence of embedded trailing commissions. Instead, the investor pays the dealer directly for advisory services rendered in connection with their account.

While most investment fund managers offer a fee-based series of their funds which have relatively low investment minimums, not every investor can access this series because:

- dealers often impose significant account size requirements ($250,000+) that must be met in order for investors to be eligible to participate in a fee-based program; and

- not all dealers/representatives work under a fee-based model. Many dealers/representatives (particularly in the MFDA channel) operate on a commission-only basis which means that they do not offer the fee-based series to their clients. Only the fund series with embedded compensation is placed on their product shelf.

[222] At February 2016, there were 17 investment fund managers offering at least one discount/DIY fund series on a total of 439 funds. Source: Morningstar Direct, SEDAR at February 2016.

[223] As at September 2015, assets in discount/DIY mutual fund series totaled $12.053 billion, up from $11 billion in December 2011, although not all of this was held in the online/discount brokerage channel. The $12 billion figure includes an estimated $4.6 billion in series D mutual fund assets held in the online/discount brokerage channel, as well as other similar discount/DIY series sold directly by the investment fund manager. Source: Investor Economics.

[224]As at September 2015, a total of $29.585 billion in mutual fund assets was held in the online/discount brokerage channel. Investor Economics estimated that only $4.6 billion in discount/DIY fund series assets was actually held in the online/discount brokerage channel. This suggests that $25 billion of the total $29.585 billion of mutual fund assets in the online/discount brokerage channel remains invested in the regular retail fund series paying full trailing commissions. Source: Investor Economics.

Fee-based fund series made up only $40 billion or 4% of fund industry assets at the end of 2013. While fee-based assets increased significantly over the five years ending 2015, increasing by 248% over that period, fee-based options still only made up $69 billion or 6% of fund industry assets at the end of 2015.[225]

Direct-to-client funds not widely available:

As explained above, only a few investment fund managers in Canada offer lower-cost mutual funds under the 'direct-to-client' model. These mutual funds charge lower management fees reflecting the absence of embedded trailing commissions. These mutual funds typically have minimum investment thresholds of $10,000 of more, which means that they may not be within reach of many retail investors. Mutual funds sold under the 'direct-to-client' model make up only 2.8% of assets under management in Canada.[226]

The lack of availability and/or accessibility of the above options for many Canadian investors allows embedded commissions to prevail and ultimately limits investors' ability to control the impact of these fees on their investment outcomes.

Issue 3: Embedded commissions paid do not align with the services provided to investors

i. Investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid

No rules requiring specified ongoing services:

The fund facts document for mutual funds typically states that trailing commissions are for the services and advice the dealer and its representative provide to the investor.

However, there is currently no securities regulation that prescribes, or guidance that articulates, the specific services that an advisor is expected to provide in exchange for ongoing trailing commissions. Under NI 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), dealers/representatives are required to provide certain services at the time of the trade (e.g. suitability, know-your-client), but no requirement to provide ongoing advice focused on the client's portfolio.

Trailing commission payments are largely used to support dealer operations and sales activity:

The various comment letters submitted by fund industry participants in response to the Original Consultation Paper indicate that trailing commissions are largely used to support dealer operations and to compensate the advisor for work done at the time of the original

[225] Source: Investor Economics.

[226] See notes 199 and 200 above and related discussion under Issue #1.

investment, rather than for ongoing advice provided over the term of the investment.

IFIC's response letter dated April 12, 2013, states that the bulk of trailing commission payments are used to support dealer operations. At page 3 of their letter, IFIC states:

> *"The first misconception is found in the Discussion Paper's underlying theme that trailing commissions are used exclusively for the compensation of advisors. The reality is that trailing commissions are paid to the dealer firm to cover a whole host of regulatory and supervisory functions and services in addition to advisor compensation. The dealer may retain one half or more of the trailing commission to pay for, for example: tier 1 and tier 2 supervision and the systems that support it, regulatory costs including fees to fund the SROs, OBSI, and securities commissions, client complaint handling processes, advisor investigation and enforcement requirements, general compliance obligations of the SROs, OBSI, and securities commissions, client reporting, due diligence on products, etc."*

The letter dated April 12, 2013 from the *Investment Industry Association of Canada* (**IIAC**) similarly indicates that trailing commissions are used to cover the cost of a host of services other than the provision of investment advice, many of which may be provided equally by execution only and full-service dealers. At page 5 of their letter, IIAC states:

> *"The following is a list of some services supported by trailing commissions that are provided by investment dealers on an ongoing basis (many apply equally to execution only and full-service dealers):*
>
> - *Printing and mailing of disclosure documents (prospectuses, Fund Facts, other shareholder communications, including proxy material);*
> - *Processing of corporate events and distributions (Since mutual funds held by investment dealers are typically registered in nominee name, the dealer takes on responsibility for updating client account records for things such as mutual fund reorganizations and client payments of interest, dividends, etc.);*
> - *Preparation and distribution of tax reporting information such as annual trading summaries, and, in some cases, T3 and T5013 tax slips;*
> - *Provide the widest selection of mutual funds from multiple fund families (This requires efforts by the dealer/advisor to conduct extensive product due diligence and legal documentation before making these funds available to clients.);*
> - *Custody services;*
> - *Portfolio monitoring of margin requirements;*
> - *Clearing and settlement of purchase and sales through FundSERV and/or CDS.*
>
> *The services above should be taken into consideration with respect to the importance of trailers to advisors and their firms."*

The letter dated April 12, 2013 from *Investors Group* states that trailing commissions pay for distribution and a variety of dealer costs, and not just the provision of ongoing services by dealers and their representatives. At page 4 of their letter, Investors Group states:

> *"This proposal [to tie trailing commissions to the provision of specific services by advisors] arises from a misunderstanding that 100% of trailing commissions are paid for ongoing services provided by advisors. In fact, the compensation is paid to the dealer in connection with the distribution of the financial products and is generally the only source of revenue for mutual fund dealers. This revenue pays for a variety of dealer costs, including supervision, back office functions, client statement production, insurance and similar expenses – many of which, we note, have increased as a result of recent regulatory requirements – in addition to the cost of compensating advisors. The dealer, not the manufacturer, determines the level of service its advisors are to provide.*
>
> *Of the industry average of two-thirds of the trailing commission actually paid to advisors by the dealer, there are two facets involved. First, they represent deferred compensation to advisors for the initial work done by them in providing advice to clients at the time of the original investment. Second, these payments are to compensate for the ongoing service provided by the advisor to the client. Because of this, the services provided by advisors to investors will vary depending on a number of factors, including the size of the portfolio and specific needs of the particular client including desired frequency of contact and updates."*

An *IFIC paper*[227] notes that, on average, 0.78% of the assets invested in a long-term fund are paid annually by the fund to the dealer, of which approximately two-thirds may go to the representative for advisory services and the rest kept by the dealer to pay for administrative, compliance and regulatory oversight functions.

Varying trailing commissions between different investment fund managers, fund types and purchase options:

As explained above, trailing commissions may vary between different investment fund managers and will generally further vary based on the asset class of the fund and the purchase option selected.[228] There is no evidence of different services despite the differences in fees. For example, trailing commissions are typically higher on equity funds and lower on fixed income funds. In such case, there is no evidence that an investor purchasing an equity fund would be provided with more services and advice than if the investor were to invest in a fixed income fund.

[227] The Investment Fund Institute of Canada, "Paying for Advice: Why Options are Important" (August 2014), at p.7.

[228] Trailing commissions are higher on equity funds and balanced funds (typically 1%) than on fixed income funds (typically 0.50%) and on money market funds (typically 0.25%). Trailing commissions are also higher on investments made under the front-end load option (typically 1%) than under the DSC option (typically 0.50%).

Higher trailing commissions for pre-packaged advice:

Most investment fund managers offer 'funds-of-funds', which are mutual funds that invest in other funds - most typically a portfolio of proprietary funds. They are pre-packaged mutual fund investment portfolios which relieve the dealer and their representative from having to do the fund selection and asset allocation they may otherwise be expected to do on their own for a client. Notwithstanding the efficiencies that funds-of-funds may provide for advisors, investors do not ultimately benefit from these efficiencies as the trailing commissions payable on funds-of-funds are the same or higher than on stand-alone equity mutual funds.[229] Accordingly, advisors who sell funds-of-funds receive greater compensation for seemingly less service and advice. The favourable dealer compensation paid on funds-of-funds may explain why this product makes up the bulk of net sales. According to data from IFIC, for the six years ending December 2015, funds-of-funds net sales totaled $191 billion versus $32 billion for traditional stand-alone funds. They have become the dominant product in the Canadian fund industry.

DIY investors in the discount channel may pay full trailing commissions:

As discussed above in connection with Issue 2, not all investment fund managers offer a discount/DIY series (e.g. Series D with reduced trailing commission of 0.25% or less) on their funds, nor do all discount brokers opt to put these series on their shelf when available. These series are available for purchase through certain discount brokerages only. Those investment fund managers that do not offer a discount/DIY series typically make their regular retail series available for purchase through the discount channel. These series pay full unreduced trailing commissions of 1% to the discount brokerage for execution-only services.

ii. The cost of advice provided through embedded commissions may exceed its benefit to investors

Investors may not derive offsetting financial benefits from the payment of trailing commissions:

Several studies show that investors derive almost no offsetting financial benefit from the payment of distribution fees, including trailing commissions. We refer to the studies by the *Executive Office of the President of the United States*[230], *John Chalmers et. al.*[231], *Stephen Foerster et. al.*[232] and *Daniel Bergstresser et al.*[233] discussed above in connection with

[229] See data on funds-of-funds provided in the Original Consultation Paper, Figure 10. Funds-of-funds are very popular products that account for almost half of all long-term mutual fund assets under management.

[230] See research by the Executive Office of the President of the United States, supra note 178.

[231] John Chalmers et al., supra note 179.

[232] Stephen Foerster et al., supra note 181.

[233] Daniel Bergstresser et al., supra note 183.

Issue 1 – *ii. Embedded commissions can encourage biased investment recommendations by dealers which negatively affect investor outcomes*. These studies overall show that:

- investors receiving conflicted advice through the payment of embedded commissions tend to perform worse than non-advised investors or passive benchmarks; and

- dealers/representatives collect more fees and commissions than any monetary value their investment advice may add to the account.

The following research however offers contrasting views on the value of advice:

- An econometric study by the *Centre interuniversitaire de recherche en analyse des organisations (CIRANO)*[234] finds that, on average, advised investors accumulate significantly more financial assets than do non-advised investors with similar socio-economic characteristics. This benefit of financial advice grows with the length of time households have received advice: after four to six years, the advised households have accumulated 1.58 times the amount accumulated by non-advised households; after 15 years, the difference has increased to 2.73 times. This difference in financial assets is explained most significantly by higher household savings rates and greater allocation into non-cash investments, not by better returns due to advisor skill;

- A *paper by the School of Public Policy at the University of Calgary*[235] asserts that embedded commissions facilitate affordable and broadly accessible financial advice which leads to greater individual wealth accumulation, which in turn makes a positive contribution to the retirement readiness of Canadian households and, ultimately, the economy. Based on a review of academic, government, regulatory and industry research, including the CIRANO study above, the author of the paper argues that eliminating embedded commissions would hurt less affluent investors who may not be willing or able to pay for advice upfront, thus creating an advice

[234] Claude Montmarquette et al., "Econometric Models on the Value of Advice of a Financial Advisor", CIRANO Institute, July 2012, http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf. Claude Montmarquette, one of the authors of that study, later admitted that a survivorship bias exists in the study and that he would like to see a more formal longitudinal study intimately tracking the performance of advised versus non-advised groups over a long period of time. See "*Financial Industry overselling value of financial advice*", Globe and Mail, November 15, 2012, http://www.theglobeandmail.com/globe-investor/personal-finance/household-finances/financial-industry-overselling-value-of-financial-advice/article5360796/. The study does not establish a causal relationship between the payment of trailing commissions and wealth accumulation as it does not identify whether its participants received advice through trailing commissions or other compensation arrangements. The study also does not factor into its findings any liabilities that its participants may have incurred through financial advice, which may offset the total wealth accumulation.

[235] Pierre Lortie, "A Major Setback for Retirement Savings: Changing How Financial Advisers Are Compensated Could Hurt Less-Than-Wealthy Investors Most", *University of Calgary School of Public Policy Research Papers*, Vol. 9, Issue 13, (April 2016), https://www.policyschool.ca/wp-content/uploads/2016/05/financial-advice-lortie.pdf.

gap which would be a major setback for Canada-wide retirement savings and Canadians' quality of life in retirement;

- The fund industry's latest *Pollara opinion survey*[236] finds that investors perceive the advice they receive from their advisor to be beneficial. Specifically, 95% of respondents indicated they can rely on their advisor to provide sound advice and 88% agreed they get better returns as a result of the advice they receive. Eighty-two percent attributed better savings and investment habits to their advisor, while 91% said they get value for the money they pay to their advisor;

- Research by *Vanguard Investments Canada Inc.*[237] finds that working with an advisor can theoretically add about 3% in net returns when following the Vanguard Advisor's Alpha framework for wealth management which involves the application of the following five wealth management principles:

    - Being an effective behavioral coach by helping clients maintain a long-term perspective and a disciplined approach (potential value add: 1.50%);

    - Applying an asset location strategy, i.e. allocating assets between taxable and tax-advantaged accounts (potential value add: from 0% to 0.42%);

    - Employing cost-effective investments, i.e. passively managed funds (potential value add: 1.31%);

    - Maintaining the proper allocation through rebalancing (potential value add: 0.47%); and

    - Implementing a spending strategy to help clients make important decisions about how to spend from their portfolios (potential value add: 0% to 0.41%).

Vanguard's research emphasizes that the potential 3% in net returns for clients should not be viewed as an annual value-add, but is likely to be intermittent, as some of the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well-thought-out investment plans. The research also stresses that the applicability of the management principles, and the resulting value added, will vary by client circumstances (based on each client's time horizon, risk tolerance, financial goals, portfolio composition, and marginal tax bracket, to name a few) as well as implementation on the part of the advisor.

[236] Pollara, supra note 204.

[237] Vanguard research, "Putting a value on your value: Quantifying Vanguard Advisor's Alpha", (September 2016), https://www.vanguard.com/pdf/ISGQVAA.pdf.

The beliefs of representatives may affect their advice:

A *study by Juhani Linnainmaa et al.*[238], using the same data as that used in the Foerster et al study[239], suggests that the quality of representatives' advice may be affected not only by conflicts of interest which can incent self-interested behavior, but also by personal beliefs and preferences regarding investment strategies (for e.g. the belief that active management – even after commissions – dominates passive management). They find that representatives manage their personal portfolios just like they manage their clients' portfolios. They trade frequently, chase returns, and prefer expensive, actively managed funds over low-cost index funds for both their clients and for themselves. Differences in representatives' beliefs affect not only their own investment choices, but also cause substantial variation in the quality and cost of advice they give to clients, raising costs for some investors.

The benefits of representatives' advice may largely be intangible:

Certain research suggests that, to the extent investors derive benefits from dealings with representatives, such benefits may be largely behavioral and thus intangible in nature, such as the development of good savings discipline, overcoming inertia, the reduction of investor anxiety, and the creation of trust. Such research includes:

- the *CIRANO Research* which finds that advised households in Canada accumulate greater financial assets over time, but that this finding is mainly due to their improved savings discipline due to the advisor.[240] Another CIRANO study finds that the discipline imposed by a financial advisor on the financial behavior of households and the increased savings of advised households are key to improving asset values of households relative to comparable households with no advisor.[241]

- the *paper by the School of Public Policy at the University of Calgary* which reviews a body of research showing that pervasive behavioral biases in decision-making limit an individual's ability to make sound financial decisions on their own. Such biases include the tendency to prefer short-term gratification (consumption) over longer-term returns (saving), inertia and status quo bias and a propensity to push to a later date actions that require self-control. The author asserts that financial advisors can help individuals overcome these behavioral weaknesses which can lead them to make sub-optimal investment decisions when left to their own devices.[242]

[238] Juhani T. Linnainmaa, Brain T. Melzer and Alessandro Previtero, "Costly Financial Advice: Conflicts of Interest or Misguided Beliefs?", December 2015, http://faculty.chicagobooth.edu/juhani.linnainmaa/MisguidedBeliefs.pdf.

[239] Stephen Foerster et al., supra note 181.

[240] Claude Montmarquette et al., supra note 234.

[241] Claude Montmarquette et al., *The Gamma Factor and the Value of Financial Advice*, CIRANO Institute, August 2016, http://www.cirano.qc.ca/files/publications/2016s-35.pdf.

[242] Pierre Lortie, supra note 235, at pages 6 and 7.

- *research by Foerster et al.*, which posits on the possible reasons why fund investors prefer to use the services of dealers/representative despite the research's finding that the investment advice provided through commissions does not justify the fees paid. He states: "Given householders' strong preference for using financial advisors, it is likely that they receive other benefits beyond investment advice. Our results, however, impose constraints on the set of plausible benefits. The benefits cannot be of one-time nature because investors pay the fee continually as they remain advised. Such benefits may come in the form of financial planning, including advice on saving for college and retirement, tax planning and estate planning. It is also possible that financial advisors add value by mitigating psychological costs rather than providing financial benefit; that is, reducing anxiety (Gennaioli, Shleifer, and Vishny 2014) or eliciting feelings of trust (Guiso, Sapienza, and Zingales 2008) rather than improving investment performance.";[243]

- *research by Bergstresser et al.* which, further to their failure to find that brokers deliver substantial tangible benefits to investors in broker-sold funds, speculates that brokers may deliver substantial intangible benefits that we do not observe. The researchers state that "[b]rokers may help their clients save more than they would otherwise save, they may help clients more efficiently use their scarce time, they may help customize portfolios to investors' risk tolerances, and they may increase overall investor comfort with their investment decisions;" [244]and

- *research by Gino et al.* which finds a robust relationship between anxiety and advice seeking and between anxiety and advice taking. Specifically, this research finds that anxious individuals are found to be more likely to seek and rely on advice than are those in a neutral emotional state. The relationships between anxiety and advice seeking and anxiety and advice taking are mediated by self-confidence. Although anxiety also impairs information processing, impaired information processing does not mediate the relationship between anxiety and advice taking. Anxiety motivates individuals to seek advice from others and to be less discriminating between good and bad advice and between advice from advisors with and without a conflict of interest.[245]

[243] Stephen Foerster et al., supra note 181 at pages 27-28.

[244] Bergstresser et. al., supra note 233, at p. 4131.

[245] F. Gino, A.W. Brooks and E. Schweitzer, "Anxiety, Advice, and the Ability to Discern: Feeling Anxious Motivates Individuals to Seek and Use Advice", *Journal of Personality and Social Psychology*, Vol. 102, No. 3, (2012), pp. 497-512, http://www.hbs.edu/faculty/Publication%20Files/gino_brooks_schweitzer_jpsp_2012_fd79893e-9f44-4a69-9460-848527d2d598.pdf.

APPENDIX B

OTHER OPTIONS CONSIDERED

In determining how best to address the investor protection and market efficiency issues identified, the CSA considered the merits of a number of other policy options in addition to discontinuing embedded commissions and those discussed in Part 6 of this Consultation Paper. Some of these options were proposed in the Original Consultation Paper, while some options were identified following the consultation. Each option was thoroughly and thoughtfully evaluated.

Generally, where we determined that an option would potentially address one issue to some degree, but at the same time fail to address or even exacerbate another issue, we opted not to pursue the option. Other options were not retained because they were found to be inconsistent or redundant with options proposed in CSA CP 33-404.[246]

Like the options discussed in Part 6 of this Consultation Paper, for each of the options discussed below, we analyzed the anticipated positive and negative impacts/effects on each of the following stakeholders:

- advised investors (specifically those with investable assets below $100K, between $100K and $500K, and above $500K);
- DIY investors;
- independent investment fund managers;
- independent fund dealers; and
- integrated financial service providers.

The following discussion provides a brief overview of the primary alternative options considered by the CSA and why we have decided not to pursue such options further.

1. Enhancements to Disclosure

The CSA considered making a number of disclosure-based enhancements to the current account statements[247] and fund fact documents required by the CRM2 and POS reforms respectively. The primary focus of these enhancements would be to increase investor awareness of the costs associated with their investments and the impact that such costs play on investor returns. The particular enhancements considered are discussed below.

i. CRM2 account statement enhancements

The CSA considered enhancing the disclosure on dealers' websites and/or in the account statement currently provided by dealers to provide the median percentage return and total cost in

[246] For example, the option of defining and disclosing advisor service levels in exchange for trailing commissions as set out in the Original Consultation Paper wasn't retained due to the proposals noted in CSA CP 33-404.

[247] Report on charges and other compensation and content of investment performance report.

dollars for a range of account sizes and risk types. The following diagram illustrates an example of the disclosure contemplated:

Median Client Account Returns in 2015

Account Size	Client Risk Tolerance: Low	Medium	High
0 - $100,000	2.5%	5.0%	3.0%
$100,000 - $500,000	2.5%	7.0%	3.0%
$500,000 and over	4.0%	10.0%	5.0%

Median Client Account Costs 2015

Account Size	Client Risk Tolerance: Low	Medium	High
0 - $100,000	750.25	801.38	1,002.30
$100,000 - $500,000	7,538.20	8,951.02	15,892.30
$500,000 and over	38,582.89	52,891.40	74,120.00

The foregoing information would be based on data aggregated at the firm level in respect of all accounts for which dealers are required to produce a report on charges and other compensation and investment performance.

If implemented, the CSA would anticipate this benchmarking exercise to have the following benefits:

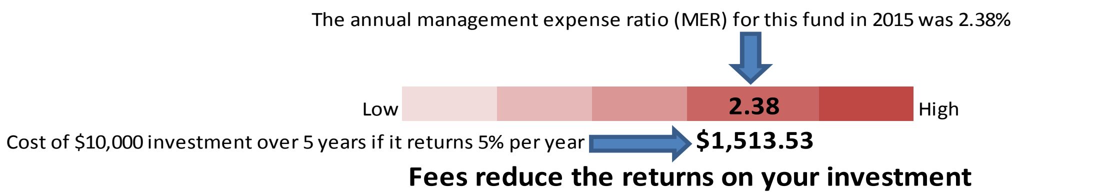
- it may better allow investors to assess their performance and costs relative to others, which in turn may allow investors to better assess the quality of the services they receive from their advisor; and
- it may over time create competition among advisors and incent advisors to enhance their level of service, which could also lead to potential cost reductions in the services provided.

The drawbacks of this option would be that:

- it would be difficult to control for variability in services provided, as well as investor objectives and time horizon, making comparisons misleading and/or ineffective;
- investors may require a certain level of investment knowledge to fully understand and interpret the additional information to benefit from the added disclosure (especially when considered in the context of all of the other information provided in the account statement); and
- some dealers who distribute proprietary products and are part of larger, integrated financial service providers, do not receive commission revenue such as trailing commissions and instead receive internal transfer payments from affiliates based on agreements with their corporate group. In these instances the true costs of the services provided may be difficult to compare across different dealers.

ii. POS fund facts enhancements

One potential way we considered to enhance the disclosure in the fund facts document was to provide more prominent fee disclosure, and greater context about the fees charged and their impact on performance. For example, as shown in the following diagram, the CSA considered requiring an illustration of where a fund's MER falls on a spectrum from "low" to "high" based on industry averages:



In conjunction with the foregoing, the CSA also considered requiring disclosure of the actual dollar amount of fees paid and returns foregone (each demonstrated over certain investment periods assuming specified returns). This disclosure could also have been supplemented with educational statements to alert a potential investor of the impact that fees play on their investments, such as "fees reduce the returns on your investment".

As an alternative to the foregoing, the CSA also considered amending the fund facts to provide enhanced disclosure regarding fund MERs and what they pay for. For example, the CSA considered breaking down the individual components of the MER to give an investor a more complete picture of the fund's expenses. Such information expressed in dollars would include, for example, the portion of management fees paid by the fund that directly compensates the investment fund manager for its services, the portion paid for operating expenses of the fund, and the portion that is used for distribution (such as all compensation paid to a dealer, including trailing commissions and sales commission, and marketing and promotional material). In addition, the CSA considered changing the term "trailing commissions", which is used in the fund facts and other reports provided to investors, to a more descriptive term such as "fees for advice and dealer services".

If implemented, the CSA expect that the disclosure enhancements could have the following benefits:

- investors may have greater fee awareness at the time of sale, which may also cause investors to consider the impact of the fees on their investment and/or the value of their advisor's advice before making an investment decision;
- investors may be prompted to ask more questions about the costs of the investment fund products being recommended and potentially ask for lower-cost alternatives; and
- to the extent that such disclosure leads advisors to recommend less expensive alternatives, competition among investment fund managers may be increased over time as managers may be pressured to lower costs to compete for market share.

Some drawbacks with this approach, however, would be that:

- investors may require a certain level of investment knowledge to fully understand and interpret the additional information to benefit from the added disclosure (especially when considered in the context of all of the other information provided in the fund facts document);
- the costs associated with the amendments may be burdensome and would be borne by investment fund managers (and ultimately, by fund securityholders);
- it may be difficult to compare information between different fund types (for example, between fixed income and equity funds); and
- it may suggest that fund types that typically have lower fees are better than fund types that typically have higher fees.

Why the CSA is not pursuing enhancements to disclosure

Provided that the disclosure is simple and easy to understand, the CSA anticipate that the enhancements discussed above may lead to greater fee awareness among investors, as investors would be provided with more prominent fee disclosure that would include additional information to help an investor assess the costs and performance of their investment (both at the time of sale and ongoing).

Notwithstanding the enhanced disclosure, the CSA chose not to proceed with this option as it does not anticipate that it will have any measurable effect in addressing any of the other investor protection and market efficiency issues identified by the CSA, particularly the conflicts of interest stemming from embedded commissions. In our view, and as discussed in more detail in Part 6, we think that disclosure alone may not be an effective remedy for conflicts of interest in an advisor-client relationship.

Moreover, the CSA do not believe it is prudent to pursue additional enhancements to disclosure until such time as the effectiveness of the current POS and CRM2 requirements has been tested through a post-implementation review.[248]

2. Investment Fund Manager Focused Initiatives

The CSA also considered implementing a number of targeted reforms at the investment fund manager level to help address the investor protection and market efficiency issues identified. The particular initiatives considered are discussed below.

i. Require a separate series or class of funds for each purchase option

One option considered was to require investment funds to maintain a separate series or class of securities for each available purpose option (i.e. front end sales charge, DSC and no load)[249].

[248] The CSA recently began a multi-year research project to measure the impacts of CRM2 and POS on investors and the industry. See note 149.

When an investment fund has multiple purchase options, part of the management fees earned by an investment fund manager are typically used to fund the payment of sales commissions to dealers on sales made under the DSC option. The cost of these commissions is commonly allocated to the fund as a whole and, by consequence, all investors in the fund regardless of the purchase option they chose. As a result, investors who purchase under the front end load option (who generally make an upfront commission payment directly to the dealer at the time of purchase) bear the same management fee as those investors who purchase under the DSC option (who do not make such upfront payments because the dealer's commission is paid directly by the investment fund manager).

To the extent investment funds would be required to maintain a separate series or class of securities for each available purchase option, the CSA would expect the resulting benefits to be that:

- the management fee charged to the particular series or class would reflect the costs attributable to that particular series or class; and
- costs incurred by each series or class would be borne only by investors in that particular series or class, as opposed to all investors equally.

However, if this proposal was implemented, the CSA would expect some of the following drawbacks:

- a proliferation in the number of individual fund series currently offered by investment fund managers, which may negatively impact investors as it will add further complexity to the investment choice, and potentially reduce fee awareness due to the increased number of options;
- a fund facts document would be required for each purchase option as each purchase option would be an individual series. This requirement would lead to increased costs on the investment fund manager (and ultimately, fund securityholders) and require investors to refer to the prospectus to discern all of the other available purchase options, further adding to the complexity of this option; and
- there would be no guarantee that the pricing for the separate series or class would reflect only the costs attributable to that particular series or class.

ii. Require trailing commission and other embedded sales commissions to be charged as an expense of the fund

Another potential approach was to require all trailing commissions and other embedded commissions (such as sales commissions paid on DSC options) to be an expense of the fund. In particular, this option would require separation of the trailing commission from the management fee and require disclosure of any trailing commission paid as an individual, asset-based fee of the fund. This approach would be similar to the current practice in the U.S., where investment

[249] We note that currently there a few mutual funds that separate fund series by each purchase option (i.e. front end, no load, and DSC). In these instances, we note that pricing for the DSC/low-load series is generally greater than other series to reflect the higher distributions costs associated with this series.

companies that pay trailing commissions to advisors bear an asset-based "12b-1 fee"[250], which is separate and apart from the management fee and covers the cost of distribution.

If this approach was implemented, the CSA would expect the requirement to make all embedded costs, which would include the sales commissions paid on DSC options, an expense of the fund to:

- necessitate the separation of purchase options into individual series (leading to the same benefits and drawbacks as the option discussed above);
- provide investors with greater transparency of the actual costs of advice and fund management; and
- allow investors to have greater control over, and awareness of, the costs and advice of distribution (as any increases to the commission, which would be an expense of the fund, would be subject to security holder approval). Similarly, the fund's independent review committee would also be in a position to provide governance and oversight over any potential rate increases.

There would be, however, several drawbacks to this approach that may reduce its effectiveness. For example:

- it could potentially lead to negative tax implications at the fund level;
- the funds offered by vertically integrated fund managers who make transfer payments rather than pay trailing commissions to their affiliated dealers may appear to have lower distribution costs than funds offered by independent fund managers as there may be no trailing commission to disclose; and
- changes to transfer payments would also not be subject to securityholder or IRC approval, which would limit the governance and oversight, as well as investor control, over these types of embedded payments.

iii. Require a standard class for DIY investors with no or reduced trailing commission

A further option considered was to require each investment fund to have a low-cost, "execution only" series or class of securities available for direct purchase by DIY investors and to require discount dealers/brokerages to offer such series or class. This series or class could be made available to investors in a number of ways, including through discount brokerages as well as directly from the investment fund manager. Since DIY investors typically do not seek advice, this series or class would have a lower management fee to reflect that no, or nominal, trailing commissions are paid to advisors. While advice is not provided to investors in these instances, the CSA understand that any nominal trailing commission paid would cover the costs of administrative, compliance, and technological services provided by the dealer or manufacturer.

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[250] Details regarding "12b-1 fees" may be found at: https://www.sec.gov/answers/mffees.htm.

One potential benefit to this option would be that investors could choose to either: (a) use an advisor for the purchase of a fund and assume the higher costs associated with this choice; or (b) not use an advisor and have access to the same fund at a reduced cost. Accordingly, this option could:

- make the true costs of advice more apparent, which would allow those who use an advisor to better evaluate the value of the advice/services they receive;
- over time, lead investors to have greater awareness of, and control over, the level of fees paid with their investment; and
- improve the alignment between embedded dealer compensation paid and the services provided to DIY investors.

One potential significant drawback to this approach, however, is that it may not be feasible or possible for the CSA to compel investment fund managers to create a new “execution only” series; and/or compel dealers to distribute this type of series.[251]

Why the CSA is not pursuing the investment fund manager focused initiatives

The CSA acknowledges that these options would appear to introduce a beneficial governance mechanism to the fee structure that could help mitigate the conflict of interest that embedded compensation raises for the investment fund manager, and also possibly improve the transparency and fairness of fees for some investors. However, the CSA chose not to proceed with these initiatives as we determined that the costs associated with these reforms would likely outweigh any potential benefit to be received. Moreover, these reforms would fail to directly address some of the important investor protection and market efficiency issues we have identified, in particular the bias that embedded compensation engenders in sales recommendations and its detrimental effect on investor outcomes and market efficiency.

The CSA also determined that to the extent the initiatives would respond to an issue, it would mainly do so for only a small part of the market (in particular DIY investors)[252]. Moreover, these options would very likely add further complexity to our current fund fee structure through an expected significant increase in the number of new fund series, and fail to have a meaningful impact on competition.

[251] As further discussed in Part 4 of this Consultation Paper, we note that since 2012, certain investment fund managers have launched a series of securities for direct purchase for DIY investors (see for example, series D securities). However, the majority of mutual fund assets held in the discount brokerage channel still remain in a series that pay a full trailing commission. As a result, the CSA are of the view that this option could only reach its optimal effectiveness if investment fund managers are required to create, and dealers are required to sell, a discount series.

[252] According to *Investor Economics*, as at December 2015, only $56 billion of investment fund assets were held through the online/discount brokerage channel.

3. Cap commissions

Another option considered by the CSA was the possibility of setting a maximum limit (i.e. cap) on embedded commissions that investment fund managers may pay to dealers/representatives. Under this option, dealer firms and their representatives would be free to directly charge their clients commissions or fees for their services, either as a supplement or a substitute to embedded commissions. The CSA considered that this option could also be a possible interim step toward an eventual discontinuation of embedded commissions.

A potential way to implement this option would be to limit the trailing commission rate payable from the investment fund manager's management fee revenue. This option could also be complemented by additional disclosure in fund offering documents that would plainly describe the fees charged as "ongoing sales commissions". In addition to, or as an alternative to, setting a cap on trailing commissions at the investment fund level, another potential option considered was to impose a cap on the aggregate sales charge (in terms of a total dollar value) that could be paid by an individual investor at the account level over the length of a fund investment. In this way, once the cap is reached, the investor's assets could be switched to a series or class of securities that does not have any ongoing trailing commission or other embedded commission payment, bringing certainty of costs to the investor.

The CSA anticipates the primary benefits of this option to be:

- standardization and reduction in the variability of trailing commissions across funds, which may reduce incentives for (a) dealers and their representatives to sell funds based primarily on the trailing commission, and (b) investment fund managers to rely on the trailing commission to attract and preserve assets under management;
- reduction of the incentive for dealers and their representatives to promote the use of DSC options as the offering of these options is likely to be reduced or possibly eliminated as a result of the cap on embedded commissions; and
- decreased fund costs (as DSC purchase options typically tend to be more costly to administer than front end or no load options, we would expect a modest decline of 15-25 bps based on the pricing practices of investment funds that separate these purchase options into unique series).

The shortcomings with this approach would be:

- as the payment of embedded commissions will continue to be permitted, they may continue to create a barrier to entry that may reduce the likelihood of lower-cost providers entering the market;
- the presence of embedded commissions may continue to make the fee structure more complex, which may continue to inhibit investors' understanding of such costs;
- embedded commissions will still remain a "one-size-fits-all" fee that may not align well with the services and advice actually provided to individual investors in accordance with their specific needs, expectations and preferences; and

- to the extent DSC options are reduced or eliminated, this approach would tend to place firms that rely on these options (e.g. independent investment fund managers and dealers) at a disadvantage relative to those that do not (e.g. integrated investment fund managers and dealers).

Why the CSA is not pursuing a fee cap

Despite the apparent benefits to this approach, it is not being further considered by the CSA at this time, either as a stand-alone option or as an interim step toward discontinuing embedded commissions because, as the shortcomings demonstrate, many of the issues we have identified would likely continue to persist in the presence of a fee cap.

This option would also cause the CSA to take a non-traditional role of setting fee caps for investment products, rather than implementing measures intended to promote market efficiency. Moreover, the CSA is not prepared to cap commissions due to the potential unintended consequences that may result from a cap. For example, research has shown that a price cap can indirectly cause average prices to rise.[253] Accordingly, it would be very challenging to determine and justify the appropriate cap rate in the circumstances.

[253] Mark Armstrong, supra note 184. At page 6, Armstrong states: "Although the direct effect of a price cap is to reduce prices, the indirect effect of reduced search lessens each firm's demand elasticity so much that prices on average go up. This formalizes a claim sometimes made informally, which is that imposing price controls on an oligopoly market could raise equilibrium prices. One intuition for such a claim is that a price cap acts as a focal point for tacit collusion."

APPENDIX C

INTERNATIONAL MUTUAL FUND FEE REFORMS

Regulators of several international jurisdictions have implemented or are considering implementing regulatory reforms with a view to addressing some of the issues we discuss under Part 2 of this Consultation Paper. Below, we give an overview of the relevant reforms that have been implemented or proposed in the U.S., the U.K., Australia, New Zealand, Singapore, the European Union (**EU**), and in some of the EU's member states, namely the Netherlands, Germany and Sweden. We also give an account of their impact to date, as assessed further to initial post-implementation reviews.

1. United States

On April 6, 2016 the United States Department of Labor (**DOL**) issued a final rule to address conflicts of interest situations in the advisor-client relationship concerning the provision of retirement advice (the **Fiduciary Rule**).[254]

i. Scope of the regulation

The Fiduciary Rule significantly broadens the scope of who is considered a "fiduciary" under the *Employee Retirement Income Security Act of 1974* (**ERISA**). Generally, and among other requirements, those who are considered fiduciaries will need to abide by a fiduciary standard in the provision of investment advice to retirement accounts.

ii. Overview of the regulation

Under the Fiduciary Rule, any individual receiving compensation for providing advice that is individualized or specifically directed to a particular plan sponsor (e.g. an employer with a retirement plan), plan participant, or Individual Retirement Account (**IRA**) owner for consideration in making a retirement investment decision is a fiduciary. Such decisions can include, but are not limited to, what assets to purchase or sell and whether to rollover from an employer-based plan to an IRA. The fiduciary can be a broker, registered investment advisor, insurance agent, or other type of advisor. Basic order-taking is not considered a fiduciary activity.

To the extent an advisor is considered a fiduciary under ERISA, the advisor will need to abide by a fiduciary standard. The advisor must also, among other requirements, either avoid payments that create conflicts of interest (including, for example, trailing commissions) or comply with certain exemptions that will mitigate the conflict. Among the available exemptions is the "Best Interest Contract Exemption" (the **BIC Exemption**).

The BIC Exemption allows advisors to continue to receive commission-based compensation provided that they meet certain conditions intended to mitigate the conflict created by such compensation. Generally, advisors must acknowledge fiduciary status, provide advice that is in

[254] The Fiduciary Rule and summary by the DOL may be found at: http://www.dol.gov/ebsa/regs/conflictsofinterest.html

their client's best interest, avoid making misleading statements, and receive no more than reasonable compensation. The firm must also ensure it has policies and procedures aimed at mitigating conflicts of interest, must not provide incentives to its employee advisors to make recommendations that are not in the client's best interest, and must ensure all conflicts of interest are disclosed.

iii. Impacts

As compliance with the Fiduciary Rule will not be required until April of 2017, and there will be a further transition period for many requirements of the BIC exemption to January 1, 2018, the impacts of the Fiduciary Rule have yet to be determined.

2. U.K. – Retail Distribution Review

On December 31, 2012, the predecessor of the Financial Conduct Authority (**FCA**), the Financial Services Authority, introduced new rules under their Retail Distribution Review (**RDR**) reforms that aimed to raise advisor qualifications levels, improve the transparency of advisor charging and services, and realign advisor incentives with those of consumers by removing the commission they received from product providers.

i. Scope of the regulation

The commission ban relates to retail investment products only (including, but not limited to, investment funds and life insurance with investment component). It excludes mortgages and pure protection products such as non-investment life insurance, critical illness and income protection insurance.

The commission ban originally applied in the case of any advisor (whether tied to or independent of a product provider) making a recommendation in respect of a retail investment product to a retail client. It requires advisors to be paid through fees charged directly to clients and not solicit or accept from providers any other commissions, remuneration or benefit of any kind (regardless of whether they intend to refund the payments or pass the benefits on to their retail clients). Ongoing commission payments generated by transactions entered into on or before the RDR entered into effect were not affected.

The commission ban was subsequently extended to retail platform service providers on April 6, 2014, with a sunset clause permitting ongoing commission payments generated by transactions executed on or before April 5, 2014 to continue until April 5, 2016 (when they were required to terminate).

ii. Overview of the regulation

The reforms under RDR introduce the following requirements:

- **Ban on conflicted advisor remuneration**: The rules require advisors to set their own charges for their services in agreement with their clients. Advisors may no longer receive commissions from product providers or commissions otherwise embedded in the cost of the product. Their charging structure must be based on the level of service they provide, rather than the particular provider or product they recommend. Whether the charging structure is based on a fixed fee, an hourly rate or a percentage of funds invested is for the advisor to decide together with the client, provided the advisor always bears in mind its duty to act in the client's best interests.[255] Ongoing fees are permitted only where a client is paying for an ongoing service that has been properly disclosed or where the product is one in which the client makes regular payments, and may be cancelled by the client at any time without penalty.

Consumers can choose to pay an advisor's fee separately from the payments for the product, or have the advisor's fee deducted from their investment/insurance contribution. The FCA allowed for **"provider facilitation" of payments** under which the customer agrees to payments with their intermediary, but it is the provider that delivers the payment to the intermediary, for example from premiums paid. If payment is to be taken from the investment, the product provider must obtain clear instructions from the client about the amount to be deducted.

- **"Independent" vs. "Restricted" advice**: The rules aim to ensure that investors understand the services they receive by requiring advisors to clearly describe their services as either "independent" or "restricted". An "independent" advisor provides personal recommendations that are: (a) based on a comprehensive and fair analysis of the relevant market, and (b) unbiased and unrestricted. Where this test is not satisfied, an advisor offers "restricted" advice (e.g. advice limited to proprietary products or a reduced range of products).

- **Increased proficiency and professionalism**: The rules require that individual advisors meet higher proficiency requirements, subscribe to a code of ethics, carry out at least 35 hours of continuing professional development a year, and hold a statement of professional standing from an accredited body. Advisors that do not meet these standards are no longer able to make personal recommendations to retail customers since December 31, 2012.

The desired outcomes of the RDR were set out in a discussion paper (FSA DP07/01) and included, among others:

- standards of professionalism that inspire consumer confidence and build trust;

- an industry that engages with consumers in a clearer way about products and services; and

- compensation arrangements that allow competitive forces to work in favour of consumers.

[255] In the U.K., the *Financial Conduct Authority Handbook* provides that all registrants must act honestly, fairly and professionally in accordance with the best interest of the client. This best interest standard is qualified, however, since registrants are subject to a spectrum of requirements which vary according to the nature of the advice given to clients ("independent", namely on a broad range of products, and "restricted", namely on mainly proprietary or other specific products).

iii. Impacts

a. FCA – First stage of RDR post implementation review:

On December 16, 2014, the FCA published the findings from the first stage of its post implementation review.[256] While the FCA cautioned that it is too early to obtain a definitive picture of the impact of RDR, the evidence from the first stage of the review showed a positive picture, with encouraging signs that the RDR is on track to deliver its objectives in many areas. The main findings are described below:

- **Reduced product bias**: The removal of commission paid by providers to advisors has reduced product bias from advisor recommendations, reflected in a decline in the sale of products which paid higher commissions pre-RDR and an increase in the sale of those which paid lower or no commission pre-RDR. This reduced bias has led to an increased focus by advisors on the provision of more holistic ongoing advice services and an enhanced quality of advice for at least some consumers.

- **Reduced product cost and improved competition**: Product prices have fallen by at least the amounts paid in commission pre-RDR, and there is evidence some product prices may have fallen even further. This is due in part to the introduction of simpler products and funds with lower fees and advisors and platforms exerting more competitive pressure on providers, with platforms increasingly able to negotiate lower product costs. The removal of commission also means that providers who sold lower or no commission products pre-RDR (e.g. index tracker funds) are now competing on a more equal basis.

- **Higher advice costs for some**: Post-RDR, one-off charges appear in line with pre-RDR initial commissions paid to advisors and ongoing charges have increased relative to ongoing commissions for at least some firms and in some regions of the U.K. There however lacks a comprehensive evidence base (particularly for the pre-RDR period) to tell whether payments to advisors have increased more generally, or whether such changes will be long-term. A longer post-RDR trend in advisor charges will help inform this.

- **Number of firms/advisors not significantly impacted**: While there was some exit from the advisory business in the period leading up to RDR, by the banks and by some financial advisors (largely due to the requirement to meet higher proficiency requirements and also due to a number of market factors), there remains a large number of advisory firms and advisors to serve consumers. Average revenues and profitability of these advisory firms has increased.

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[256] FCA, *Post-Implementation review of the Retail Distribution Review – Phase 1*, December 2014, https://www.fca.org.uk/publication/research/post-implementation-review-rdr-phase-1.pdf. The FCA commissioned external consultants Europe Economics to undertake the first phase of the review. Their full report is available here: https://www.fca.org.uk/static/documents/research/rdr-post-implementation-review-europe-economics.pdf.

- **Increased focus on higher wealth clients**: The reforms have led many firms to consider the fundamentals of their business models and make key changes, e.g. segmenting their customers, with some focusing on services to those with higher levels of investible assets and more complex (and profitable) investment advice needs.

- **Limited evidence of an "advice gap"**: There was limited evidence of an advice gap emerging for lower-wealth consumers as a result of some firms having moved to target higher net worth clients post RDR and not being able or willing to provide advice to consumers outside this segment. The evidence however suggested that the number of consumers affected by this was generally small and that these consumers were likely to have been picked up by other advisory firms. The FCA determined that there was little evidence that the availability of advice had reduced significantly as a result of the RDR, with the majority of advisors still willing and able to take on more clients. At the same time, there was evidence that consumers were increasingly buying products on a non-advised basis. The FCA also found that the group of consumers who seek advice but were not willing to pay the true cost of such advice on the grounds that it did not represent value for money was likely to have increased under the RDR. The FCA however pointed out that these consumers existed to a degree prior to the RDR and that it was arguable as to whether this group was in fact part of an "advice gap". The FCA further noted that the increase in this group of consumers had been limited by the adoption by the majority of advisory firms of contingent charging structures rather than upfront fees. The FCA also noted the efforts they were making to increase the supply of lower-cost simplified advice to meet consumer demand.

The FCA expects to publish the next phase of its post-implementation review in 2017, which will allow it to draw from at least three years of evidence. A subsequent, third phase of the review will consider the longer-term implications**.**

b. HM Treasury and FCA – Financial Advice Market Review:

In the face of concerns of a potential advice gap for some consumers and a lack of engagement with financial services, the HM Treasury (**HMT**) and the FCA launched the Financial Advice Market Review (**FAMR**) with a consultation paper (**Call for input**) published on October 12, 2015[257], seeking input on how to make financial advice work better for consumers. The aim of the review was to explore ways in which government, industry and regulators can take individual and collective steps to stimulate the development of a market which delivers affordable and accessible financial advice and guidance to everyone, at all stages of their lives.

The review explored the supply and demand sides of the market for financial advice and guidance, the barriers to providing these services and the potential remedies.

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[257] HM Treasury & FCA, FAMR – Financial Advice Market Review – Call for input, October 2015, http://www.fca.org.uk/static/documents/famr-cfi.pdf.

HMT and the FCA published the final FAMR report on March 14, 2016.[258] Some of the report's key findings include:

- **Access to advice**: Following the RDR, FAMR notes that the U.K. has a high quality financial advice market and that standards and professionalism in the industry have increased. The drive for higher standards and professionalism, along with other factors, has however contributed to a reduction in advisor numbers. The move to fee-based advice on retail investment products has improved transparency and eliminated conflicts of interest caused mainly by a commission-driven model. Nonetheless, advice is expensive and is not always cost-effective for consumers, particularly those seeking help in relation to smaller amounts of money or with simpler needs. It may not be economical for firms to serve consumers with lower amounts to invest or with simple needs. These changes have highlighted concerns that there is an advice gap in the U.K. as not all consumers can currently access the advice they need at a price they are willing or able to pay. FAMR also notes that the low levels of consumer demand for advice are also contributing to the advice gap. Such low demand is driven by several factors, including but not limited to high costs (especially relative to small amounts available to invest), limited confidence in engaging with financial issues, and a lack of trust following past instances of mis-selling.

- **Decline in advisor numbers**: The review notes a decline in advisor numbers over recent years (an approximate 23% decline of registered advisors between 2011 and 2014) for a range of reasons, including the introduction of the RDR. FAMR identifies that the majority of advisors exiting the market during this period were those employed by the banks and building societies. There are a number of reasons for these exits, including declining profitability of branch-based distribution models, a lesser role for branch-based activity, anticipation of the RDR and the consequences of past episodes of mass mis-selling (in terms of redress and reputational damage).

- **Services to mass market customers**: FAMR also identifies that banks, insurers and other large firms have, however, traditionally been more likely to serve mass-market customers with lower levels of wealth. The FCA's recent survey of advisors found that customers with pension wealth of less than £30,000 made up 27% of customers advised by medium or large advisory firms and 19% of customers advised by very small firms (those with only one or two advisors). This is likely to be because firms with high numbers of advisors are able to benefit from economies of scale, which make it possible to serve consumers with lower levels of affluence. Larger, more diversified financial services firms also benefit from having an existing customer base across which they can cross-sell their advisory services.

- **Cost of receiving advice**: FAMR notes that there are many consumers who would be willing to pay for advice but who are discouraged by higher prices. The responses received to the Call for input noted, among other things, that the perception and the reality of clients affect their willingness or their ability to pay fees for advice. FAMR also

[258] https://www.fca.org.uk/publication/corporate/famr-final-report.pdf.

notes that it is currently difficult for the traditional model of advice to serve consumers economically at lower fee levels.

- **Cost of providing advice**: For the cost of providing advice, a 2016 industry survey of advice firms suggested that, over the last two years, the proportion of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. The FCA's recent survey of advisors also supports this, suggesting that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000) to invest. There are several reasons for this. A consistent theme emerging is that there are significant minimum costs per customer associated with supplying face-to-face advice which inevitably affect commercial decisions about whether to offer services to consumers with lower amounts to invest. It will also inevitably affect whether the consumer feels that the service they receive represents good value for money.

  FAMR notes, however, that some larger firms have recently signalled a return to the advice market. In some cases this is being facilitated by effective and creative use of new technologies. A number of firms currently in the advice market are also planning to increase the number of customers they serve. The FCA's recent survey of advisors found that around 30% of firms surveyed expect to grow the number of advisors over the next year.

The FAMR's recommendations for tackling the barriers to consumers accessing advice fall into 3 key areas:

- **Providing affordable advice to consumers –** these recommendations include proposals to make the provision of advice and guidance to the mass market more cost-effective. FAMR makes a number of recommendations intended to allow firms to develop more streamlined services and engage with customers in a more engaging and effective way. These recommendations include a proposal that the FCA should set up a dedicated team to assist firms that are seeking to develop automated advice models to bring those to market more quickly;

- **Increasing the access to advice –** these recommendations are aimed at increasing consumer engagement and confidence in dealing with financial advice. FAMR proposes a number of measures to help consumers engage more effectively with advice. These recommendations include making their own information more easily available to those that advise them; the development of 'rules of thumb' and the use of nudges to encourage customers to seek support at key life stages and recommendations to help employers give more support to their staff in financial matters; and

- **Addressing industry concerns relating to liabilities and consumer redress –** these recommendations aim to address concerns about the boundary between regulated advice and more general forms of guidance. In particular, firms do not feel able to develop more streamlined advice services that meet simple consumer needs in the absence of clarity around the liabilities involved in providing simpler forms of advice or guidance. Firms consider that if streamlined advice services cannot be guaranteed to involve lower liabilities, it may not be commercially worth the risk to provide it. FAMR makes a number of recommendations to increase clarity and transparency about the way in which the Financial Ombudsman Service deals with consumer complaints. The report also includes proposals relating to the funding of the Financial Services Compensation Scheme to assist in managing longer term liabilities.

In June 2016, a Financial Advice Working Group was established to take forward the three recommendations outlined above. Since then, the FCA has set up an Advice Unit to provide regulatory feedback to firms developing automated models that seek to deliver lower-cost advice to consumers.[259]In addition, HMT has issued a consultation looking to narrow the current definition of regulated investment advice.[260]

c. FCA – Retail Mediation Activities Return results:

In October 2016, the FCA issued a Data Bulletin[261] providing insights into the activities, revenue and charges of advice firms post RDR. These insights are based on the FCA's analysis of data from the Retail Mediation Activities Return, which is submitted by approximately 12,000 FCA regulated firms. The FCA's findings are:

- *Overall revenue:* Overall revenue from retail investment business increased by 16% between 2013 and 2015 and the number of firms increased by 6% over the same period;

- *Revenue from commission vs direct fees/charges:* In 2015, commission accounted for 31% of revenue earned and direct fees/charges accounted for 64%, compared to 2013 when commission accounted for 56% and direct fees/charges accounted for just 37%. The reduced but continuing revenue from commissions consists of legacy (pre-RDR) business which advice firms are allowed to continue to receive under RDR subject to certain conditions;

- *Type of advice:* 83% of retail advice firms report that they provide independent advice with only 14% providing restricted advice and 3% both types. However, restricted advice accounted for 62% of revenue from advisor charges (with independent advice at 38%). These numbers reflect that, although fewer in number, the restricted advice population includes some very large firms that account for a significant slice of the total business conducted;

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[259] Further details about the Advice Unit can be found here: https://www.fca.org.uk/firms/project-innovate-and-innovation-hub/advice-unit.

[260] Further details of this consultation can be found here: https://www.gov.uk/government/consultations/amending-the-definition-of-financial-advice-consultation/amending-the-definition-of-financial-advice-consultation.

[261] FCA Data Bulletin, October 2016, Issue 7, https://www.fca.org.uk/publication/data/data-bulletin-issue-7.pdf

- *Method of advisor payment:* Payments facilitated by product providers are the main form of advisor payment accounting for 81% of initial charges and 74% of ongoing charges, with 19% and 26% respectively being paid direct to the advisor by the client;

- *Charging method:* The main advisor charging methods include charging by the hour, as a percentage of investment value, fixed fee, or a combined charging structure, with the most typical charging method used being charging as a percentage of investment value. Some firms may use more than one method of charging;

- *Fee rates:* Where charging as a percentage of investment value, the average charges for initial advice are 1% (minimum) and 3% (maximum). For ongoing charges, the average rates are 0.5% (minimum) and 1% (maximum). Where charging an hourly fee, the most common hourly rate nationally is £150 per hour. National average minimum and maximum rates vary between £150 and £195 per hour, with regional variations in charges.

As for insights into the activities of product providers post-RDR, a sales activity report from the Investment Management Association[262] shows that from 2012 to 2015, gross retail sales of investment funds in the U.K. increased from £105.4 billion to £160.2 billion, a 52% increase.

3. Australia – Future of Financial Advice

The Future of Financial Advice Reforms (**FOFA**) came into effect in Australia on July 1, 2012. Its primary objective was to improve the quality of financial advice, and access to this advice for Australian consumers. Compliance with the new rules was voluntary in the first year of operation, and became compulsory from July 1, 2013.

i. Scope of the regulation

The regulation under FOFA applies to all advice given to retail clients on any retail financial product except non-life insurance products and basic banking products.

ii. Overview of the regulation

Key changes introduced under FOFA include those listed below:

- **Prospective ban on conflicted remuneration**: Any monetary or non-monetary benefits that could reasonably be expected to influence the distribution of, and advice to clients about, retail financial products are considered to be conflicted remuneration. There is a prospective ban on upfront and trailing commissions as well as a ban on any form of

[262] The Investment Association, "Summary of UK Domiciled Unit Trust / OEIC Sales 2006-2016", http://www.theinvestmentassociation.org/assets/files/press/2016/stats/stats0116-02.pdf

volume-based payments in relation to distribution and advice given on retail investment products. Commissions paid by product providers to advisors in relation to investments in place prior to the coming into force of the FOFA reforms are not banned and can continue to be paid. The key aim of this change is to ensure the interests of advisors and retail clients are more closely aligned, improving the quality of advice provided, as well as removing the potential for providers to influence the advisor's recommendation.

- **Advisor charging regime**: Advisors are expected to agree on their fees directly with their clients, and disclose those fees in a clear manner. If an advisor is providing an ongoing service for which clients pay ongoing fees such as asset-based fees, they are required to ask clients to opt in (or renew) their advice agreement every two years. Moreover, advisors are prohibited from charging asset-based fees on borrowed amounts that are to be used to acquire financial products by or on behalf of a client. If a client has a portfolio of products purchased with a combination of borrowed and non-borrowed amounts, asset-based fees can be charged on the proportion of the portfolio purchased with non-borrowed amounts.

- **Statutory best interest duty:** Advisors are required to act in the best interests of their clients, subject to a 'reasonable steps' qualification[263], and place the best interests of their clients ahead of their own when providing personal advice to retail clients.

- **Annual fee disclosure statement**: Advisors must give each client an annual statement containing information from the previous 12-month period about:
  - the amount of fees paid by the client;
  - the services that they were entitled to receive; and
  - the services that they did receive.

In 2014, a newly elected Australian Government introduced a Bill proposing several amendments to the new requirements under FOFA with the aim of streamlining the regulations and reducing compliance costs. In November 2015, the Senate passed a motion regarding the Bill, effectively disallowing a number of the proposed amendments, and otherwise implementing minor and technical changes,[264]none of which eliminated or changed the above core elements of the FOFA reforms.

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[263] There is a safe harbour that advice providers can rely on if they can show that reasonable steps relating to know your client, know your product, suitability and proficiency are taken by the registrant.

[264] For example, one amendment that was passed included an extension of the time for advisors to provide renewal opt-in notices and fee disclosure statements to retail clients from 30 to 60 days after the clients' renewal notice day.

iii. Impacts: FOFA Post Implementation Review

On September 17, 2014, the Australian Securities and Investments Commission reported on the findings of its review of the implementation of the FOFA reforms.[265] Key findings include:

- Most dealer registrants did not change their service offerings as a result of FOFA, although some indicated an increase in scaled advice;[266]
- One-third of the registrants had changed the composition of their product shelf in light of the best interest duty and related FOFA obligations;[267]
- Advisor numbers had not changed;
- The advice industry remained concentrated,[268]and registrants were often affiliated with issuers of financial products;[269]
- Most registrants reported changes to their revenue streams, with a reduction in commissions after the ban and an increase in advice fees;
- Most registrants stated the biggest challenges they had experienced in implementing the reforms related to the requirement to provide fee disclosure statements and the related changes they needed to make to their systems; and
- Registrants considered the best interest duty to pose a relatively high risk of non-compliance in the future. To mitigate this risk, registrants had revised their advice systems and procedures, and most were relying on the "reasonable steps" safe harbour provision to demonstrate their compliance with the best interests duty and related obligations.

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[265] ASIC Report 407, Review of the financial advice industry's implementation of the FOFA reforms, September 2014, http://download.asic.gov.au/media/1845586/rep407-published-17-september-2014.pdf. The findings in the report are based on ASIC's review of 60 registrants accounting for close to 10,000 advisors servicing 4.6 million retail clients.

[266] The FOFA reforms allowed for "scaled advice", being a form of personal advice that is limited in scope, either by being in response to a limited range of issues or by addressing a specific area of the investor's needs (for example, insurance needs or saving for a home). ASIC stated its view that "scaled advice" must still be of the same high quality as more comprehensive advice and is therefore subject to the same legal requirements as advice that is fully comprehensive, including ensuring that the advice provided is in the best interests of the client.

[267] Of the changes to approved product lists, 14% were decreases to the types and number of products, 11% related to benchmarking and only 4% increased the number or types of products.

[268] Over 90% of the retail clients of licensees in the sample were clients of the 15 largest licensees (25% of the sample), with the remaining 75% of licensees in the sample accounting for just 10% of the clients.

[269] For large firms, 25% of the products on their approved product lists were issued by related parties.

4. *New Zealand – Review of Financial Advisers Act 2008 and Financial Service Providers Act 2008*

In July 2016, the Ministry of Business, Innovations and Employment (**MBIE**) of New Zealand published a review[270] of two acts governing the financial advice industry, namely the Financial Advisers Act 2008[271] and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

The 2016 review had four main objectives:

- Ensure consumers can access the financial advice they need;
- Improve the quality of financial advice;
- Be enabling and not impose any undue compliance costs, complexity or barriers to innovation; and
- Ensure access to redress.

The MBIE concluded that new reforms were needed to move the legislator's focus away from professionalizing advisors toward creating a level playing field of regulation for all those providing financial advice. The MBIE stated that the reforms were to be refined through consultations and would be officially introduced to the New Zealand legislative authorities at the end of 2016.

Currently the MBIE expects to make the following key changes to the legislation governing financial advice:

- **Removing some regulatory boundaries**: The requirement for advice tailored for a consumer to be provided by a natural person will be removed in order to enable robo-advisors to offer tailored advice;
- **Best-interest standard**: All individuals or robo-advisors providing financial advice will be required to place the interests of the consumer first and to only provide advice where competent to do so. All financial advice will also be subject to a Code of Conduct, where

[270] Ministry of Business, Innovation & Employment – Factsheet – Review of the operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 – July 2016, http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/pdf-document-library/factsheet-review-fa-fspa-13-july-2016.pdf.

See final report here: http://www.mbie.govt.nz/publications-research/publications/business-law/Final%20report%20on%20the%20review%20of%20the%20FA%20and%20FSP%20Acts.pdf.

[271] The scope of the Financial Advisers Act encompasses advice for several financial products, including but not limited to debt securities, equity securities, managed investment products, investment-linked insurance contracts and derivative products. Section 18 of the Financial Advisers Act stipulates who is permitted to provide personalized service to retail clients in relation to certain financial products.

standards will be set that are consistent with those legislative obligations. In addition, a client-care obligation will also be introduced, requiring advisors to ensure that consumers are aware of the limitations of their advice, such as how many products and how many providers they have considered;

- **Professional designations**: To improve consumer understanding, current financial advisor designations will be replaced with simpler ones;

- **Disclosure**: More meaningful disclosure requirements for all types of advice will be introduced to improve consumer understanding and transparency. Disclosure will be simplified and shortened to include core information about the scope of service, remuneration (including commissions) and competence, and would be available in user-friendly formats;

- **Licensing**: Anyone (or any robo-advisor) providing financial advice will need to be licensed. Licensing will be required at the firm level. There will be flexibility, depending on the size and nature of the firm, in how prospectus licensees will be expected to meet the licensing requirements;

- **Stronger connection to New Zealand**: To maintain the reliability of the regulation of New Zealand financial markets, firms will only be able to be licensed if they are in the business of providing financial services from a place of business in New Zealand or if they are providing services to New Zealanders.

In their review, the MBIE states that they will not prohibit sales commissions because they believe banning is not a 'silver bullet' that will improve the quality of advice. They recommend focusing on the conduct of those providing financial advice, rather than imposing a ban or restriction on commissions. They believe a ban might limit access to financial advice, especially when New Zealanders are already reluctant to pay for financial advice. The MBIE states that it also believes that banning commissions would not address conflicts of interest arising from soft-commissions, bonuses and the sale of proprietary products.

Nonetheless, the MBIE states that they will closely monitor the conduct of advisors, alongside the New Zealand Financial Market Authority, to determine whether their reforms will be sufficient to ensure consumers have access to quality and transparent financial advice.

5. Singapore

In March 2012, the Monetary Authority of Singapore (**MAS**) announced the launch of the Financial Advisory Industry Review (**FAIR**) with the aim of raising the standards of practice in the financial advisory industry and improving the efficiency in the distribution of life insurance and investment products in Singapore. A panel, chaired by MAS and comprising representatives from industry associations, consumer and investor bodies, academia, media, and other stakeholders (**FAIR Panel**), was formed in April 2012 to conduct the review. In January 2013, FAIR Panel released their recommendations[272] under the following key themes:

- raising the competence of financial advisors;
- raising the quality of financial advisory firms;
- making financial advising a dedicated service;
- lowering distribution costs; and
- promoting a culture of fair dealing.

In particular, the FAIR Panel recommended that financial advisory firms be prohibited from paying their financial advisors cash and non-cash incentives which are:

- tied to the sales volume of a specific investment product; and
- over and above the typical commissions paid to financial advisors for selling that investment product.

In response to the public consultation on the recommendation of the FAIR Panel, the MAS stated that they would not change the remuneration structure of financial advisors by capping or banning commissions[273] for the following reasons:

- based on an April 2012 survey conducted by the MAS, 80% of respondents said they were not willing to pay an upfront fee for advice;
- the implementation of a fee-based regime could result in consumers needing to pay more for their protection or investment needs, especially for consumers with smaller investments; and
- there could be other unintended consequences, such as a reduction in the number of financial advisors in the industry, exacerbating the lack of financial and protection planning by consumers.

The MAS stated that they will take into consideration the effectiveness of the current measures and the experience of other jurisdictions with a mandated fee-based regime.

In 2015, under the New Financial Advisers Remuneration and Incentive Regulations, the MAS introduced a cap on specified commissions that financial advisors can receive from sales of life

[272] Monetary Authority of Singapore, *Consultation on Recommendations of the Financial Advisory Industry Review*, March 2013, http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2013/5%20Mar%202013%20Consultation%20Paper%20on%20FAIR.pdf

[273] Monetary Authority of Singapore, *Response to Feedback Received – Public Consultation on Recommendations of the Financial Advisory Industry Review*, September 2013, page 55, http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Response%20to%20Feedback%20Received%20on%20Public%20Consultation%20on%20Recommendations%20of%20the%20Financial%20Advisory%20Industry%20Review.pdf

insurance policies[274]. This rule was due to come into force in January 2016, but its implementation has been delayed until January 2017 further to the industry's request for more time to implement the changes.

6. European Union – Markets in Financial Instruments Directive II (MiFID II)

MiFID II is designed to take into account developments in the trading environment since the implementation of MiFID in November 2007 and, in light of the financial crisis, to improve the functioning of financial markets making them more efficient, resilient and transparent. MiFID II came into force on July 2, 2014, and is required to be transposed into national law by Member States by July 3, 2017, and must generally apply within European Union Member States by January 3, 2018.[275]

i. Scope of the regulation

MiFID II introduces new investor protection measures, which include, among other changes, a ban on inducements for independent advisors and portfolio managers (discretionary investment management). The ban applies to all "financial instruments" within the scope of MiFID II that they sell to both institutional and retail clients (including, but not limited to, funds).

ii. Overview of the regulation

Some of the key investor protection measures introduced by MiFID II include those listed below:

- **Ban on inducements**: Firms providing independent advice or portfolio management may not accept and retain[276] any fees, commission, or monetary or non-monetary benefits from third parties in relation to the advice or service. Minor non-monetary benefits from third parties (such as training on the features of a product) are permitted, provided they are: (a) capable of enhancing the quality of service provided to a client; (b) of a scale and nature such that they could not be judged to impair compliance with the firm's duty to act in the best interest of the client; and (c) are clearly disclosed. Commissions on non-independent advice (e.g. in respect of in-house products) are still allowed. However, any such commissions must: (a) be designed to enhance the quality of the relevant service to the client; (b) not impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients; and (c) be clearly

[274] Additional information is available here: http://www.mas.gov.sg/news-and-publications/speeches-and-monetary-policy-statements/speeches/2015/explanatory-brief-financial-advisers-amendment-bill-2015-and-insurance-bill-2015.aspx and here: http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/Annex%2017%20New%20Financial%20Advisers%20Remuneration%20and%20Incentive%20Regulations.pdf.

[275] For more details of the regulation, consult the website of the European Commission at: http://ec.europa.eu/finance/securities/isd/mifid2/index_en.htm.

[276] Firms may accept compensation from third parties if that compensation is passed through to the client in its entirety and hence is not retained by the firm.

disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant service.

- **Independent vs non-independent advice**: Firms must tell clients in advance whether their advice is provided on an independent basis or a more restricted analysis of the market and, in particular, whether the range is limited to financial instruments issued or provided by related entities. Firms that provide advice on an independent basis must assess a sufficiently large number and diversity of financial instruments available on the market and should not limit the range to instruments issued by the firm or related entities.

- **Bundled services**: Firms have to inform clients whether they can buy the different components of a bundled service separately, providing information about costs and charges in respect of each component.

- **Suitability**: Existing suitability requirements applying to investment firms providing investment advice or portfolio management are enhanced with the requirement to now take into account the client's risk tolerance and ability to bear losses.[277] In addition, when an investment firm recommends a bundled package of services or products, the overall package must be suitable. And finally, firms providing investment advice must provide clients a suitability report before the transaction is made or immediately after the client becomes bound, specifying how the advice given meets the preferences, objectives, and other characteristics of the client.

- **Information on costs and charges**: Information on all costs and charges, including the cost of advice and the cost of the product must be disclosed, the method of payment stated, along with details of any third-party payments. All costs and charges should be aggregated so the client understands the overall cost as well as the cumulative effect on the return of the investment (with an itemized breakdown should a client request it). Information about costs and charges is to be provided, where applicable, at least annually post-sale.

- **Product governance**: Manufacturers of financial instruments will have to maintain a product approval process that will identify the target market for each product and assess all relevant risks. Firms that offer such products but do not manufacture them will have to understand the features of those products, including the identified target market.

[277] Current suitability requirements under MiFID include the requirement to obtain information regarding the client's knowledge and experience, their financial situation and investment objectives.

iii. Impacts

As the new requirements won't apply until 2018, the impacts of these new measures remain to be determined.

7. Netherlands – Ban on commissions (provisieverbod)

On January 1, 2013, the Netherlands Authority for the Financial Markets (**AFM**) introduced a complete ban on commissions on financial products outside the scope of the original EU Markets in Financial Instruments Directive (**MiFID**), such as mortgages and life insurance, with the aim of achieving a cultural shift from product-driven sales of financial products toward client-centered advice. On January 1, 2014, the ban was extended to all retail investment services (e.g. investment advice (whether independent or restricted), execution-only and (individual) portfolio management) in respect of financial instruments within the scope of MiFID, such as funds.

i. Scope of the regulation

The ban on commissions now applies to all financial products sold by way of (individual) portfolio management, investment advice or execution only. The products covered by the ban include mortgages, insurance (except property and casualty insurance)[278], savings products such as annuities, and investment funds.

ii. Overview of the regulation

The key elements of the reforms include those listed below:

- **Ban on inducements**: Commission payments on all financial products are banned.[279] Advisors have to set distinct prices for advice and intermediation. Fees are agreed between the intermediaries and consumers. To help consumers spread the cost of distribution over time, intermediaries and consumers can agree on the fee payment being spread over a set period (maximum 24 months).

- **'Cost price' approach**: Fees charged for advice have to cover the costs incurred in the process of giving the advice. Providers of financial products who are also advisors (direct sales) are also required to ensure that fees for advice/intermediation are cost-effective,

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[278] In determining which products should be covered by the ban, the Minister of Finance considered both (i) product complexity and (ii) the intensity of competition in the market for products. If a product was found to be subject to strong competition among providers, and consumers were found to have a good understanding of these products and awareness of there being multiple providers, the product was excluded from the ban. As a result, while motor vehicle and content and liability insurance are excluded from the ban, life insurance and funeral insurance are not.

[279] The key elements of the reforms are discussed in a report by Oxera Consulting, "Regulating remuneration systems: effective distribution of financial products", January 2015, at pages 24 to 29, http://www.oxera.com/getmedia/c28539cd-c6dc-42e4-9940-a624b0ff47ea/Remuneration-systems_Final-report_Jan2015.pdf.aspx?ext=.pdf.

and that they do not fall below the direct cost of providing the advice/arranging the intermediation.

- **Remuneration transparency**: Advisors must prepare a summary disclosure document which presents:

    - Information on the fees they charge (for an average customer);
    - The type and scope of their advice; and
    - The costs they incur.

    The document must be provided to investors prior to a transaction and is intended to allow investors to more easily compare costs and the scope of advice across different advisors.

- **Knowledge and experience test for execution only**: Consumers who declare their intention to purchase execution-only financial services must first pass a knowledge and experience test to show they have sufficient knowledge and experience to purchase financial services execution-only.[280]

iii. Impacts

During the 2009-2013 period, various related pieces of regulation were implemented in Netherlands, which makes it challenging to separate the effects of the ban and other pieces of regulation. The market for financial advice appears to have consolidated over recent years. This development cannot however necessarily be attributed to the ban on commissions as the trend towards consolidation had already begun before implementation of the ban. A full assessment of the impact of the ban is expected to be undertaken in the first half of 2017. Anecdotal evidence to date suggests that:

- the ban may have caused a reduction in fees for advice; and

- consumers may be somewhat reluctant to pay for advice, and may be purchasing less advice. Evidence in both mortgages and annuities suggests that consumers are opting for execution-only more frequently.

8. Germany – Strengthening Investor Protection Act and Fee-Based Financial Advice Act

In the wake of the 2007-2008 financial crisis, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or **BaFin**), introduced a series of reforms aimed at improving the quality of financial advice that retail consumers receive. Specifically, the Act relating to Strengthening Investor Protection and Improving the

[280] The AFM has indicated that, while it allows consumers to purchase financial products without purchasing financial advice (execution-only), it believes that such advice should be recommended to most consumers, particularly if the financial products are complex. In response to concerns that requiring consumers to pay for advice could lead to an unwarranted increased demand for execution-only products, the AFM introduced a knowledge and experience test. It is unclear how the AFM is enforcing this requirement.

Functionality of the Capital Market (**Strengthening Investor Protection Act**) became effective in November 2012. This reform was followed by the Act on the Promotion and Regulation of Fee-Based Investment Advice regarding Financial Instruments (**Fee-Based Investment Advice Act**), which came into force in August 2014.

i. Scope of the regulation

The new rules aim to improve the quality of advice by increasing advisor monitoring and advisor qualifications, as well as increasing the transparency of fees and commissions paid for investment advice. [281]

ii. Overview of the regulation

The Strengthening Investor Protection Act contained the following three key provisions targeting financial advice:

- **Product information sheet**: Financial advisors must provide their clients with a short product information sheet for each investment product advised to purchase. The product information sheet should contain all the information required for an investor to make an informed comparison across financial instruments, including the nature of the recommended financial instrument, how it works, and its associated costs and risks;

- **Increased advisor monitoring**: Institutions must disclose to BaFin the individual employees who provide financial advice to clients and all complaints lodged against an advisor based on the advice provided. With this information, BaFin created a database to monitor and respond to abuses;

- **Increased advisor qualifications**: Financial institutions must ensure that their advisors have sufficient expertise to provide financial advice. In particular, all advisors must have expertise in contract law and securities law and be knowledgeable about the functioning, risks, and costs of the financial instruments on which they advise.

Commission-based investment advice is the predominant model in the German market. BaFin found that although advisors are legally obligated to disclose to clients any inducements received from product providers or issuers of financial instruments, many clients remain unaware of that conflict. The Fee-Based Financial Advice Act was introduced with the aim of increasing transparency about advisor compensation and promoting non-conflicted advice. The regulation introduced "fee-based investment advice" as a legally protected designation and imposed specific restrictions on those seeking to become fee-only advisors.

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[281] Additional information is available here: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Fachartikel/2014/fa_bj_1407_honorar-anlageberatung_en.html and in a report by RAND, "Financial Advice Markets: a cross-country comparison", Jeremy Burke, Angela A. Hung, October 2015, at pages 14 to 16, http://www.rand.org/pubs/research_reports/RR1269.html.

In order to designate their services as "fee-based investment advice", financial institutions must register with BaFin by submitting an audit certificate establishing that their advisors meet the following requirements:

- **Remunerated only by the client**: To promote non-conflicted financial advice, fee-only financial advisors must receive remuneration directly from their clients and may not receive inducements from third parties;[282]
- **Adequate range of offered financial products:** The range of offerings which the advisor's recommendations are based on must be sufficiently diversified with regards to providers and issuers of financial instruments. If associated with a product provider, financial advisors must ensure that their range of financial products is large enough to provide their clients with suitable recommendations. Fee-based investment advisors are prohibited from offering only financial instruments from sellers or issuers who are closely affiliated with the advisor's investment firm or with which they are otherwise economically linked. In all cases, the advice provided must be market-oriented;
- **Disclosure of manufacturer affiliation**: If affiliated with a product manufacturer, financial advisors must disclose that affiliation to their clients;
- **Functionality and organizational separation**: Financial institutions providing fee-based investment advice must segregate fee-only advisors from conventional advisors to help ensure that fee-based investment advice is not influenced by commissions-based investment advice. In addition, firms are preventing from setting sales targets for their fee-only advisors that may conflict with the interests of clients.

To promote and ensure access to the new legally protected "fee-based advisors", BaFin created a publicly available registry of certified fee-only advisors for German investors to consult.

iii. Impacts

The specific impacts of the reforms are unknown at this time.

9. Sweden – Proposal to ban commissions in the financial industry

On February 3, 2016, *Finansinspektionen*, the Swedish financial supervisory authority (**FI**), published a report on its investigations and research on how to improve the Swedish savings market.[283] FI witnessed problems on the savings market that are due to the conflicts of interests that arise when advisors and intermediaries receive payments from the product provider in the form of commissions. FI notes that the size of these commissions varies a significantly

[282] When neither the recommended financial instrument nor a comparable suitable one is available free of commission, the fee-based investment advisor can make the recommendation and any commissions received must be passed on to the client in full immediately after they are received.

[283] Finansinpektionen – *A Necessary Step for a Better Savings Market*, February 3 2016, http://www.fi.se/upload/90_English/20_Publications/10_Reports/2016/battre_sparandemarknad_engNY.pdf

depending on the product and the firm, which gives rise to a conflict of interest that is very difficult to manage. Their investigations showed that funds that are sold through advisors have higher fees than those sold through, for example, fund trading platforms. FI states that the current rules regarding the management of conflicts of interest as well as the self-regulation initiatives of the financial advisory industry were insufficient to tackle the identified issues and proposed to impose a ban on all types of commissions.

i. Scope of the proposal

FI proposed to ban all commissions for investment advice, portfolio management, as well as for life insurance with an investment component, as a necessary step towards a better functioning savings market even if such a ban would not solve all the problems facing Swedish savers.

ii. Overview of the proposal

The Swedish authority stated its reasons behind its proposal and tackled the concerns voiced about a ban of commissions and its possible consequences. Some of its conclusions are as follows:

- **Market failure**: Consumers in the savings market are at an information disadvantage in relation to the firms that offer financial services and products. They are unable to judge the quality or price of products and services which prevents them from influencing the market. Financial advice today exacerbates consumers' information disadvantage because it is influenced by the size of commissions paid by producers instead of the needs of the consumer.

- **Harming competition**: There are concerns that a commission ban could harm competition in the advisory market by favouring large banks. On the contrary, FI finds that a ban would be a necessary step to improve competition by forcing independent advisors to offer truly independent advice and to challenge the banks' dominance on the advisory market.

- **Major industry adjustments**: A commission ban would entail major adjustments and transition costs for the Swedish financial industry. With transparent pricing, firms providing financial advice will need to demonstrate what value they are adding whereas product providers that pay high commissions to get their products onto the market will instead have to compete on pricing and quality. FI believes this will lead to simplified advisory services and an increased range of lower-fee products and argues that the gains from a better functioning savings market will outweigh the transition costs on the long term.

- **Advice gap**: With respect to concerns that a commission ban would potentially cause firms to no longer offer advice and result in a shortage in the supply of advisory services to consumers with modest assets, FI finds no empirical proof that this would be the case. FI also notes that to argue against a ban on commissions on the basis that consumers won't be willing to pay a price which they have always been paying, but which is now clearly visible, is not a good argument. In FI's view, clear pricing creates possibilities for

> consumers to influence the supply of advisory services. If advice, as it looks today, is perceived to be expensive in relation to the value it provides, there is an opportunity for other types of advisory services to emerge – services that are more cost-efficient and adapted to consumers' willingness to pay. Accordingly, FI finds that transparent pricing for advice can lead to simplified advisory services that are more adapted to consumers' needs.

On May 24, 2016, Sweden's minister of Financial and Consumer Affairs communicated that the government will be proposing legislation in response to the EU directives such as MiFID II and the Insurance Distribution Directive, but that the government would not introduce a general ban on third party remuneration or commissions at this stage.[284]

[284] Jonathan Boyd, "Swedish government proposes not to ban commission-led sales", *Investment Europe*, (May 24, 2016), http://www.investmenteurope.net/regions/swedendenmarkfinlandnorway/swedish-government-proposes-not-ban-commission-led-sales/

APPENDIX D
SUMMARY OF CONSULTATION QUESTIONS

Part 2

1. Do you agree with the issues described in this Part? Why or why not?

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

Part 3

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

    - mutual fund
    - non-redeemable investment fund
    - structured note

    should the product be subject to the discontinuation of embedded commissions? If not:

    a. What would be the policy rationale for excluding it?
    b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:
    a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;

b. referral fees; and
c. underwriting commissions

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

10. With respect to internal transfer payments:

    a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?

    b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

    c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

<u>Part 4</u>

Addressing the issues

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

Change in investor experience and outcomes

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

    - Will investors receive advice and financial services that are more aligned with the fees they pay?
    - What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?
    - Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?
    - What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?
    - What effect will the proposal have on the cost and scope of advice provided to specific investor segments?

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

    - Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?

17. Do you think this proposal will lead to an advice gap? In particular:

    - Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.
    - Do you agree with our definition of an advice gap?
    - Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?
    - What types of advice or services currently provided today would be most affected by the proposal?
    - Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?
    - How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?
    - Do you think that online advice could mitigate an advice gap? If so, how?
    - Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

    - Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

    - Do you see payment options and business models evolving at present?
    - How are they likely to change over time if the CSA were to choose not to move forward with the proposal?

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Potential impact on competition and market structure

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

    - Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?
    - What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?
    - What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?
        - Independent dealers?
        - Independent fund manufacturers?
        - Integrated financial service providers?
        - Mutual fund dealers?
        - IIROC dealers?
        - Online/discount brokers?
    - What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?
    - What would be the impact on dually-licensed mutual fund dealers and insurance agents?
    - Will the proposal lead new, lower-cost entrants to the market? Why and how?
    - Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?

- Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?
- Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?
- What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

    - Is there any specific operational or technological impact that we should take into consideration?

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

    - Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?
    - To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:
    - career path;
    - attractiveness of the job;
    - typical profile of individuals attracted to the career;
    - recruitment; and
    - relative attractiveness of careers in competing financial service business lines?

<u>Part 5</u>

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:
    - access to advice for investors,
    - choice of payment arrangements for all investor segments, and
    - a level playing field amongst competing investment products?

28. What other measures should the CSA consider to mitigate the above unintended consequences?

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

    - Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.

    - To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?

    - What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

    - to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;

    - does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and

    - what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.
    - Are there unique costs or challenges to specific businesses?
    - What transition period would be appropriate?
    - Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

Part 6

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

    - address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and

    - address or not address any additional harms or issues that you have identified.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

Subject: Embedded fees

My name is Debbie Hartzman, and I am a Certified Financial Planner, with Professional Investments, Kingston Ontario.

I have a client base of approximately 500 families in the eastern Ontario regions. I started my career in 1995, and have been active in the financial planning community since then. On the board of Advocis, on Financial Planning Standards council working group and the CFP exam board.

Over the passed few years I have surveyed every client I have come in contact with as to whether or not they would be in favour of paying out right for my services, I have explained the issues of embedded fees, and not one has agreed that they would like to pay me directly. The the overwhelming indication is that they want to be informed and would like choices but they do not want to billed independently of their investments.

Because I service a niche market, clients going through separation and divorce, I have to co-operate and liase with the legal and accounting professionals. I can not tell you how many times I have had one of these professionals tell me that they can not help the client in the way I am suggesting because they have no way of billing for that service. Conversely, I have clients contact me first because they know they are not on the clock with me, and I will help them as much as I can, but will refer them back to the appropriate professionals if it is outside my area of expertise.

If we are forced to bill for our time and services much of what we presently do to service clients will have to fall by the way side as clients will not be able to pay for services. Much like when I suggest a client have a "Will" written, the first thing they say, is "how much is this going to cost me"?

I implore you to listen to the people who engage in our services and hear what they say. Disclosure for sure, separate billed payments are not preferred and will solve no problem. Give the clients the power to choose. In the past two years, there have been shift towards, lower fees, no dsc, full disclosure of fees and more and more compliance. Give these measures a time to work and then see if in fact there are further requirements needed. Change for no good reason does not serve the clients you are trying to protect. In the long run, studies show that a ban on fees, to be paid directly back fires on the very people you say you are trying to protect.

I for one would have to stop servicing the small client who couldn't afford to pay my fees. They would be relegated to deal with providers who do not offer the level of service that I do, regardless of how much money they have invested all my clients are treated with dignity and respect.

I am not the only advisor who uses our trailing commissions to subsidize the service for our smaller client who need us as much or more than our higher net worth client. Don't make a mistake and hurt the very public you say you are trying is to protect. This is Canada, not the US, or the UK, learn from their mistakes.

Regards

Debbie Hartzman.CFP.CLU.CDFA.TEP.RRC

Sent from my iPad

Dear Sir/Madam

Re - CSA Consulting Paper 81-408 (10 January 2017)

Regarding the aforementioned consulting paper, it is clear CSA intends to transition away from all forms of "trailing/embedded commissions", even the reduced ones of 25bps currently available on Series D mutual funds. Page 137 indicates CSA does not think it is able to "compel" Fund Managers to make Series D Mutual Funds available. Well, you don't have to. As Series D Funds are already in the marketplace, the demand from DIY investors, who invest through discount. Brokerage accounts, will have the effect of forcing the brokerage companies to make these funds available, or they will risk loosing clients/assets to their competitors.

Generally speaking DIY investors have "chosen" to make their own decisions and are quite content paying a trailer fee of 25bps in order to secure access to Series D Mutual funds at a cost they deem reasonable for the services they get from their discount broker (including, but not limited to, providing up to date account statements, confirmations of transactions, year end summary of account activities, tax documents, etc, etc). Rather than telling DIY investors "what they can get", how about CSA asking DIY investors "what do you want". This "Alternative Perspective" would a refreshing breath of fresh air for DIY investors, who neither want, or need, any form of hand holding.

Looking forward to your response –

Best Regards
Nick Carroll.

Ontario Securities Commission
Care of:
The Secretary
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

January 11, 2017

Dear Sir or Madam:

I am writing in response to the recent consultation paper released by the Canadian Securities Administrators regarding the banning of commissions in the financial services industry.

I joined the financial services industry in 2009 after completing a degree in business economics from the University of Saskatchewan. Following this, I completed the Certified Financial Planner designation and now run a small, independent financial service business along side my father and brother. Our business focuses on long- term relationships with our clients helping them navigate any number of financial decisions over their lifetime. Decisions they want to make prudently by seeking out objective counsel.

We have received an overwhelmingly positive response on our approach that focuses on a client's overall financial situation, goals and objectives first and then helps them implement a financial plan based on that client's wants and needs.

Since becoming involved in the industry it has never sat well with me the way our industry portrays itself as a true profession that is essential to Canadians along with lawyers, doctors, accountants, engineers etc. While at the same time operating under a compensation model that is in direct conflict with the ability to objectively perform this important service.

I do not buy the argument against the banning of commissions that it will result in less access to advice. In fact, I have found while attending various meetings and symposiums across country that the misinformation, especially flowing from other jurisdictions experiences such as the UK and Australia, to be based in fear and reminds me more of simply "protecting the status quo."

In our business we have transitioned to operating with only fee-based investment accounts where we receive no third party commissions. This has not precluded us from working with clients from all different income and asset levels and has freed our minds in the ability to give our clients the best possible financial advice and direction.

802-4010 PASQUA STREET REGINA.SK S4S 7B9 // P. 306.525.4707 // F. 306.525.4705
WWW.TCMFINANCIAL.CA

For example, a client with $50,000 to invest, in my mind, is either going to pay me (or our dealer) 1% directly through a fee-based account –or- I am going to receive a 1% trailer from a product provider. I do not see any difference in the end other than the direct fee is more transparent and must be negotiated and presented to the client just like they would expect engaging with any other professional service.

Will this change the way advisers and planners run their business? Yes. Attract clients? Yes. Will this change mean we have to re-evaluate how we are going to compete for business over the next 10-20 years? Yes. But it is not the responsibility of a regulator to make it easy for businesses to operate but instead need to create a fair and ethical environment, which I believe the CSA is trying to achieve with these consultations.

In closing I believe the banning of commissions in Canada along with other reforms such as raising education and proficiency standards will enhance the entire financial services industry in the long term.

Sincerely,

Taylor Hewson CFP®

802-4010 PASQUA STREET REGINA.SK S4S 7B9 // P. 306.525.4707 // F. 306.525.4705
WWW.TCMFINANCIAL.CA

Good afternoon,

Please see my comments below regarding my concerns about Canadians access to affordable financial advice and the Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions as directed to do so by the Honourable Gordon S. Wyant, Q.C. – Minister Of Justice & Attorney General of Saskatchewan.

Tyler J. Dickie

From: Dickie, Tyler
Sent: Wednesday, January 11, 2017 3:24 PM
To: 'Ralph.Goodale@PARL.GC.ca'
Subject: Please protect Canadians access to affordable financial advice.

I am writing to you with concern about possible changes in the financial advice industry. It is my understanding that these changes will require that consumers pay an upfront fee for financial advice. Right now, all consumers have a choice whether or not to pay a commission. This type of change will help the wrong people and hurt the average person who depends on affordable, quality financial advice.

I believe that Canadians should continue to have a choice in how they pay for financial advice – whether through commissions or upfront fees. These proposed changes mean that:

- Most Canadians may lose access to affordable financial advice;
- As a financial advisor, I won't be able to keep the costs the same;
- The current regulations that put consumers at risk will not be addressed;
- The quality of advice people receive will still not be ensured;
- Your constituents will have little choice about who helps them manage their finances into the future.

The regulatory bodies who are proposing this change believe that removing choice is in consumers best interests. Limiting their access to financial advice does not protect them and most of them would prefer not to have anyone dictate how they interact with me as their financial advisor.

Rather than limiting their access to financial advice, the focus should be on maintaining standards by creating a profession for all financial advisors. This will make the industry stronger and protect all investors.

Financial advisors like myself are part of the community and the advice we provide not only creates wealth but also makes people feel more secure. Your constituents deserve nothing less.

I would ask you to make every effort to raise this issue with the minister responsible for the securities regulator as soon as possible to ensure that the public voice is reflected in these types of decisions.

Thank you,

Tyler J. Dickie, CFP® , RRC®
Financial Consultant

I wish to include my comments with respect to the CSA Consultation Paper 81-408

As a currently licensed life and health insurance broker and a formerly licensed IIROC investment advisor and exempt market advisor, I fully agree that commissions as such should be banned and the sooner the better. By commissions I mean front and back end load mutual fund commissions, not trailer fees. Deferred and up-front sales charges clearly are not in the best interests of the client as they effectively lock the client into a particular type of investment for years. The only person who benefits from this is the sales person.

Trailer fees, as long as they are fully disclosed, are really no different from charging a percentage of assets under management, so I am not sure why one would ban one without banning the other. Banning trailer fees on mutual funds while not banning a charge via a percentage of assets under management would unfairly penalize those who sell and promote mutual funds. If you are going to ban trailer fees, you need to ban charging via percentage of assets under management too.

Have you considered putting a cap on trailer fees, such as 1% of assets under management?

Personally, I think that the best system for all financial planning would be to charge by the hour for services rendered, like lawyers and accountants do. The only problem with that is that very few people would be willing to write a cheque to a financial planner.

Perhaps a system that requires that financial planners be paid a salary, rather than straight commission and living off trailer fees, might be a more client-centric approach. Sort of like Best Buy when they took over Future Shop. Best Buy does not pay commissions, whereas Future Shop was on straight commission. Best Buy is the survivor.

Under the current system, all of the rewards are based on assets under management (AUM). If advisors are rewarded for AUM, then how can we realistically expect 100% of them to provide financial planning services that are holistic and in the best interests of the client? I'm reminded of an article I read during my MBA studies "On the folly of rewarding for A while hoping for B" by Steven Kerr. The title is self-explanatory as it relates to the misaligned reward system in the financial services industry.

Finally, I think that the language within the industry needs to change. Financial services companies talk about "sales", "production", and "AUM", instead of client satisfaction and enhanced client outcomes. Rewards should go to those who provide excellent advice that is in the best interests of the client, not to the best salespeople. Idealistic perhaps, but that should be the goal.

Banning commissions would and should lead to having fewer so-called "financial advisors" out there. With fewer, better advisors, who are paid based on the value they add, the reputation of the industry and the profession would be improved.

Sincerely,

Tim Weichel, MBA
705-798-0062
416-230-2703

Dear Sir/Madam,

I am an experienced investment advisor and my firm's model is the imbedded fee model. So we are paid directly by the mutual fund companies, monthly.

I have spent the last two years explaining to my clients how we are paid and why we are paid (and what I use my compensation for: like paying my rent, my assistants salary, my license costs, etc…). My most important and largest clients have been explained the fees many times. I haven't had one complaint about paying too much.

It has been my experience that the embedded model works best for most people. If we remove imbedded fees the small clients will have to pay much more. For instance I just booked an appointment with a client that has $7K with me - basically I net $50/year. I would have to either give that client up or charge them more to deal with me. Being paid directly from the fund company allows me to continue to service this client - if we change that, these types of clients would get no service.

If you ask the client, they prefer imbedded fees. I carefully explain to them that their returns are after fees. If you ask them (and I do) - would you prefer the fess come from your account - they always say no. If you look at brokerage fees (many have un-imbedded fees that are much higher than 1%, especially for the average sized client) - the fees eat away at the returns. Many of the dividends coming into the account are consumed by the fee, especially if the client has a smaller account and is paying more. Many brokerage accounts that I look at have substituted ETF's and Index Funds and then upped their un-imbedded "trailer fee" to 1.5% from 1%. They do this because they are under pressure from the bank dealer to pay more for overhead costs and bank profit. If you count the 1.5% and the ETF cost - this comes very close to what a mutual fund charges. No mutual fund pays a trailer fee of more than 1%.

I feel very strongly that explaining the fee to the client is enough. They understand what they are paying, in dollars, and we print it on their statement now, so if they chose to they can move their funds elsewhere (perhaps at a negotiated rate). Most like the service they get from us, we don't gouge, we are fair (in my opinion).

Un-imbedding the fee I believe will lead to a different type of excess. One where you will start to charge the small client a larger fee. Most of my larger clients started small and I helped them grow their account to the large size it is today. Compensation is one of the reasons I have spent the many years learning that I have. It isn't easy to make money for people. We have to temper expectations when things are good, and push people to do the right thing when things are down. We are paid well but I believe most of us deserve to be. We have a unique skill that adds value.

Sincerely,

Kevin Hayes
CFP Professional

I would like to share my views from over 25 years working in the financial advisory business, about the proposed move away from embedded trailer fees. On the surface I have no objection as most of my advisory practice is based on the 1% service fee I receive from the fund companies I deal with. I do not now charge up front commissions at all, nor do I use DSC funds. There are trends I have seen however, that worry me.

I will first preface by saying that I originally got into this business to help people. It didn't matter to me whether they had a lot of money, just that they wanted to do the best with their money, and become as financially independent as they could, given their personal gifts. Of course back then it was quite acceptable to put many people saving for long term into DSC funds. The increased income to my business from DSC funds allowed me to keep those smaller clients and give them the help that they needed. The DSC fees also served to deter them from dipping into their retirement savings for short term needs such as vacations. Since I no longer use DSC funds, I have had to send some clients away. I simply can't afford to keep them due to the rising costs of doing business.

Today, my practice focuses on higher net worth clients because I am running my practice on just service fees. Fee disclosure is not the issue. My clients know the fees they pay. I know my clients value the advice I give them, and will pay for what I do for them (I already have some clients in fee for service model).

I think that ensuring the service fees are the same across all investment funds would be beneficial for all clients, and ensure that there is no alternative reason for advisors to choose a specific investment for clients. By ensuring that clients know how MERs and service fees work, through the CRM2 initiative has gone a long way to full disclosure to clients. Flat service fees would ensure advisors are not choosing funds so that they get a higher commission rate. The amount of embedded service fees I receive are based on the performance of the investments I choose for my clients. It is in both my and my client's best interest to choose the best portfolio managers I can find. Remember that those service fees have to pay for my all of my own office expenses, my staff salaries and leave something for me for compensation for the work I do.

And those fees pay for a lot of services for my clients. I work with their other professionals such as accountants and lawyers for tax planning and estate planning. I do retirement projections, put together family protection plans, and work with small business owners to make the best financial decisions for them, their businesses and their families. Ongoing research goes without saying. But most of all, I keep my client's emotions from blowing up their financial plans. So many times people have reacted to either market or life events that could have totally derailed them financially. I have clearly explained the possible outcomes, thereby helping them realize that an alternate decision is a much sounder one. My level of knowledge over 25 years ensures that my clients are way ahead financially, than if they didn't have an advisor. Keep in mind that the majority of people have no education in finances, so they desperately need good advice.

There is more of a conflict of interest at the banks than at any independent dealer. The banks have a vested interest to encourage people to borrow money and use credit when it is not in their best interests to do so. I have heard some really terrible advice coming from that quarter. I am really sick and tired of seeing the banks get away with the lies they tell people. The rules don't seem to apply to them or the insurance companies. There is no level playing field when it comes to these two other streams of business.

I am at the end of my career, but it doesn't mean I don't care about the people I serve, and the future of Canadians as a whole. The end result of banning service fees will be that only the wealthy will get good and thorough financial advice and planning, because they are the only ones who will be able to afford it. Remember that most people have no understanding of the true value of getting professional advice. (most high net worth people on the other hand do know) All that the average person will see is the upfront fee they pay, with no real understanding of the value they are getting. So, like so many aspects of our country, the rich will get richer, the poor will get poorer. Not the kind of country that most Canadians want, I am sure. I can't see how banning embedded service fees, which are fully disclosed to clients now on their statements, in dollar terms, will help them in the long run.

If you as regulators would spend your time and resources to educate all potential investors about how the whole system actually works, so that they can make truly informed decisions, the country would be so much further ahead. By educating people you protect them from abuse so that things like banning service fees, become irrelevant. These fees are being fully disclosed on client statements now anyway.

I urge you to listen to those of us on the ground who are independent advisors, with our client's best interests at heart. I want you to really understand what sitting in my chair means. Thank you for receiving my submission and my point of view.

Kay Crawford, PFP
Senior Financial Advisor & Insurance Advisor

-----Message d'origine-----
De : Jo and Theo Georgiou [mailto:the.georgious@hotmail.com]
Envoyé : 23 janvier 2017 12:18
À : CSA ACVM Secretariat
Objet : Embedded Fees

Please help get rid of hidden fees as Australia and Britain has done.B on the citizens side rather then big company's!

theo

Sent from my iPad

-----Message d'origine-----
De : Donna Kagan [mailto:dmkagan@icloud.com]
Envoyé : 23 janvier 2017 17:47
À : CSA ACVM Secretariat
Objet : Contact Us - Information

I am an individual investor and I am completely perplexed as to why the regulators have not banned embedded fees once and for all. It is not a complicated issue and it strikes me the Regulators are being cowed by the Mutual Fund sellers who love to refer to themselves as “financial advisors”. Because I am interested I educated myself about trailer fees and back end loads and front end loads etc. many years ago but amongst my friends there are almost none who recognize how much they are paying. Yes, I know the new regulations require the fees be shown in dollar amounts as well as percentages on the monthly or quarterly statements. The sad truth is that most people and particularly those who are financially unsophisticated or uneducated don’t really look at the statements or if they do it is a cursory glance at best. There are members of my book club who insist they have mutual funds with their bank and they pay no fees at all - give me a break!!

How long do you intend to study the issue and when can I anticipate some movement on this matter. A response would be appreciated.

Donna Kagan
Winnipeg, Mb.

Blainville, le 26 mai 2017

Commentaires de Yves David [redacted]

À l'âge de 14 ans j'ai demandé à mon père quoi faire avec mes épargnes. Il m'a présenté son agent d'assurance-vie.

En 1979, célibataire, j'économisais 110$ par mois dans 3 polices car personne n'avait pris le temps de m'éduquer financièrement.

En 1989, travaillant aux États-Unis, j'ai rencontré une compagnie dédiée à la classe moyenne et j'ai décidé de revenir ici aider mes proches et leur proches à investir dans les fonds communs.

Je disais que je serais là pour les gens qui avaient même de la difficulté à investir 50$ par mois. Prenant le temps de les éduquer financièrement et de développer des stratégies de protection et de désendettement.

Puis nous avons réduit le plancher à 25$ par mois.

Aujourd'hui nous dirigeons une force de distribution de près de 200 représentants qui servent 25000 clients dont le compte moyen est de 13145$.

Oui 13145$....!!!

2 exemples de mes clients personnels. Les noms sont fictifs mais les cas réels.

Jeanne qui a commencé à épargner 343$ par mois. Je l'ai accompagné à travers les soubresauts de l'économie mondiale depuis 1998. Elle m'a récemment remercier de ma patience et du fait qu'elle a maintenant plus de 500000$ en Reer.

Alex et Julie qui avait à peine 50$ par mois à investir et qui aujourd'hui ont une valeur nette de plus de 1 millions$.

Les commissions intégrées m'ont aider à servir ce marché.

Comment accepter de payer des honoraires quand on est un petit épargnant?

Comment tronconner le peu que l'on a?

De plus les frais de rachats sont un excellent outil pour inciter les gens à utiliser les fonds communs sur le long terme et à rester investi pendant les baisses du marché.

Je ne connais pas vos motivations pour considérer éliminer les commissions intégrées mais je connais les besoins de gens qui veulent avancer financièrement et qui n'ont pas les moyens de payer des honoraires.

Merci à vous de considérer ces commentaires.

26 January 2017

The Secretary
Ontario Securities Commission 20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8 Fax: 416-593-2318

Attention: Provincial and Territorial Canadian Securities Administrators Regulators

EMBEDDED COMMISSIONS

Reference: CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

1. I am an individual investor and have been concerned with the ongoing practice on embedded commissions for several years now. This practice obfuscates broker fees and harms investors through the conflict of interest it creates for advisors. As I have watched other countries e.g. the United States, United Kingdom and Australia ban embedded commissions it is confusing as to why this practice has not been stopped in Canada. Having reviewed the reference paper I believe that the conclusions are self-evident and support cessation of embedded commissions i.e.:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;

2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and

3. Embedded commissions paid generally do not align with the services provided to investors.

The evidence we have gathered to date shows that embedded commissions encourage the suboptimal behavior of fund market participants, including that of investment fund managers, dealers, representatives and fund investors, which reduces market efficiency and impairs investor outcomes

2. Your report provides factual evidence that the practice of embedded commissions is counter to investors interests and would ensure a more efficient and competitive industry. Therefore, I would like you take note of my support for the immediate elimination of embedded commissions. I would also implore you to not delay any decision based on industry self-interest and the fallacious argument that many Canadian’s will be denied investment advice because they will have to pay for it. Canadian’s have been paying too much for advice under

the current system and it is time to force the industry to compete for business in a more open market. I believe that individual investors can make appropriate choices on the selection of investment advice and what value to pay for said advice when they are faced with a level playing field and not faced with information asymmetry that is supported via embedded commissions.

3. The recent, if not glacial, implementation of CRM II is a good step for investors. I urge you eliminate embedded commissions as quickly as possible to protect and serve Canadian investors.

Sincerely,

Signed by

Alistair Harrigan Cdr (Retired) RCN BComm
2057 Haley Rae Place
Victoria BC
V9B 6A8
alharrigan@icloud.com

Statement on behalf of myself to the Ontario Securities Commission

Hello there,

Let me tell you a little story. I recently visited with my father over the holidays. He is a smart man, retired at 54 and has an investment portfolio of over $1 Million (mostly in registered accounts) with a financial advisor for a large bank. I spoke briefly with him about the new changes coming in 2017 for advisor fees reporting (namely "CRM2") - he had no idea. When he confidently proclaimed that he only pays about %1 in advice fees, he was taken back to realise that that really accounts for over $10,000/year and immediately scheduled a meeting in the new year with his advisor to discuss possibilities of reducing his rate as a high-net-worth investor.

Here's the thing, as you can imagine as he didn't fully grasp the concept of his %1 advice fee, he had *no idea* that the trailer fees on his mutual funds (which make up more than %65 (!) of his portfolio) could be an additional hidden cost that may be greater than the advice fee he had just been taken back by.

I'm starting to worry that my father isn't the exception, but the rule. A large population of baby boomers that have continuously amassed wealth over many years and have stuck with their "down-the-street-big-bank" that they walked into 40 years ago when they started to accumulate more money than a savings account justified.

Embedded, or "trailer", fees are secretive, underreported and misalign the interests of advisors and advisees. At least when I pay 'hidden' airport upgrade, tax and fueling fees when purchasing a flight, I am told about these fees at the time I pay. Hidden trailer fees are predominantly never reported in monthly statements, despite being a serious drag on investor's pockets. This is borderline robbery and investors shouldn't have to dig through 30 pages of mutual fund pdf information packets online to find the true cost of owning a product.

I am strongly for the <u>elimination</u> of embedded fees in mutual fund products, or at least, the mandatory reporting of fees on a monthly statement in *dollars*.

The argument that it will become more difficult for investors to obtain financial advice if the fees are eliminated is absolutely **laughable**, and a desperate argument from the large fund managers and salespeople across the country that are accustomed to having their pockets filled with investors' unknown money. There are a plethora of options available today to investors including, but not limited to, low-cost index funds and ETFs, independent brokers, fee-based advice and Robo-advisors. WealthSimple, Nest Wealth, BMO SmartFolio and an abundance of others would be more than happy to take on the additional accounts (big or small) and would more than likely be better for investors.

Thank you for taking my comments into consideration,
JR Tobias (Toronto)

Friday, January 27, 2017

Good afternoon,

First, I would like to thank each one of you for your time and dedication you put into the roles you play, that help to shape the financial services industry in Canada for the better.

All of the discussion and conversations in the industry show there is much work to be done to ensure clients are served well, and that the trust they place in the industry is not placed in vain.

I am writing as one small voice in a sea of many Advisors, I am 30 years old and have had the pleasure of being in the financial services world since I was 21. This business has been a great way to support my wife and 4 kids, and be involved in a very rewarding career.

Over the last few years especially, this business is evolving quickly, In your positions, I know your quite familiar with current and coming changes. My reason for writing comes from a frustration of not knowing who it is the advisor can go to share our concerns, and comments on how our business is changing, it seems in many ways that the ones who' have so much time, and money wrapped up into the business, the ones who are at the ground level are not entitled to have an opinion. It almost seems as if regulators feel the advisor should not have the write to help shape the way their own industry evolves. Though in many ways through licenses, fees and taxes we help employ the very people who regulate us.

With that said, I very much understand the reasons for all of this change. Over my 9 short years I have seen many cases where clients were sold something, an advisor profited greatly, but the client was not better off, or worse yet, disadvantaged. Though I can't say I have done a perfect job for my clients, I do take very seriously the trust they put in us for advice that puts them and their interests first.

With the implementation of CRM2 I think it is a very healthy thing that clients see what we get paid, and the advisor insure that the client is getting value for each dollar spent.

I guess my biggest concern is the direction we are headed. It seems as if we are taking into account the practices of poor advisors and regulating everyone based on them. When I hear the discussions of what's coming next, it feels like we are trying to draft legislation that assumes that the advisor will always take advantage of the client unless regulators step in to force them be honest and care for their clients.

Well before we have ever seen if CRM2 is working we are now moving to remove embedded commissions, even though, there are many lower-middle class families who benefit greatly from this structure. Many of my clients fall into that category, and as I work to help them reach their financial goals I can honestly say for many of them, they have had more time and advice then they could afford to pay for. One thing I have never read is an article about what the industry is going to do to compensate Advisors who spend time to help families, and build them into good clients, no one is worried about how, in many cases an advisor has worked with people even though their compensation was minimal, any new advisor will have a hard time surviving in this business if he/she only served low-middle income families. I think this has been proven true in other countries who have adopted the fee-for-service only model, the smaller clients no longer receive financial advice.

Even though there are many advisors who would serve us all well to leave the business than to keep giving the business a bad name, lets not forget the studies that have clearly shown that in the final analysis people in Canada have done better with a financial advisor than without one.

One of the things that has been a huge focus is clients disclosure, now I don't know what the answer to this is, but when opening a simple TFSA feels to clients more like buying a house (as far as paperwork is concerned) I think we have to think hard on its effectiveness. Though I don't know the answer, it seems these things are serving to simply protect our dealers from lawsuits but as the burden of reading and disclosure increases I'm not sure the clients are more informed, even though we do our best to get them to ready everything carefully.

One other regulation I hear being contemplated is the idea that every product offered by a dealer needs to be understood by both advisor and branch manager. For this I would encourage you to step into our shoes, there are thousands of funds in Canada. We do our best work to comb through and find quality funds and then make sure we understand the ones we have chosen. It is almost as unreasonable to tell someone working in the Walmart electronics section that they need to understand every single product in the whole store inside and out, or they have no job. I think they would be better served knowing well the products they actually sell, and their clients would be better served as well. The cause and effect to this will again impact our clients. Dealers will no longer to be able to offer much choice, smaller boutique fund companies will close, and our clients will be left with a lot less choice to invest in. Does this really help the client? I think its great for banks or big fund companies, but not our clients who deserve choice.

The increased pressure on outside activities seems like it is becoming overreaching, in my spare time I organize a small recreational hockey team, I realized this week that I need to be compliance approved in order to offer my son and other families a more affordable option so they can play hockey. It just seems that common sense always gets sacrificed in the name of regulation. As in every business there will always be those who use their reputation, position, and authority and leverage it for their own gain, no matter how heavy the regulation people with that intent seem to find a way. I agree we need something to keep an eye on what else advisors are doing, but I would have to think there is a better balance, not every one, in fact I would guess it's a low percentage of people, who are using their volunteer positions, or religion to undermine those who trust them, so is there a way to not overburden the majority because of the minority?

Often I have heard the stat that the average age of a financial advisor in Canada is 55 years old. If I am a regulator, this is one of the biggest problems we face. What are we going to do to ensure the generation coming up can have access to financial advice. For the ethical advisor, who is not going to sell DSC funds and whole life insurance to anyone with a pulse, starting this business is very challenging. For an advisor to start, and start right, a great deal of their business will be term insurance, and front end load funds with 0% front end commission. You are all well aware of the challenge it would be to make a living off of those, especially if you're a younger advisor, working with younger families. So my question to you is, how are you encouraging younger people to get into this business? If we continue to make it more expensive and continue to increase the regulatory burden without more balance, it will be too expensive to start (it probably already is) and too much of a compliance burden to maintain. When I am retiring the question will not be “are advisors paid too much?” it will be “where can I find a financial advisor?” That to me is the issue that should keep us all up at night, because the future of any industry will be its ability to bring in and train younger people to take it over. I know a number of people in their 20’s & 30’s who entered the business, but could not afford to stay in it.

Today the average income for a financial advisor is in the neighborhood of $47,000, I am guessing many of you would not keep the jobs you have now if that is all that it paid. In fact I would further argue, since you know more than anyone the current regulation and upcoming regulation, that many of the people making these regulations would not want the responsibility put on financial advisors today if they were only going to make $47,000 per year.

As the industry continues to develop with regulation, and seeks to improve the quality of service offered by our industry, my simple request would be to bear in mind the many practices and livelihoods that are effected positively or negatively by the decisions you make.

As you all go home from work each day to your families, please keep in mind that the average advisor does the same thing. We are people trying to serve our clients with good advice, and ultimately make a living for our families. Everything you do to change our business, to make it more difficult, more expensive and less profitable effects us and our families, please keep this in mind.

At the end of the day I think our goal should be, a well informed client, who is able to make choices, instead of having a regulator making those choices for him.. An environment where ethical advisors are encouraged to grow, and regulation that assists in this. And spending more time cleaning up the industry so that the everyday advisors life is not further burdened by regulation meant for the unethical one.

I say all of these things with the utmost respect for your position, and an appreciation of what you do. As much as you do not see the business through my lense, I do not see the business through yours. The lenses of the client, regulator and advisor are all necessary in order for regulations to be effective, without all three perspectives they will not have the desired intent.

Thanks so much for taking the time to read this!

Thanks,

Ben Davies

Hello. I have been reading about the projected to change imbedded commissions for mutual funds in Canada.

I have been in the financial services industry since 1994. I am now 59 years old. I agree that an advisor needs to earn the "trailer commissions" on the block of fund clients!
As such, I run a small block,and I spend my time firstly recording the return history of all my clients in a ledger book. My role is to be the gate keeper for my clients and advise them of asset switches when the stock markets make such a move appropriate.

I am constantly in contact with my clients. I have to provide service work for my clients on things such as beneficiary changes, PAC changes, banking information or address changes, and redemptions all the time, this work I am not compensated for.

Due to my vigilance in not allowing large drops in my clients portfolio, my clients have experienced the best returns possible.

I am confused because I'm not sure when I became the bad guy. I have sat in clients homes to advise them on financial matters, including paying out death claim cheques! I was working when you guys were at home relaxing!

I will do everything I can to help in this. You have to remember, I could have been in another line of work for the last 23 years, if I was told that my very financial lively hood was going to be taken away at my age.

Please think carefully, there are lives at stack.

Yours truly,
Brad O'Morrow
O'Morrow Financial Services

De : Patrice Doucet [redacted]
Envoyé : 31 janvier 2017 15:01
À : CSA ACVM Secretariat
Objet : Pour nous joindre - Renseignements

À qui de droit,

Je vous transmet aujourd'hui un courriel afin de vous faire part de mon opinion concernant le fin des commissions de suivis. La fin des commissions de suivi sera néfaste pour le consommateur car tous les conseillers vont changer continuellement de compagnie et toucheront toujours une commission de placement. Le conseiller agira ainsi à tous les deux ans et ne travaillera pas pour son client. Avec les commissions de suivi, la grande partie des conseillers ne font pas ce petit manège et se concentre sur le fait de bien connaître ses produits et d'y être fidèle donc de bien conseiller ses clients.

NON À L'ABOLITION DES COMMISSIONS DE SUIVI

Patrice Doucet

Provenance : [redacted]pour Windows 10

CSA Consultation Paper 81-408

I work in the investment industry but my submission is on behalf of all financial product consumers in Canada. Embedded commissions do create a conflict of interest. I have marketed investment products since 1993 and part of the value proposition to differentiate products was commission.

However, if you ban embedded commissions the issue of consumer choice worsens.

Here's why.

A)
Product Innovation:
Any mutual fund manufacturer that also owns a distribution channel will innovate and launch a suite of new products. These products will not have any commission.

By way of examples:

- Canadian banks will launch products at 2.00% MER and no commission. These products will be sold through the banks retail outlets via salaried employees.
- Investors Group, London Life (Freedom 55), Sun Life career agents etc will create a product at 2.00% MER and no commission. Advisors will be paid a salary and bonus to sell these products

Vertically integrated organizations will utilize a value proposition to Canadians that states "move your account to us since we don't charge any commissions". The consumer may be paying the same cost (MER) but the statement proves compelling.

B)
Fee Based Accounts:
Many of these vertically integrated organizations, especially the IIROC channel currently offer fee based accounts. They will continue to grab market share. However, most aim exclusively at the High Net Worth community not all Canadians.

C)
Independent Advice:
This channel will be decimated. Many advice channels do not offer a fee based accounts. Average Canadians will not pay for advice. Competitive forces drive this channel further into a downward spiral.

D)
Independent Portfolio Management:
Without access to distribution this channel struggles to reach Canadians and continues to shrink.

Summary Outcome:

Canadians are left with vertically integrated manufacturing, distribution and advice controlled by some 20 organizations. These organizations will market that you can purchase any product through their channel but when you leave a CIBC branch you will have purchased a CIBC product. The CIBC product is professionally managed by either employees or owned portfolio management companies. Repeat for Freedom 55 or any other surviving organization.

Independent Portfolio Management organizations who do not have a sub advisory relationship with one of the vertically integrated networks struggle to survive and this channel shrinks. Who works harder for Canadians employees or independent Portfolio Managers who want to earn your investment dollars?

Independent advice is dead

Independent portfolio management is dead

Choice is decimated.

You will own a proprietary product.

Banning of embedded commissions reduces choice and creates more conflict of interest not less.

Thanks and regards
Steve Kunzel

PS If you want to help Canadians create wealth, ask the government to eliminate tax on investment funds and create one regulator for all products, including insurance in Canada.

To whom it may concern. I have yet to see a coherent and well-articulated rationale for the outright banning of embedded commissions on mutual funds. The pervasive scrutiny applied to the financial services industry that has resulted in this ridiculous proposal seems entirely self-serving and biased.

The embedded commission is no different from the mark-up of any item for sale. For the advisor who sells mutual funds on a FEL basis, is a .00125%-.005% annual trailing commission on a $100,000 investment so egregious when compared to the 2.5% a real estate agent may earn on the sale of a property? For that matter, is the advisor who sells mutual funds on a DSC basis and receives 2.5-4.0% up front any different? Why the scrutiny on one and not the other?

To adopt the reductio ad absurdum, do I, as a consumer, not have just as much right to know what the mark-up is on the suit I buy from my retailer as I do the embedded commission I'm being charged on my mutual funds? By the same token, can we justify the mark-up on the food we buy? Shouldn't we be focusing on reducing the "embedded fees" that increase the cost to consumers on the staples of life in addition to the embedded fees we pay on our mutual funds?

Without getting into a very long-winded digression, the solution to this issue is very simple. It comes down to choice and disclosure. A free market will provide choice. And an ethical advisor will present both choice and disclosure. But the CSA wants to limit my choices. They've adopted the self-serving moral position that ending embedded commissions is the better way, with no clear evidence that the consumer will be better served.

Yet, even if they were able to offer clear evidence, the decision on whether or not to buy should always be left to the consumer. At least in a free society, it should be. Give me a choice. Let me decide what I want to buy. Don't make that decision for me. If I wish to pay more for organic food, I should have a right to do so, even if the alternative might save me more money. If I wish to buy mutual funds which come with a trailer commission or DSC option, again that should be my right. If I have the choice to buy a fund with no embedded commissions, and I feel that it will ultimately be better for me, then I can make that choice for myself. I have that choice today.

In an era where we have a growing abundance of choices thanks to a free-market, legislating what legitimate products companies can and cannot offer smacks of fascism and anti-competition. The moral argument here for limiting choice is specious at best and utterly tenuous in the light of full examination. Let us be honest with both ourselves and the public. This is strictly a PR move and nothing else. Give the consumer choice.

In the interest of full disclosure, I sell mutual funds in my practice. I do not sell funds on a DSC basis. However, I support the right of advisors who wish to run their practice on the DSC model. And I support the right of clients to purchase funds from advisors who wish to run their practice on the DSC model. Who are we to take away those rights from others simply because we don't ascribe to that model or have a moral aversion to it?

Respectfully,

Craig Cornell, B.A., CHS
Wealth & Risk Management Solutions
for professionals and business owners
5575 North Service Rd, Suite 500
Burlington, ON L7L 6M1

Monday, February 6, 2017

Hello,

Please note my change in regards to embedded fee. These are to be added to the comments.

First of all that is a large document to go through and I would be lying if I said it was fully understood.

Please use these comments:

- trailer fees should not be paid when accounts lose money. If fact - it should refunded.
- the amount of trailers should be obviously stated on every statement (transparency)
- the amount of trailer fees paid should be on my annual statement
- total trailer fees deducted should be calculated for my whole account over time.
- trailer feels need to presented in a clear way to clients - with a signed acknowledgement - annually.

Thanks,

Victor Prasad

Harry Lockerby

To: comments@osc.gov.on.ca
Subject: BC Securities Commission re: mutual fund fees.

To Whom it may concern.
My name is Harold Lockerby, 68 years old, worked all my life, retired 2 years ago. I have purchased mutual funds, for my retirement, thru financial advisers for the for the past 35 years. Over that time period I have asked these advisers, over and over again, how much they are charging me in dollars and cents. All I got were vague answers that the fees were somewhere between 1.5 & 3 % of my portfolio value, whether they made me money or lost me money. They said it was very difficult to calculate a dollar figure. If I owed THEM money, it didn't seem difficult at all, I had the bill the next day. I, and everyone I know, have been extremely annoyed that regulating bodies have allowed this lack of accountability to go on for so many years.

Last year my financial adviser told me they had to disclose these fees, I believe mandated by the securities commission, by the end of 2016, and would show them on my statement, which they did. I recently had a meeting with my financial adviser and found out that the fees disclosed on my statement are only the fees charged by the financial adviser company and didn't include fees charged by the mutual fund company. The fund company fees are buried as a % in the MER, same as always and I still don't know, as a dollar figure, how much I am being charged. How has this been allowed to happen and when is it going to change? I am now beyond annoyed, progressing to extreme anger, the same as my friends. These companies have to be held accountable for the average citizen to make informed choices on who manages their money.

Yours Truly
Harold Lockerby

To Whom It May Concern:

As an advisor and PM for the past 20 years I have been fortunate enough to survive an industry where 90% of my Midland Walwyn peers in my graduating class are no longer in the industry. Thankfully, owing to a supportive wife and some persistence through lean years, I have been able to forge a successful career. Nevertheless, I am deeply concerned about the future of our industry.

I'm sure I don't need to inform you that the average advisor is 59 years old (so I've been told). I'm also fairly certain that precious few of these people got into this business due to a love of paperwork, although this is now the status quo. No doubt you are also aware that financial education in this country is practically non-existent and that front line bank employees are often lacking in experience and knowledge through no fault of their own. Despite all of this, you are contemplating major changes to an industry that just finished implementing 3 years' worth of major changes, which we have yet to be measured for effectiveness.

Embedded commissions are not a perfect solution but they are certainly better for some clients -- especially those with smaller amounts to invest. It is the 25 and 35 year olds that really need our help as advisors, not the 60-year-olds where shrewd planning and decent returns have less time to change lives. I liken the situation to medical advice, which to me is the only type of advice more important than financial. Here, our society chooses to bill everyone through taxes, knowing full well that people would often not pay the thousands of dollars needed for care when needed. Medical advice is deemed too important to not charge people for, irrespective of whether they use the services. As regulators, you know that financial help is almost as critical and for young people, likely more so. I have seen a few clients choose to leave our practice over the years because they don't like the push to direct fee-billing and they have moved to online investing. I still wonder how these people are doing sometimes, because I've seen through experience, that not many have the skill to properly manage all aspects of investment management and financial planning.

In fact, I think this is really the crux of the debate. If we know that limiting billing options may lead to some advisors choosing to retire, and less choice as the banks and others are unlikely to go on a hiring spree; then the question becomes where do we want people to get the advice from? The internet seems to be a great place to get a lot of information but also a lot of "alternative facts". Online accounts, ones I've seen, almost always lead to pathetic returns or too much or too little risk. A new alternative, robo-advice is in its infancy, and it remains to be seen if this will produce superior results to online, diy accounts. I suspect that it may for some, but not for all.

Whatever, you decide, and I'm sure your minds are largely made up, my business interest is not why I'm writing. At 45 I can adapt, and my clients are generally content, well-served, and frequently referring others to us. That said, I fear the future costs of your pending review, to those who may not be able to access quality advice, will be immense.

Over 20 years, I have seen so many lives ruined from prospectus-exempt investments where people lose 100% of their money. I've seen depression caused by this. On another occasion I've called in to report fraudulent misrepresentation, only to be told there was nothing that can be done. Clients of mine almost lost their life savings in this scam, and I know of several non-clients that did lose everything. Furthermore, I have seen lives ruined by needlessly complex and grossly overpriced insurance product. And I've seen the negative impact of poor or improper investment return disclosure over long periods. Some of these have been recently fixed, to your credit. Never have I seen lives ruined by an extra .3% charge on a mutual fund. If this is a major concern, there are much simpler ways to fix this issue without limiting investor choice.

The actions you are contemplating are important but to me will clearly have both positive and negative effects for investors. I would urge you to give the full weight of your contemplation to this The work I do effects the lives of a couple hundred families. Your work will affect millions for many years. Choose wisely.

Stan Penner | CFA, CFP, FCSI
Investment Advisor / Portfolio Manager

Good afternoon,

My name is Chris Dietz and I am a Certified Financial Planner based in Listowel Ontario for the last 27 years. I would like to pass on the following comments on your proposal to ban embedded commissions and DSC/LL.

I fully agree with the direction that you have taken in regards to CRM and full disclosure of fees which has just taken effect for 2017. Each client should be made well aware of what the dealer/advisor is getting paid to manage their account. Now clients will be able to open their statement and see exactly what they are paying for advice. I expect there will be many investors who will be surprised and will question the value they are receiving for those fees but in the end they will be better served.

Our business model here is a combination of fee based and embedded fee model and has been for the last 10 years. We fully disclose to clients exactly what we get paid in percentage and dollar amounts since making the switch from DSC/LL. The recent changes from CRM now fully discloses the fee paid to our dealer and is welcomed. My recommendation for CSA would be to keep embedded trailers as it provides another option of purchase for the Investor. The client is receiving full disclosure on the amount of fees they are paying now with CRM so why would you eliminate the embedded option? How does the embedded fee option differ now from the fee based option? The client is now seeing exactly what they pay in either account.

In regards to the banning of DSC and LL funds, this will not affect my business at all but I feel it may cause a barrier to entry for new advisors into our industry. I cannot see how a new advisor would be able to enter the industry and build a business from nothing like I did without this option of compensation. The only option a new advisor would have is to come in under a veteran advisor and gradually grow that way. As the average age of an advisor is rising, I am sure that as an industry we wouldn't want to limit entry.

In summary I feel strongly that you need to provide choices for the investor on how they compensate their advisor. Reporting of the actual dollar amount of fees to the client is a good first step, but, I would question why wouldn't CSA take some time to get feedback from Investors before eliminating embedded commissions. It might be prudent to wait a couple of years until you find out how the industry and investor is adjusting. I think CSA will find out pretty quick that small investors will not be served well by the decision of eliminating DSC/LL. Under the new fee model small investors will be charged more to deal with an investment professional to make their account size viable for the advisor's business plan. CRM has taken the steps to fully disclose advisor compensation which we applaud, but, take the time to fully analyze these changes before jumping to conclusions on what is best for investors.

Thank you for taking the time to read my letter and I hope it provides some insight into our client base and our thoughts on elimination of embedded commissions.

Thanks,
Chris

Chris Dietz CFP CLU ChFC CHS
Dietz Financial/Peak Investment Services

CARP

24 May 2017

Sent via email on 24 May, 2017 to comments@osc.gov.on.ca

Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H3S8

ATTENTION: Robert Day
Senior Specialist, Business Planning and Performance Reporting

Re: CARP – Submission to the Canadian Securities Administrators (CSA Consultation Paper 81-408)

Please note that we have compiled additional data to supplement our position on the option of discontinuing embedded commissions, and as such, we would ask that you kindly replace CARP's February 17, 2017 Submission on Consultation Paper 81-408 with the attached.

CARP is a national, non-partisan, non-profit organization that advocates for financial security and improved health care for Canadians as we age. With over 300,000 members and nearly 50 chapters across Canada, CARP works closely with all levels of government and collaborates with other organizations to advocate on health and financial issues. CARP enlists its members' voices to increase its clout to most effectively advocate for its priorities.

Thank you for your kind consideration.

Sincerely,

W.W. Morris

Wanda Morris
VP of Advocacy

Marissa Semkiw
Director of Policy

70 Jefferson Ave. Toronto ON M6K 1Y4 www.carp.ca **Phone:** 1.888.363.2279 **Fax:** 416.363.8747

Summary
CARP is pleased to have the opportunity to provide input on CSA Consultation Paper 81-408 regarding the option of discontinuing embedded commissions. We believe in a well-regulated investment industry that allows Canadians to manage their investments more effectively and to plan for their retirement with added confidence. As such, CARP would like to see provincial regulators prioritize the initiatives necessary to make financial markets safer, less costly and more transparent for our members, and by extension, all Canadian investors.

CARP calls for the immediate elimination of embedded commissions (trailer commission) paid to advisors. We believe that there is no compelling argument for permitting embedded fees to continue.

Embedded Commissions

Question 1. Do you agree with the issues described in [Part 2, Section A]? Why or why not?

A recent study calculated the average equity mutual fund fee in Canada to be 2.1% - six times higher than the average pension plan fee.[1] While Canadian regulators recently implemented the second phase of changes to the Client Relationship Model, known as CRM2, reforms didn't go far enough. Financial firms must only disclose the cost of advice; there is no requirement to disclose the cost of products sold.

CARP unequivocally agrees with the findings found in Part 2, Section A of the consultation paper regarding the key investor protection and market efficiency issues raised by mutual fund fees and related evidence. The paper identified conflicts of interest that misalign the interests of investment advisors and investors as a key investor protection issue posed by embedded commissions.

Indeed, the trouble with trailers is threefold. A recent study by York University professor Douglas Cumming found that mutual funds that pay above average commissions attract and retain investment dollars regardless of their performance. That is, the capital invested in these funds does not leave even if it is performing poorly. Meanwhile, when a mutual fund paying a typical commission underperforms, investors take their money elsewhere. This is a significant problem, but it's not the only one.

---

[1] David Macdonald. (March, 2015). The Feeling's Not Mutual: The High Costs of Canada's Mutual Fund Based Retirement System. Canadian Centre for Policy Alternatives. Located online at [https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/02/Feelings_Not _Mutual.pdf]

Second, we are aware that some on-line brokerage services sell funds which include embedded commissions. As these firms are, by definition, selling a do-it-yourself product, charging an embedded commission for advice is tantamount to theft. CARP believes that there is absolutely no merit in allowing companies to collect money for a service that they do not provide. Furthermore, some strong performing mutual funds only sell fund classes which include an embedded commission so investors cannot purchase such funds without also paying a commission for a service they will not receive.

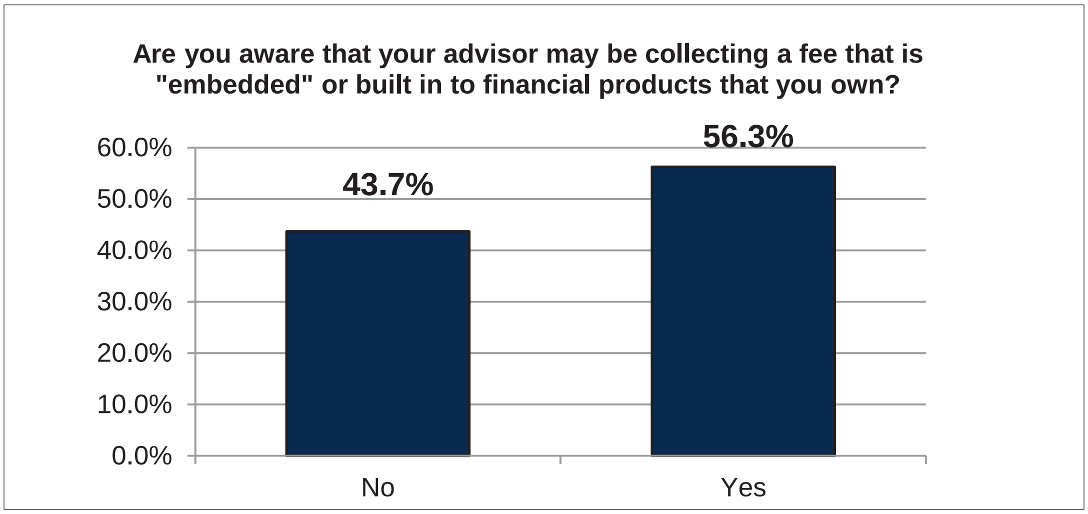
Lastly, we have heard anecdotally from members who were not aware they were paying embedded commissions. This is consistent with our survey results, which found that 44% of our members did not realize that they were paying embedded commissions to their advisors. Moreover, less than half knew when their advisor received a commission from selling a financial product or how much the commission was.

For these reasons, CARP endorses a move to direct pay arrangements and the elimination of embedded commissions, like trailer commissions. This will better align the interests of financial advisors and their clients and provide increased transparency with respect to fund costs. Not only will the elimination of embedded commissions reduce the inherent conflict of interest in the current mutual funds sales model but this will also allow investors to more easily understand and control an important cost component of their investments. CARP believes this heightened transparency and control will encourage fee reductions and improve overall returns to clients.

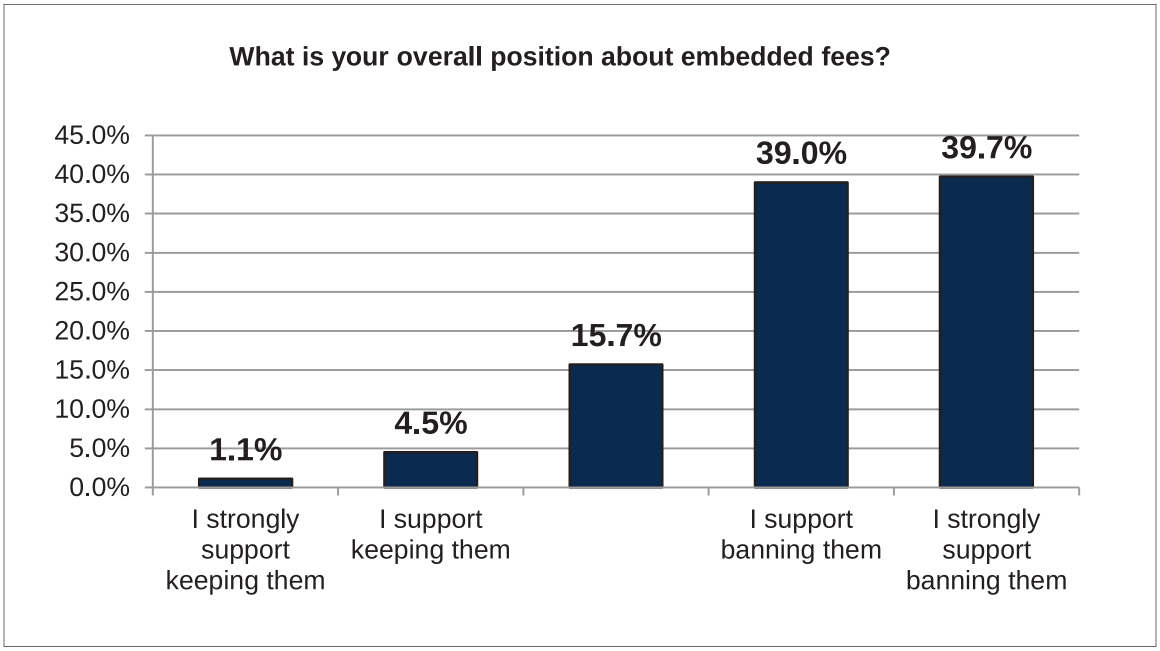
Poll Results

CARP builds its policy positions on the views of our members. @We asked members to rate their level of agreement (or disagreement) with arguments put forth by lobby groups like Advocis, The Financial Advisors Association of. The detailed questions are below. After considering all the arguments for and against embedded commissions, **79%** of CARP members polled supported a ban on embedded fees.

Question #1 Are you aware that your advisor may be collecting a fee that is "embedded" or built in to financial products that you own?

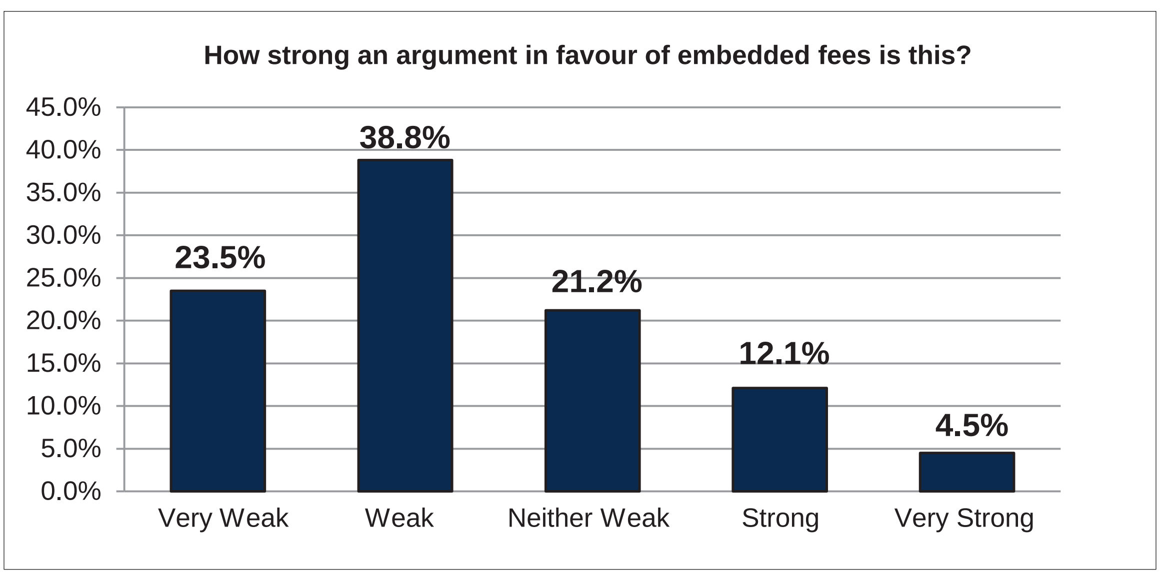


Question #2 What is your overall position about embedded fees?

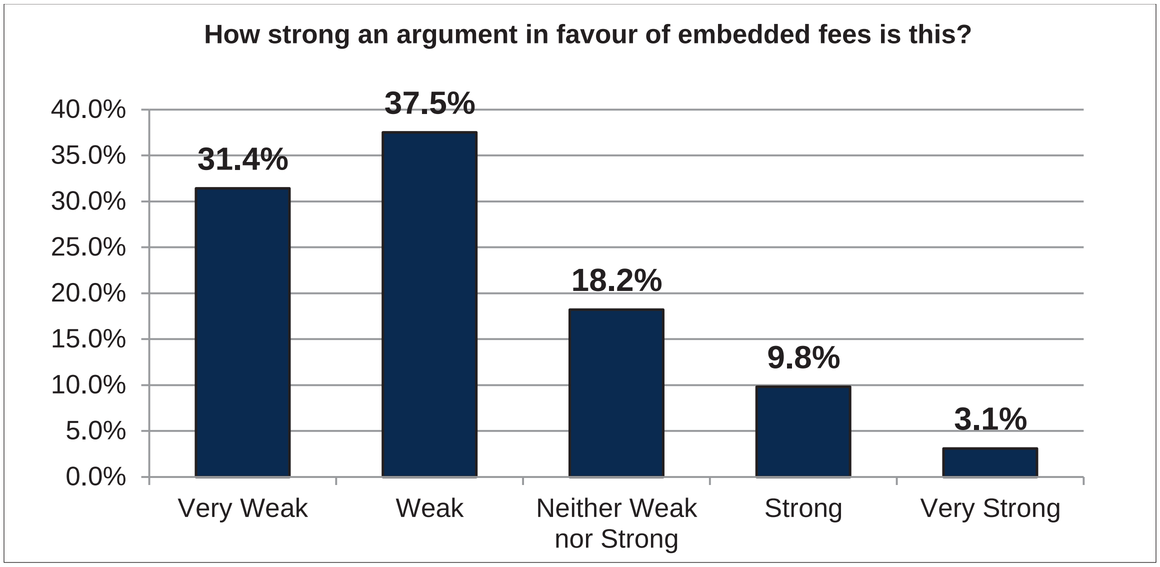


Arguments in Support of Embedded Commissions

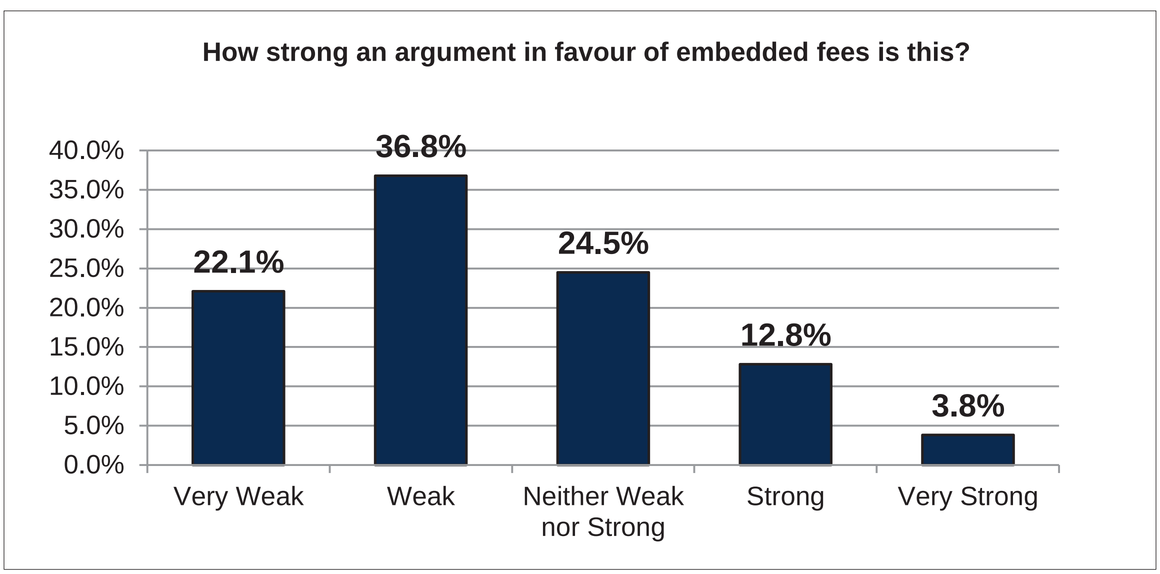
Argument #1 Individuals who have a financial advisor are better prepared for retirement than those who don't. If investors are aware of how much they are paying for advice, they'll stop doing so and will be less financially secure in retirement as a result.



Argument #2 When the UK banned embedded fees, the number of advisors in that country declined from 40,000 to 31,000. Lobby groups are concerned that fewer advisors will mean more people are left without financial advice.

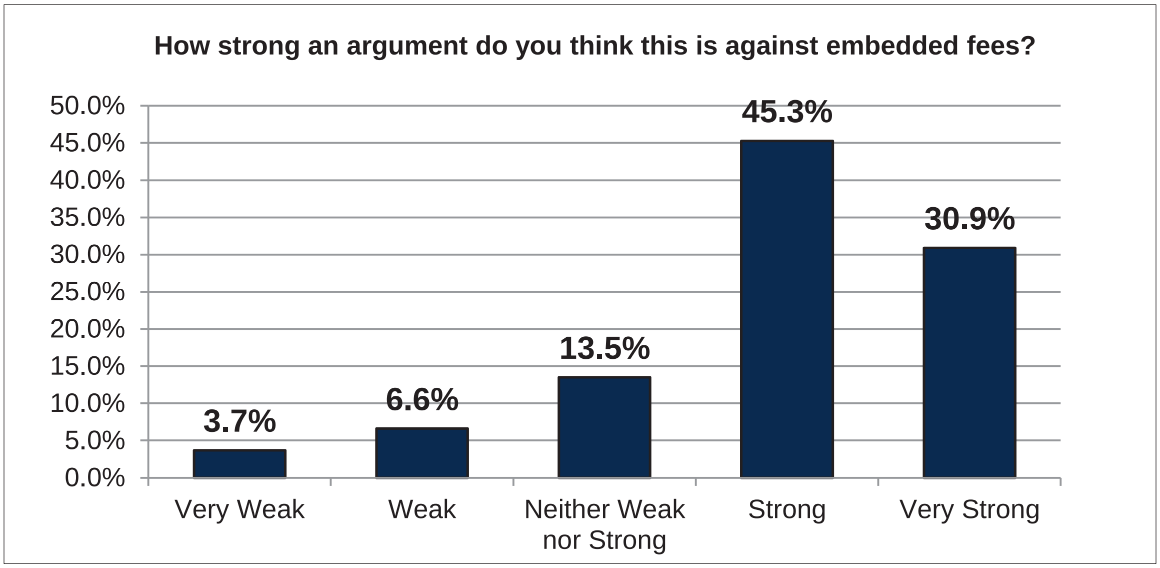


Argument #3 Without the financial incentive of future trailer commissions, advisors may be unwilling to take on clients with less money, so those with assets below, say, $100,000 will be left without access to financial advice.

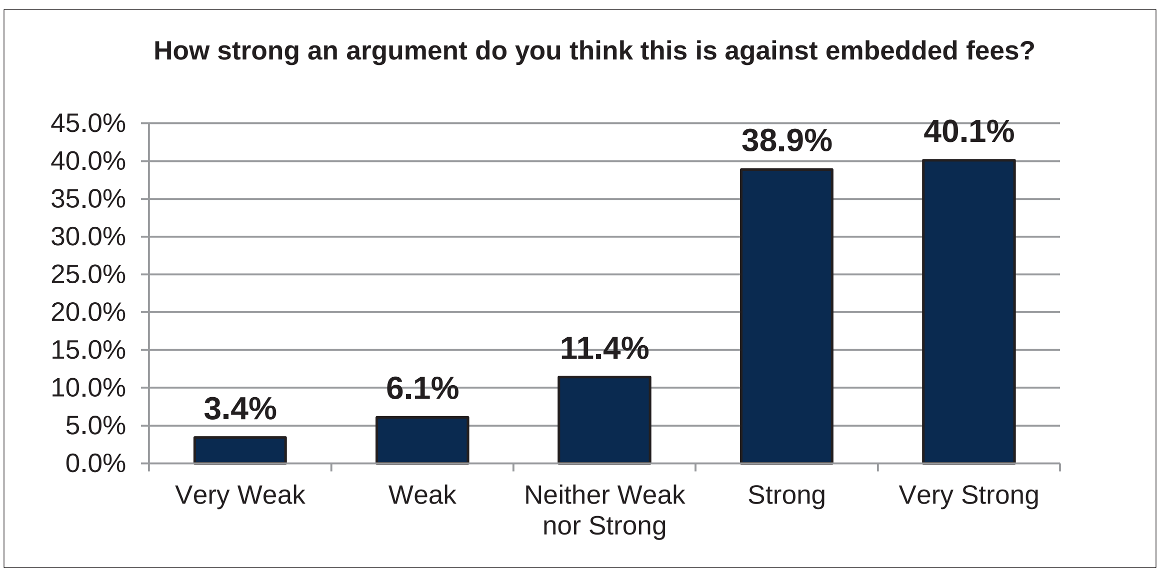


Arguments Against Embedded Commissions

Argument #1 Individuals are often unaware that they are paying these fees and as a result may be paying far more for their investments than they realize.



Argument #2 The payment of an embedded fee can encourage financial advisors to direct clients' assets to the funds that pay the highest commissions, not those that are the best performers.

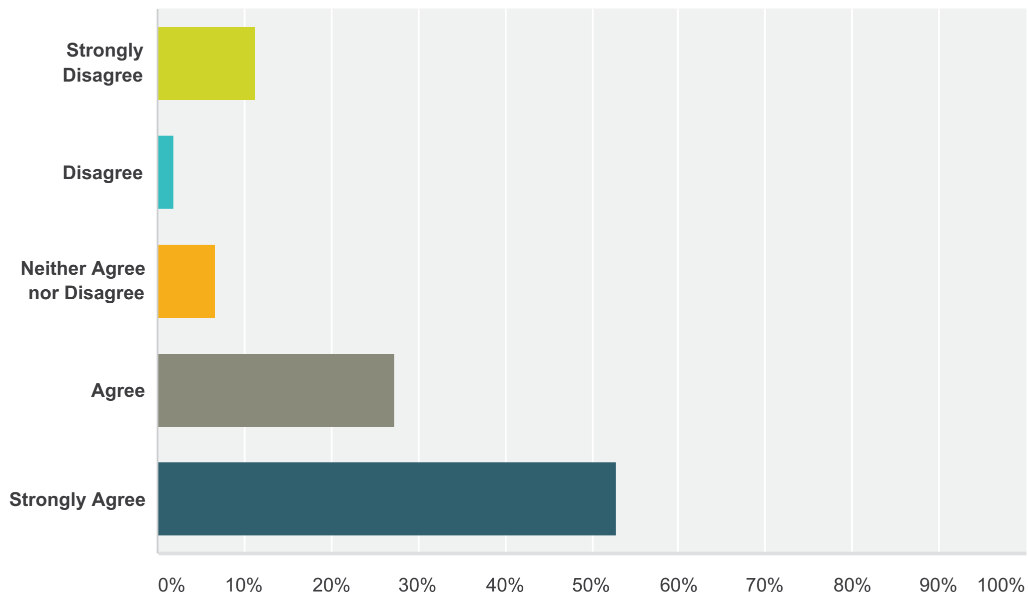


To view CARP's complete poll results, please see Appendix A.

APPENDIX A

Q1 Please indicate how much you agree with the following statement: I think that CARP should advocate for regulatory changes that will reduce the fees paid by Canadian investors.

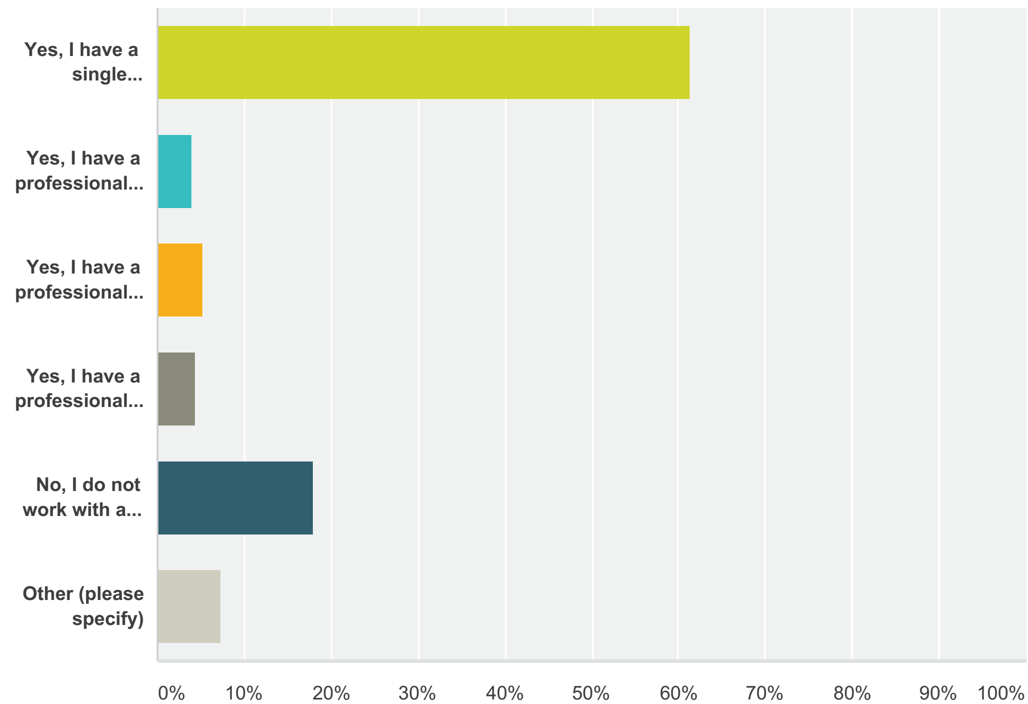
Answered: 2,588   Skipped: 23



Answer Choices	Responses	
Strongly Disagree	**11.24%**	291
Disagree	**1.78%**	46
Neither Agree nor Disagree	**6.76%**	175
Agree	**27.40%**	709
Strongly Agree	**52.82%**	1,367
Total		**2,588**

Q2 Before we get into questions about your opinions, we want to ask you some questions about your specific situation.Do you currently have a professional who provides you with financial advice and/or who buys financial products (e.g., mutual funds, ETFs, stocks, bonds, etc.) on your behalf?

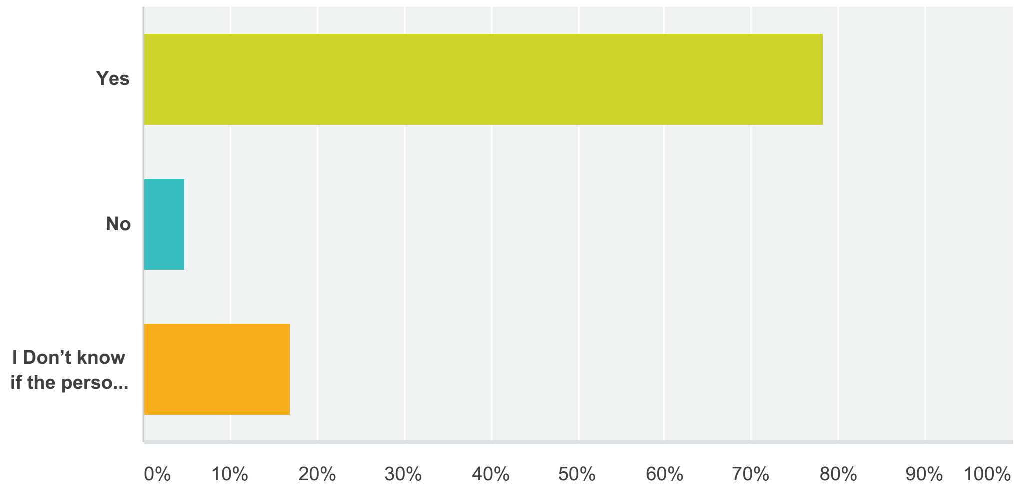
Answered: 2,539 Skipped: 72



Answer Choices	Responses	
Yes, I have a single professional who provides me with advice and also buys financial products on my behalf.	**61.32%**	1,557
Yes, I have a professional who provides me with financial advice, and a separate person who buys financial products on my behalf.	**3.98%**	101
Yes, I have a professional who provides me with financial advice (but I do not have a professional who buys financial products on my behalf).	**5.20%**	132
Yes, I have a professional who buys financial products on my behalf (but I do not have a professional who provides me with financial advice).	**4.33%**	110
No, I do not work with a professional who provides me with either financial advice or who buys financial products on my behalf.	**17.88%**	454
Other (please specify)	**7.29%**	185
Total		**2,539**

Q3 Is the person who provides you with financial advice a Certified Financial Planner (i.e. is someone who has received CFP designation)?

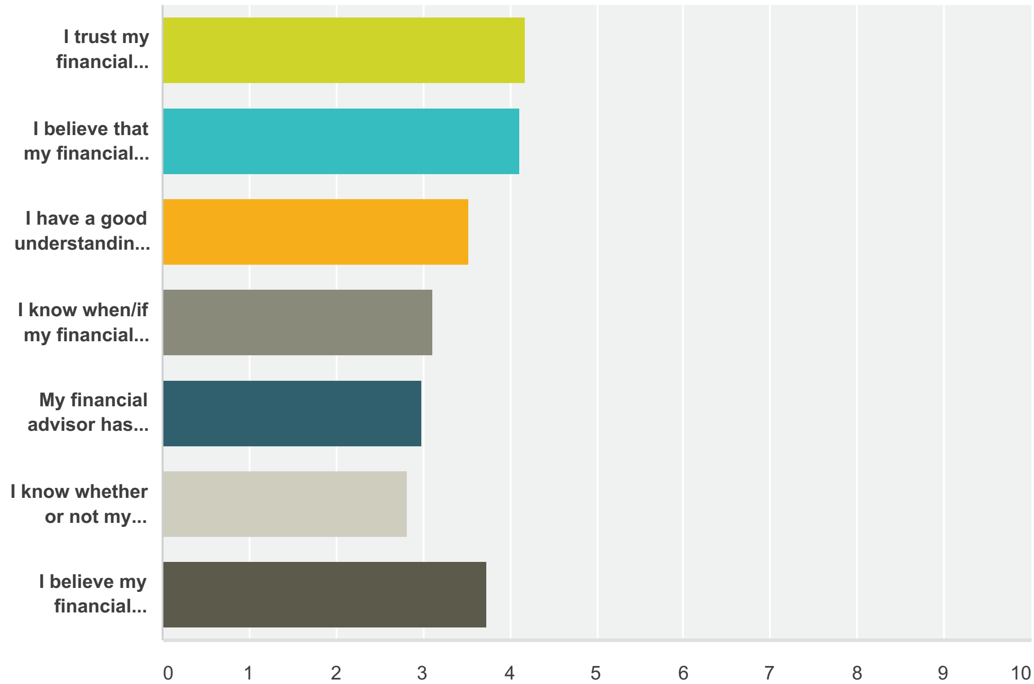
Answered: 1,751 Skipped: 860



Answer Choices	Responses	
Yes	78.30%	1,371
No	4.74%	83
I Don't know if the person has a CFP designation.	16.96%	297
Total		**1,751**

Q4 Please answer each of the following questions by indicating the extent to which you agree or disagree with each of the statements.

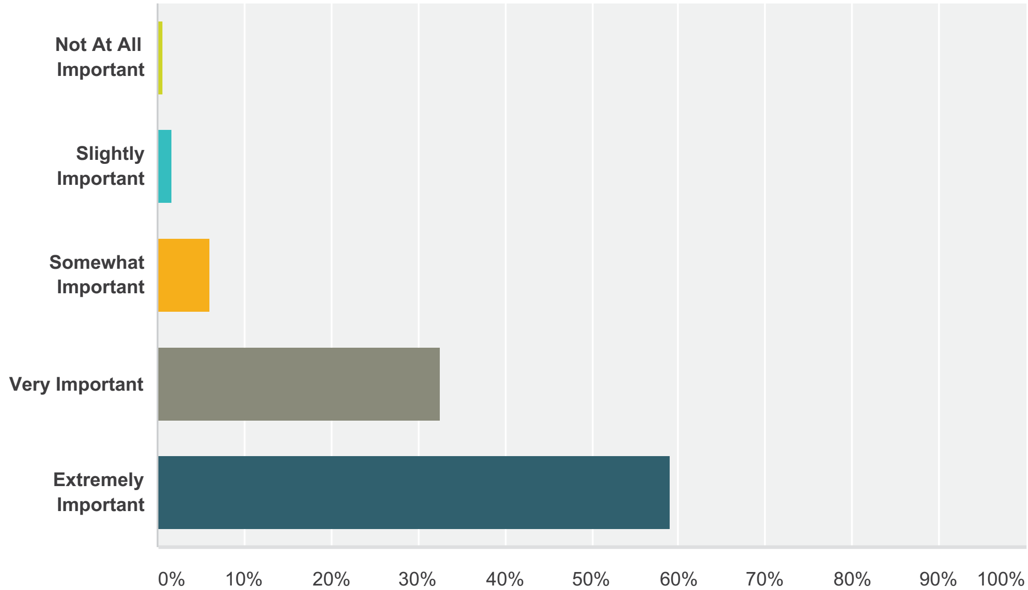
Answered: 1,763 Skipped: 848



	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree	Total	Weighted Average
I trust my financial advisor.	**1.20%** 21	**1.43%** 25	**12.09%** 211	**49.46%** 863	**35.82%** 625	1,745	4.17
I believe that my financial advisor recommends financial products that are in my best interest.	**0.92%** 16	**2.36%** 41	**14.30%** 248	**50.00%** 867	**32.41%** 562	1,734	4.11
I have a good understanding of how my financial advisor gets paid.	**4.55%** 79	**15.55%** 270	**20.33%** 353	**41.47%** 720	**18.09%** 314	1,736	3.53
I know when/if my financial advisor gets a commission from selling me a financial product and how much it is.	**9.91%** 171	**25.43%** 439	**21.21%** 366	**29.43%** 508	**14.02%** 242	1,726	3.12
My financial advisor has talked to me about ways of reducing/minimizing the fees I pay.	**16.11%** 279	**25.17%** 436	**17.55%** 304	**26.10%** 452	**15.07%** 261	1,732	2.99
I know whether or not my financial advisor gets a different commission on different products that he/she sells to me.	**16.15%** 279	**30.32%** 524	**21.24%** 367	**21.12%** 365	**11.17%** 193	1,728	2.81
I believe my financial advisor is required to recommend products that are in my best interest, not ones that maximize their commission.	**4.09%** 71	**9.22%** 160	**22.70%** 394	**37.67%** 654	**26.32%** 457	1,736	3.73

Q5 Recent changes to regulations in Canada have increased the amount of information that must be disclosed about fees paid by mutual fund investors. Under these new regulations (called CRM 2, which stands for Client Relationship Model 2), some, but not all, fees must be displayed clearly to investors on their statements. Specifically, the fund management costs is not disclosed, but the cost of advice must be.The fund management costs are paid to the mutual fund company and covers the cost of hiring the investment professionals who decide which assets (i.e. stocks or bonds) to purchase on behalf of the fund, transaction charges, and overhead costs. Although these costs are not shown on investors' statements, they are provided to investors - as a percentage - with the marketing material provided for each fund. The cost of advice is the money paid to the company the financial advisor works for. Under CRM 2, the cost of advice must be included on client's statements, but investors are still unable to tell how much commission their advisor receives for selling them different products.Please answer each of the following questions by indicating how important you think it is for each piece of additional information to be provided to investors on their statements.How important do you think it is for ALL fees to be shown on investors' statements (i.e. the cost of providing advice AND management expenses)?

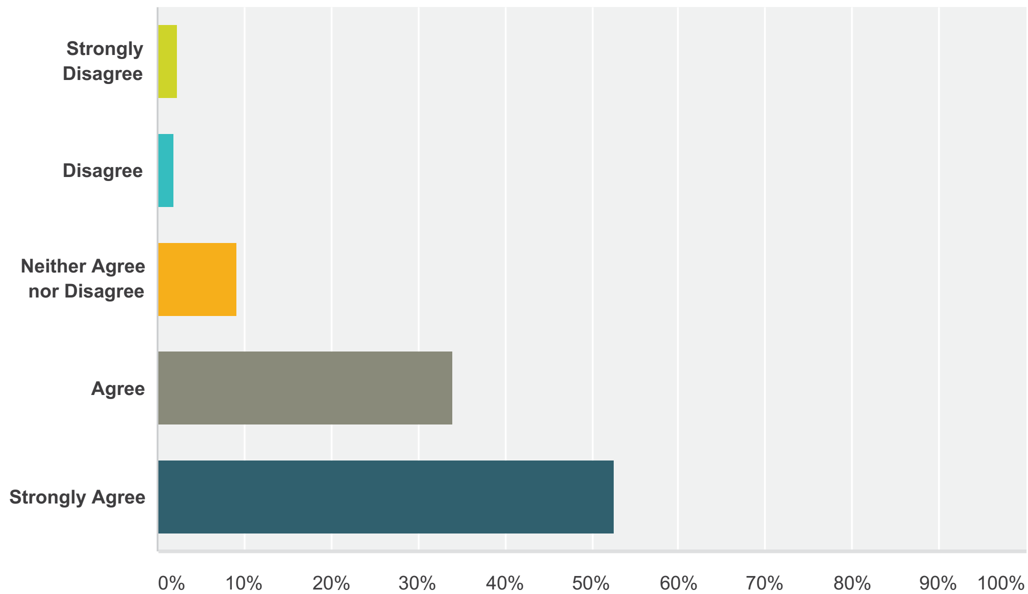
Answered: 2,435 Skipped: 176



Answer Choices	Responses	
Not At All Important	**0.57%**	14
Slightly Important	**1.64%**	40
Somewhat Important	**6.12%**	149
Very Important	**32.61%**	794
Extremely Important	**59.06%**	1,438
Total		**2,435**

Q6 How much do you agree or disagree with this statement: I think that providing investors with additional information about all the fees that they pay on each statement (i.e. fees for both advice and for fund management) will improve investors' ability to make sound financial decisions.

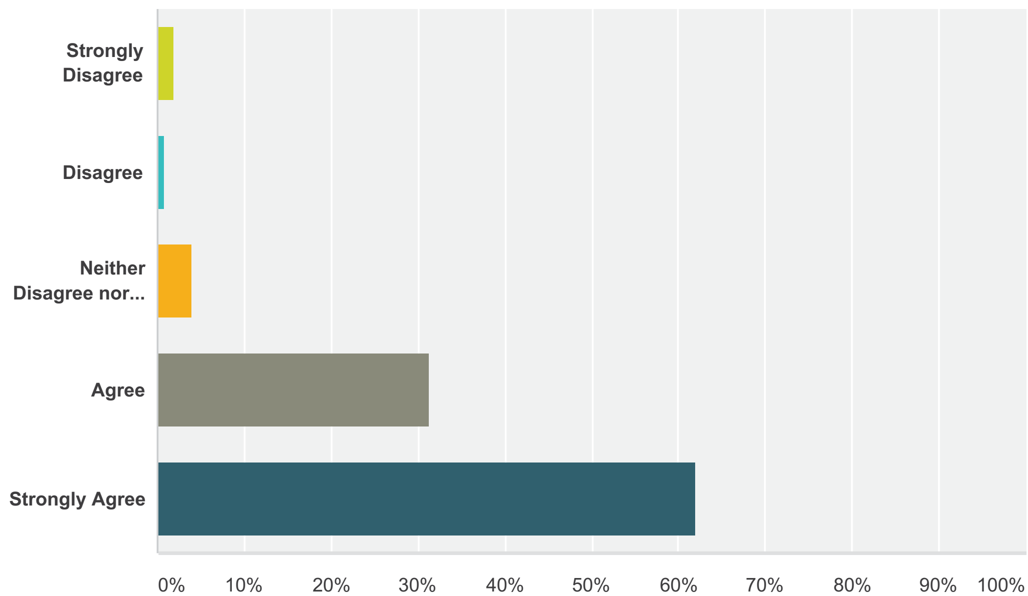
Answered: 2,437 Skipped: 174



Answer Choices	Responses	
Strongly Disagree	**2.26%**	55
Disagree	**1.97%**	48
Neither Agree nor Disagree	**9.27%**	226
Agree	**33.98%**	828
Strongly Agree	**52.52%**	1,280
Total		**2,437**

Q7 I think it is important to know how much commission a financial advisor receives form the different funds they sell to clients.

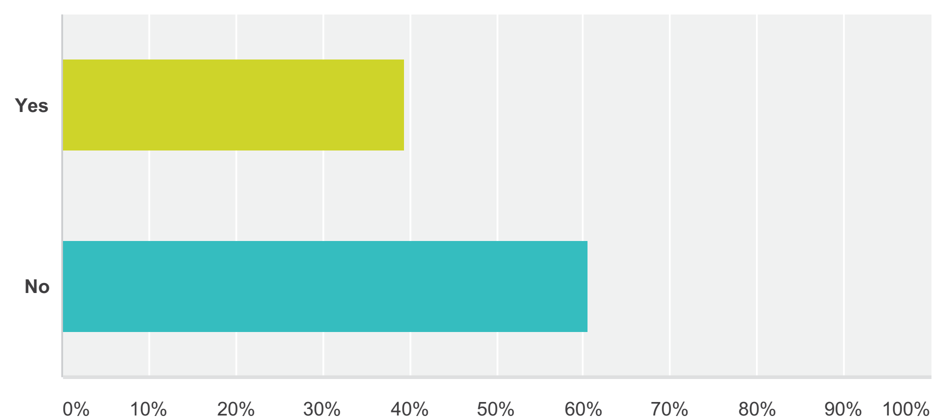
Answered: 2,433 Skipped: 178



Answer Choices	Responses	
Strongly Disagree	**1.81%**	44
Disagree	**0.82%**	20
Neither Disagree nor Agree	**4.07%**	99
Agree	**31.36%**	763
Strongly Agree	**61.94%**	1,507
Total		**2,433**

Q8 In Canada, only certain designated professionals are required to resolve compensation-related conflicts of interest in favour of their clients. The majority of financial advisors are free to recommend financial products to their clients that provide higher sales commissions, rather than better financial returns. The cost of such conflicts of interest are substantial. For example, in the US, investment-related conflicts of interest are estimated to cost investors $17 billion per year.Were you previously aware that many investment advisors are not required to recommend products that prioritize your returns over their commissions?

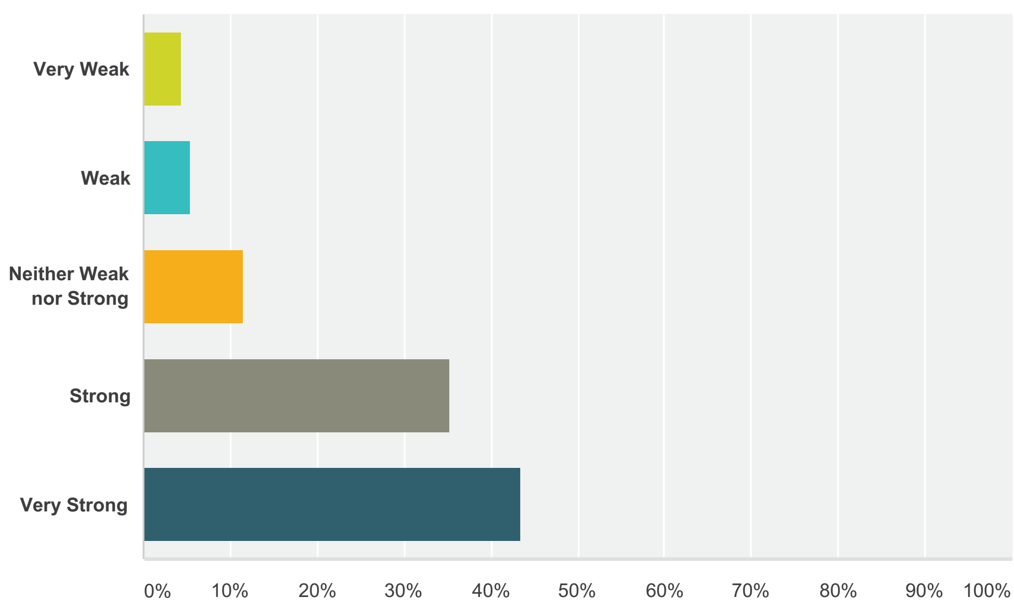
Answered: 2,208   Skipped: 403



Answer Choices	Responses	
Yes	39.40%	870
No	60.60%	1,338
Total		2,208

Q9 First Argument in Support of a Best Interest StandardUnder the current system, investment advisors frequently face conflicts of interest. This occurs when the financial product that is best suited for the client does not provide as large a commission for the financial advisor as some other, equally suitable alternative (for example a mutual fund vs. an index fund). Research clearly indicates that this conflict of interest causes investment advisors to sell products that are not in the clients' best interest, increasing the fees paid by clients, and reducing the clients' investment returns.How strong an argument do you think this is for a best interest standard?

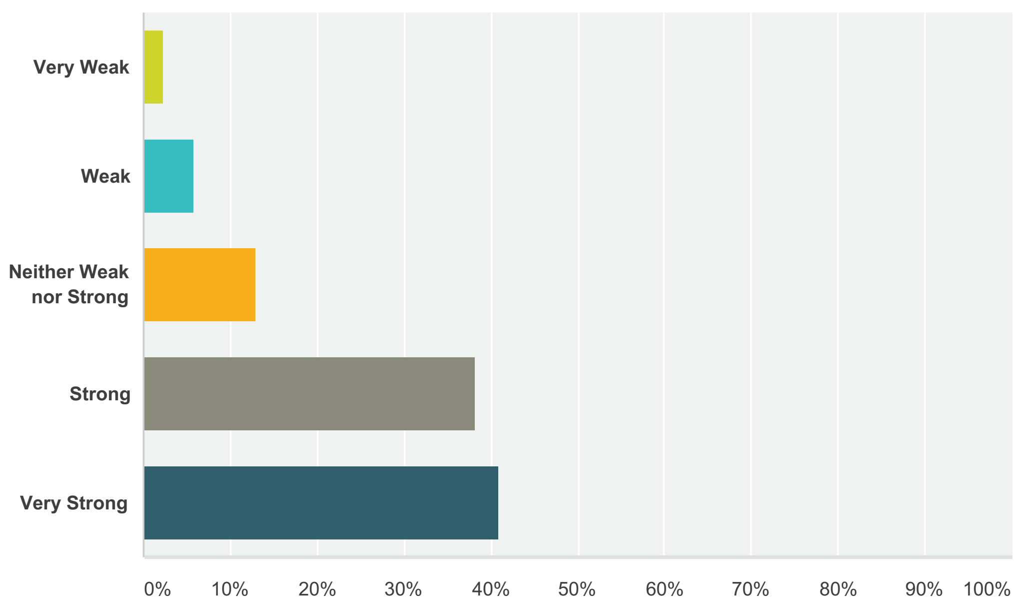
Answered: 2,199 Skipped: 412



Answer Choices	Responses	
Very Weak	**4.41%**	97
Weak	**5.41%**	119
Neither Weak nor Strong	**11.46%**	252
Strong	**35.29%**	776
Very Strong	**43.43%**	955
Total		**2,199**

Q10 Second Argument in Favour of Best Interest StandardFinancial advisors have far more information and expertise than the average investor. This gives them considerable power within the client-advisor relationship. The difference between advisor and client in knowledge and expertise makes it very difficult for investors to monitor and protect themselves from the conflicts of interest that investment advisors face under the current system.How strong an argument do you think this is in favour of a best interest standard?

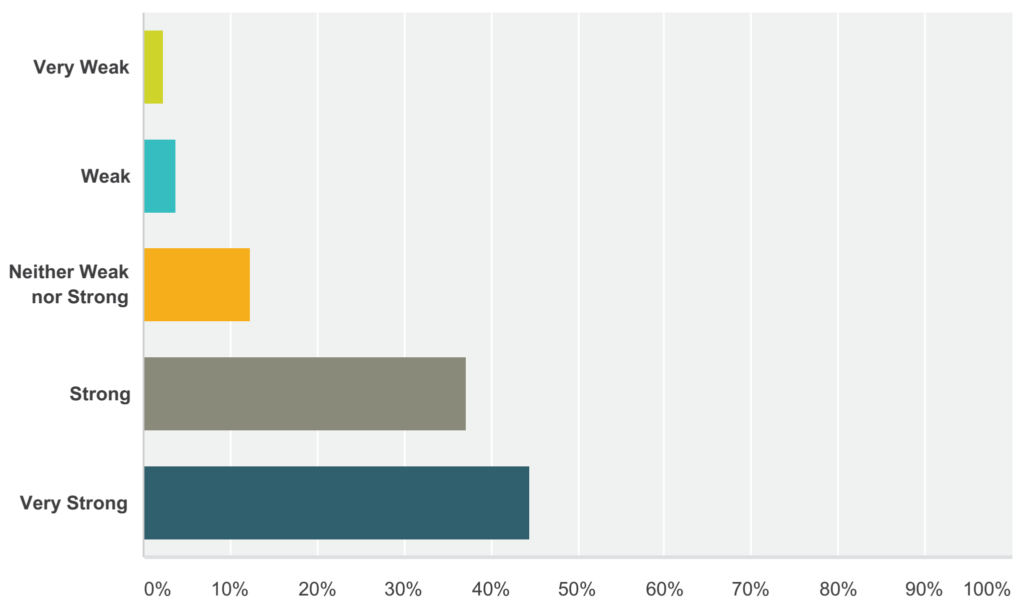
Answered: 2,195 Skipped: 416



Answer Choices	Responses	
Very Weak	2.23%	49
Weak	5.88%	129
Neither Weak nor Strong	12.85%	282
Strong	38.22%	839
Very Strong	40.82%	896
Total		**2,195**

Q11 Third Argument in Favour of a Best Interest StandardMany people who use investment advisors already assume that their advisor is required to act in their best interest. (A previous CARP poll suggested that over 90% of people thought that their advisor was required to act in their best interest.) This suggests that the majority of clients are not aware they need to question their advisor's recommendations carefully to protect themselves against the advisor's potential conflicts of interest.How strong an argument do you think this is in favour of a best interest standard?

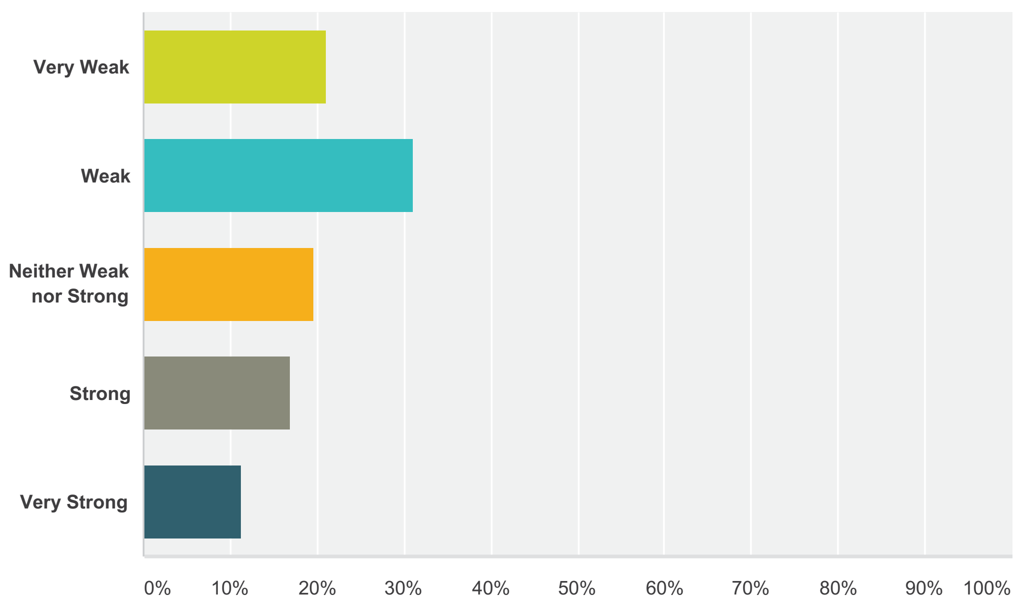
Answered: 2,197 Skipped: 414



Answer Choices	Responses	
Very Weak	2.32%	51
Weak	3.73%	82
Neither Weak nor Strong	12.24%	269
Strong	37.14%	816
Very Strong	44.56%	979
Total		**2,197**

Q12 First Argument Against a Best Interest StandardSome investment advisors only sell a narrow range of proprietary financial products and therefore could not meet a best interest standard. If a best interest standard were put in place, these advisors would be unable to continue operating as they do now because they do not currently offer the low-cost options that are in the best interest of many investors. As a result, if a best-interest standard were implemented, these advisors would either need to make substantial and costly changes to their business models, or go out of business. How strong an argument do you think this is against a best interest standard?

Answered: 2,177 Skipped: 434

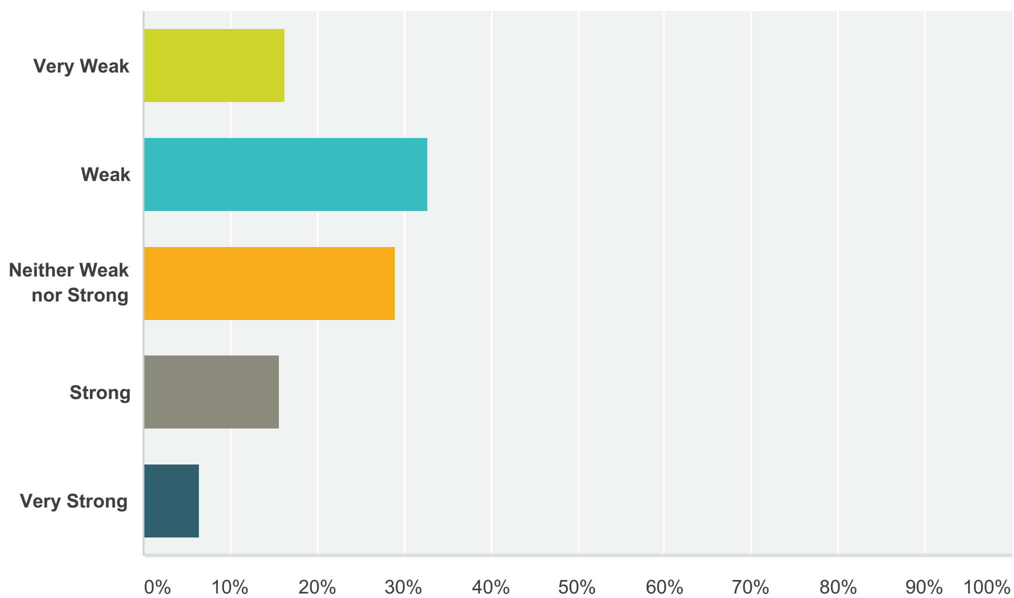


Answer Choices	Responses	
Very Weak	21.13%	460
Weak	31.10%	677
Neither Weak nor Strong	19.52%	425
Strong	16.90%	368
Very Strong	11.35%	247

Total	2,177

Q13 Second Argument Against a Best Interest StandardThe cost to investment advisory firms of meeting a best interest standard is higher than the cost of meeting the current standards. These additional costs would likely be passed on to investors in the form of higher fees. Although the overall fees paid by average investors would be reduced by implementing a best interest standard (because investors would no longer be influenced to purchase financial products that have high fees and are not in their best interest), there is a chance that a small percentage of investors would end up paying slightly higher fees.How strong an argument do you think this is against a best interest standard?

Answered: 2,175 Skipped: 436

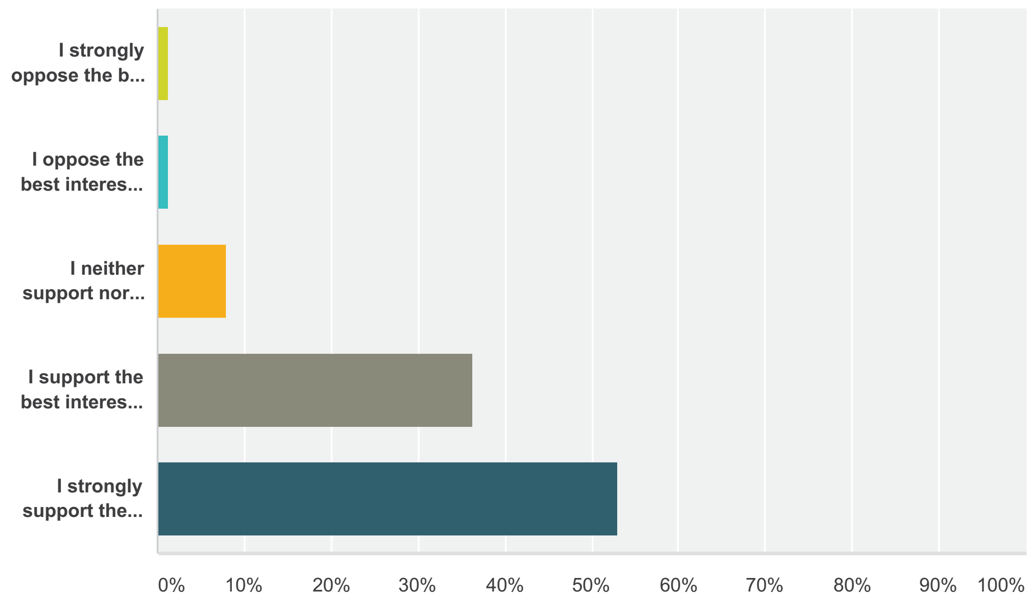


Answer Choices	Responses	
Very Weak	16.18%	352
Weak	32.74%	712
Neither Weak nor Strong	29.01%	631
Strong	15.59%	339

Very Strong	**6.48%**	141
Total		**2,175**

Q14 After reading the arguments for and against implementing a best interest standard for all financial advisors in Canada, do you support or oppose the best interest standard?

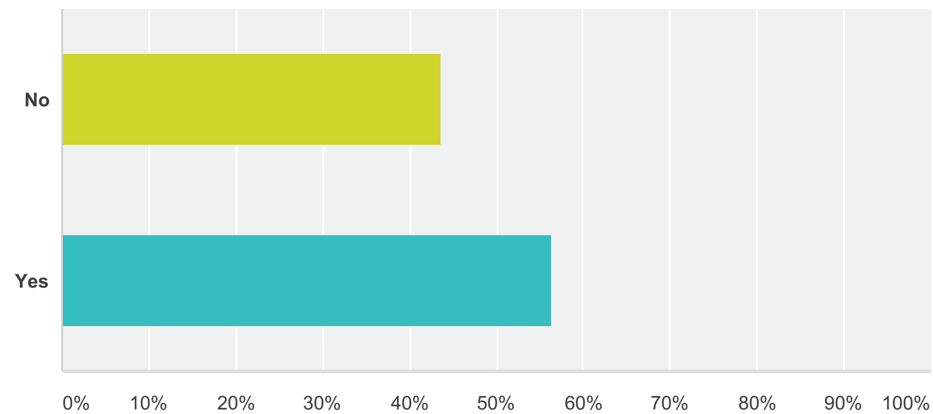
Answered: 2,186 Skipped: 425



Answer Choices	Responses	
I strongly oppose the best interest standard	**1.33%**	29
I oppose the best interest standard	**1.24%**	27
I neither support nor oppose the best interest standard	**8.01%**	175
I support the best interest standard	**36.41%**	796
I strongly support the best interest standard	**53.02%**	1,159
Total		**2,186**

Q15 Are you aware that your advisor may be collecting a fee that is "embedded" or built in to financial products that you own?

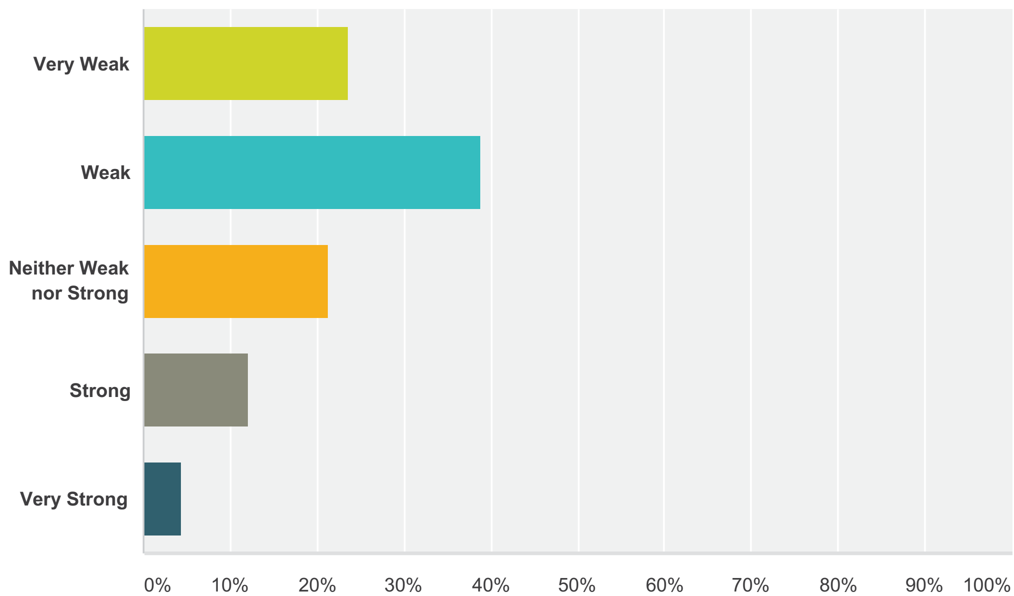
Answered: 2,037 Skipped: 574



Answer Choices	Responses	
No	**43.69%**	890
Yes	**56.31%**	1,147
Total		**2,037**

Q16 First Argument for Embedded Fees Individuals who receive financial advice are generally better prepared for retirement than those who do not. Yet individuals are not keen to pay for financial advice. By eliminating embedded fees, clients will see how much they are actually paying for advice. This may result in fewer people getting financial advice and consequently more people being unprepared for retirement.How strong an argument do you think this is in favour of embedded fees?

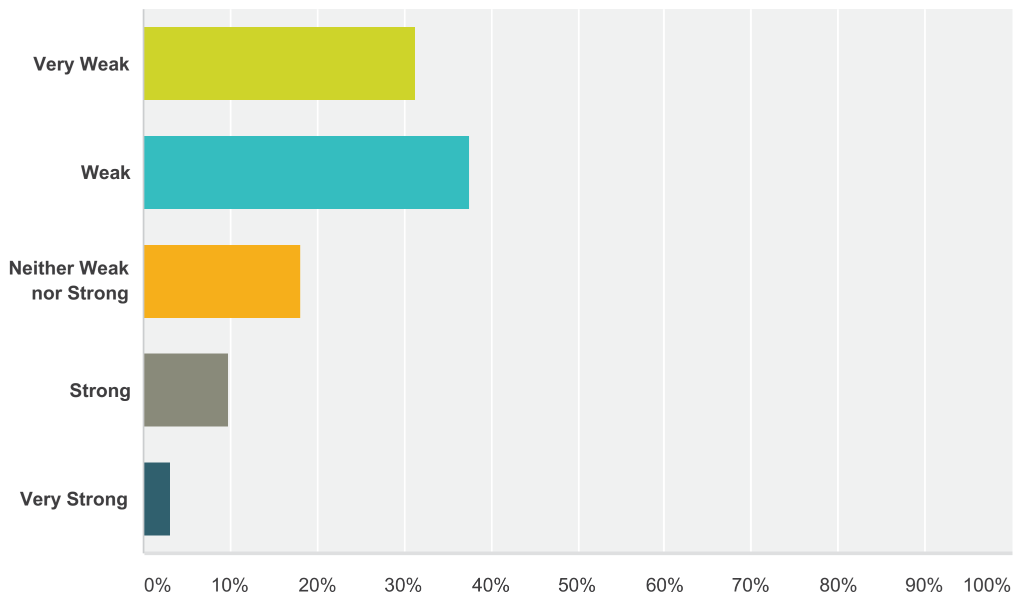
Answered: 2,018 Skipped: 593



Answer Choices	Responses	
Very Weak	23.49%	474
Weak	38.75%	782
Neither Weak nor Strong	21.21%	428
Strong	12.09%	244
Very Strong	4.46%	90
Total		2,018

Q17 Second Argument for Embedded FeesWhen embedded fees were eliminated in England, the number of financial advisors dropped from 40,000 to 31,000. The cost of advice also went up (though many clients saved money because their advisors moved them from mutual funds to lower cost products like ETFs, resulting in overall savings to investors). Embedded fees are therefore necessary to keep advisors employed, and keep the cost of advice lower.How strong an argument do you think this is in favour of embedded fees?

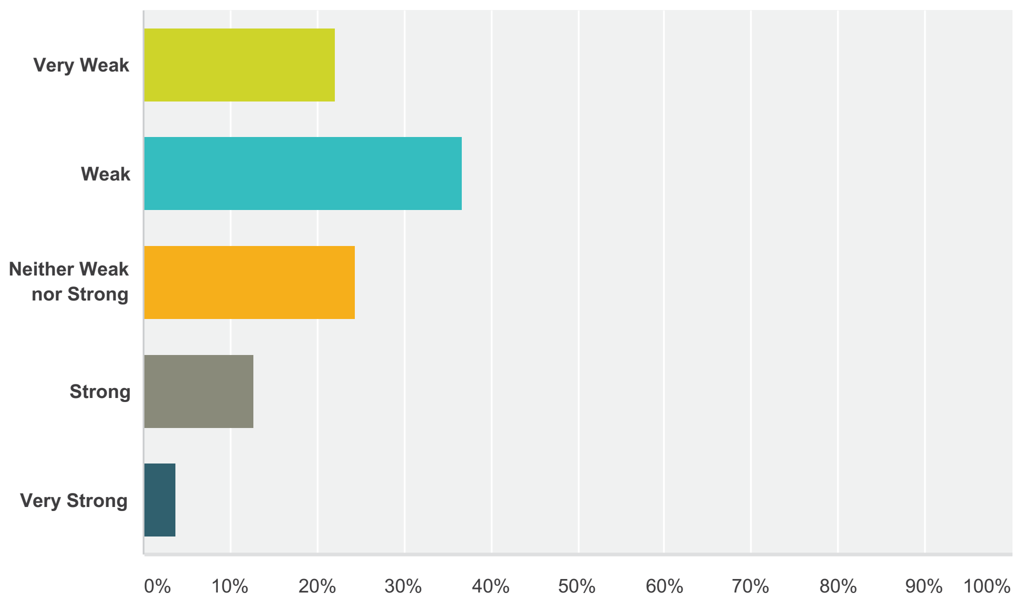
Answered: 2,012 Skipped: 599



Answer Choices	Responses	
Very Weak	**31.36%**	631
Weak	**37.52%**	755
Neither Weak nor Strong	**18.24%**	367
Strong	**9.79%**	197
Very Strong	**3.08%**	62
Total		**2,012**

Q18 Third Argument for Embedded FeesEliminating embedded fees may result in clients with lower wealth (e.g. those with less than $100,000 in investments) being unable to find an advisor. This is known as the advice gap argument. Therefore, regulators should not eliminate embedded fees to ensure that these clients still have access to advisors.How strong an argument do you think this is in favour of embedded fees?

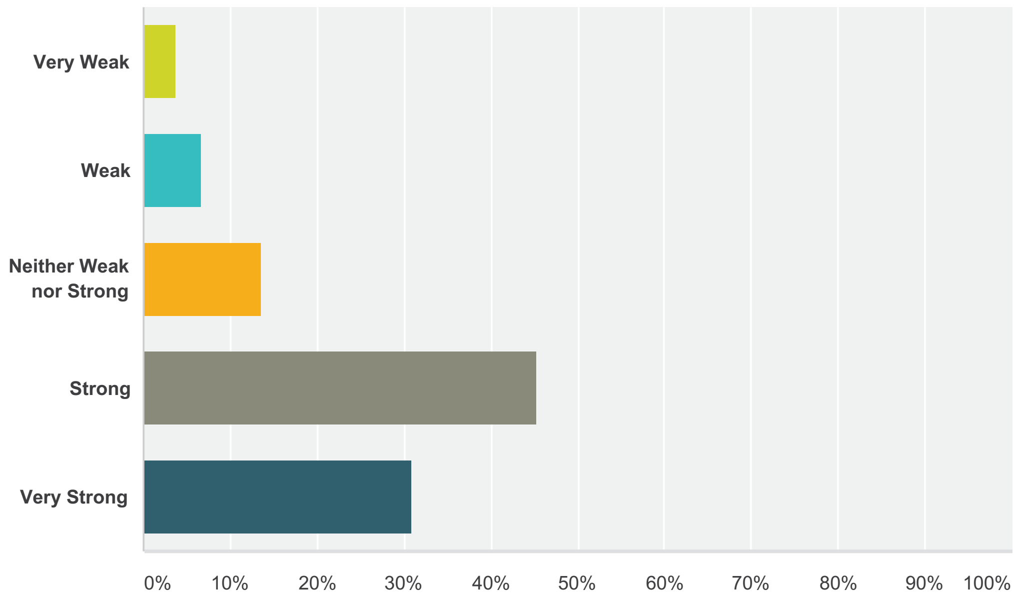
Answered: 2,014 Skipped: 597



Answer Choices	Responses	
Very Weak	22.14%	446
Weak	36.79%	741
Neither Weak nor Strong	24.53%	494
Strong	12.76%	257
Very Strong	3.77%	76
Total		2,014

Q19 First Argument Against Embedded FeesIndividuals are often unaware that they are paying these fees and as a result may be paying far more for their investments than they realize.How strong an argument do you think this is against embedded fees?

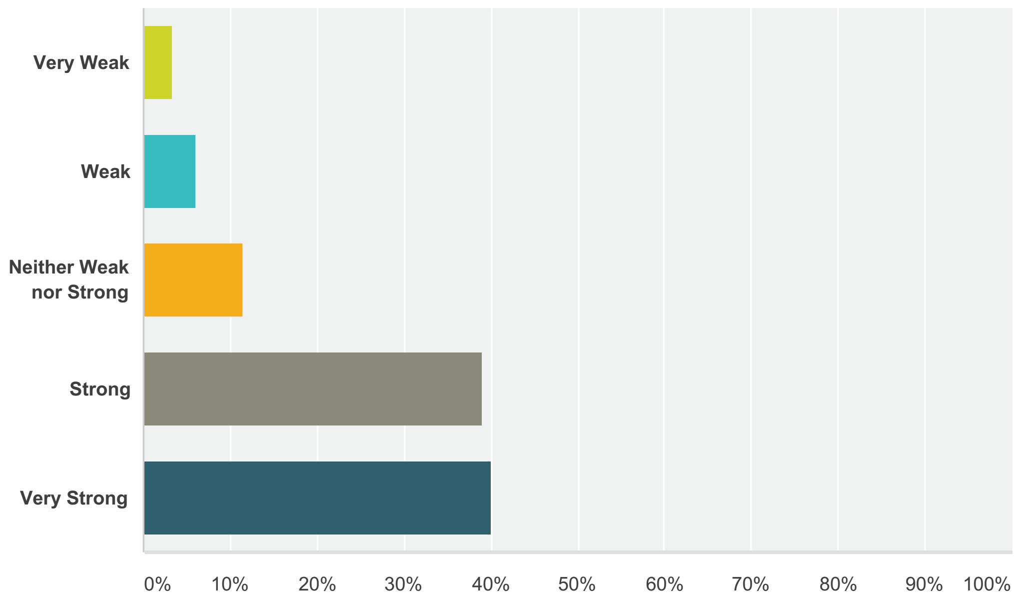
Answered: 2,008 Skipped: 603



Answer Choices	Responses	
Very Weak	3.69%	74
Weak	6.62%	133
Neither Weak nor Strong	13.55%	272
Strong	45.27%	909
Very Strong	30.88%	620
Total		2,008

Q20 Second Argument Against Embedded FeesThe payment of an embedded fee can encourage financial advisors to direct clients' assets to the funds that pay the highest commissions, not those that are the best performers.How strong an argument do you think this is against embedded fees?

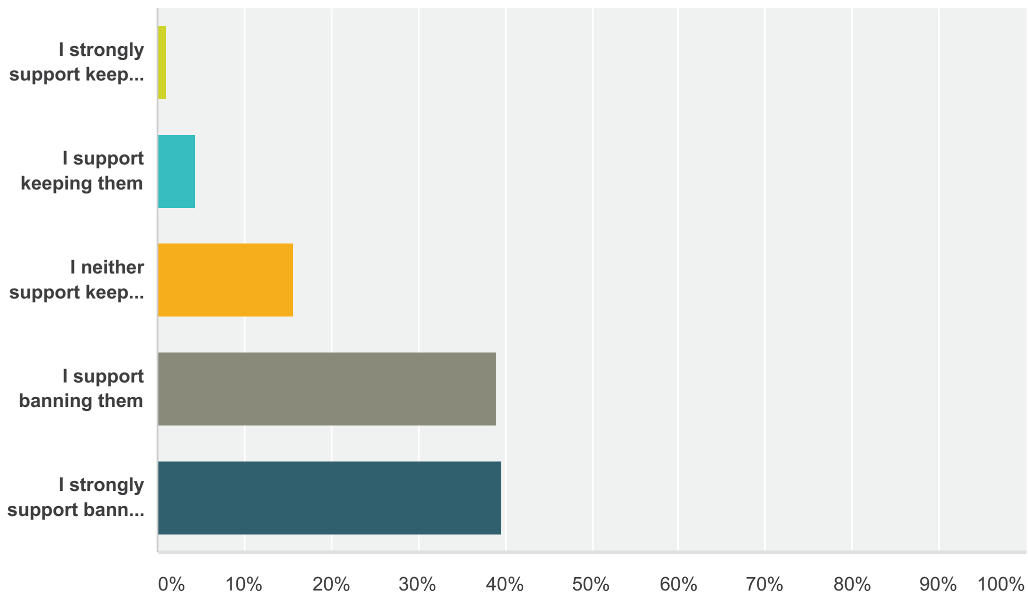
Answered: 2,011 Skipped: 600



Answer Choices	Responses	
Very Weak	**3.43%**	69
Weak	**6.12%**	123
Neither Weak nor Strong	**11.44%**	230
Strong	**38.94%**	783
Very Strong	**40.08%**	806
Total		**2,011**

Q21 What is your overall position about embedded fees?

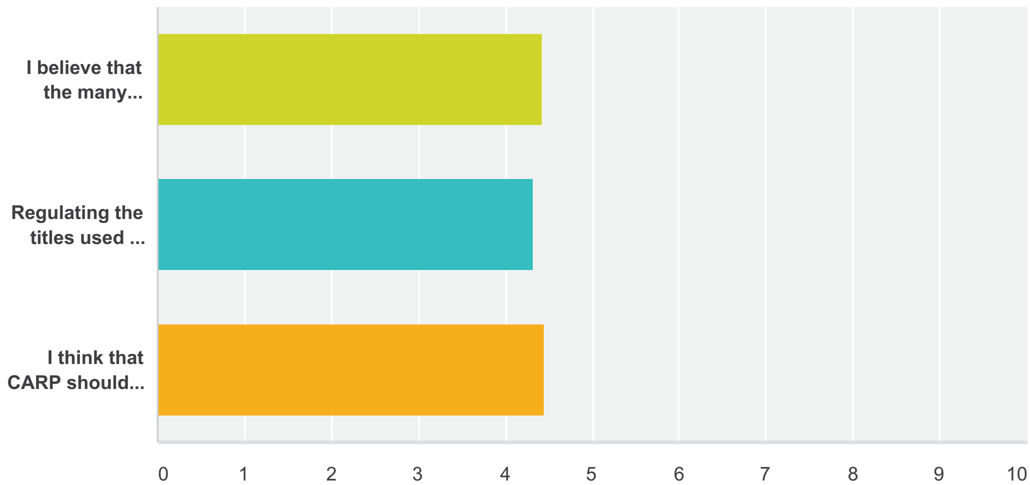
Answered: 2,016 Skipped: 595



Answer Choices	Responses	
I strongly support keeping them	**1.14%**	23
I support keeping them	**4.46%**	90
I neither support keeping them, or banning them	**15.72%**	317
I support banning them	**38.99%**	786
I strongly support banning them	**39.68%**	800
Total		**2,016**

Q22 Please indicate whether you agree or disagree with each of the following statements:

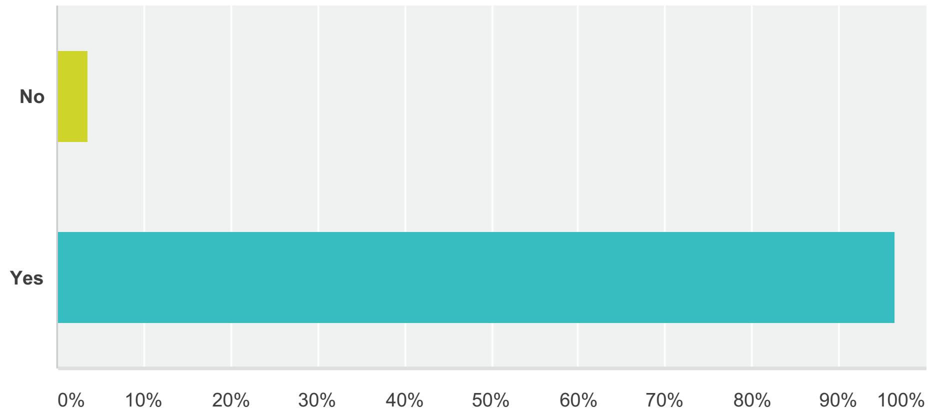
Answered: 1,976   Skipped: 635



	Strongly Disagree	Disagree	Neither Agree nor Disagree	Agree	Strongly Agree	Total	Weighted Average
I believe that the many different titles used by people who sell financial products to the public causes confusion, and creates the potential for the public to be misled.	**1.64%** 32	**1.38%** 27	**5.58%** 109	**36.11%** 706	**55.29%** 1,081	1,955	4.42
Regulating the titles used by people selling investments to the public would help people make more informed investment decisions.	**1.87%** 36	**2.18%** 42	**6.80%** 131	**39.54%** 762	**49.61%** 956	1,927	4.33
I think that CARP should advocate for the regulation of titles used by people who sell investment products to the public.	**2.15%** 42	**1.38%** 27	**5.07%** 99	**31.98%** 624	**59.41%** 1,159	1,951	4.45

Q23 Do you currently have financial investments?

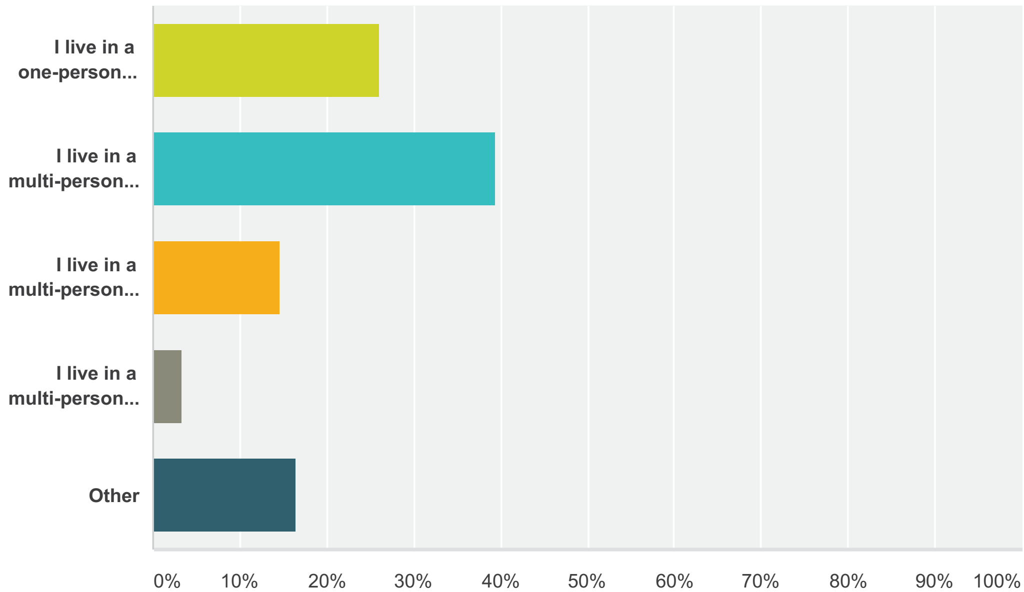
Answered: 1,956 Skipped: 655



Answer Choices	Responses	
No	**3.48%**	68
Yes	**96.52%**	1,888
Total		**1,956**

Q24 Within some households, one person manages all the finances; in other households, each person manages their own finances. Which of the following best describes your situation?

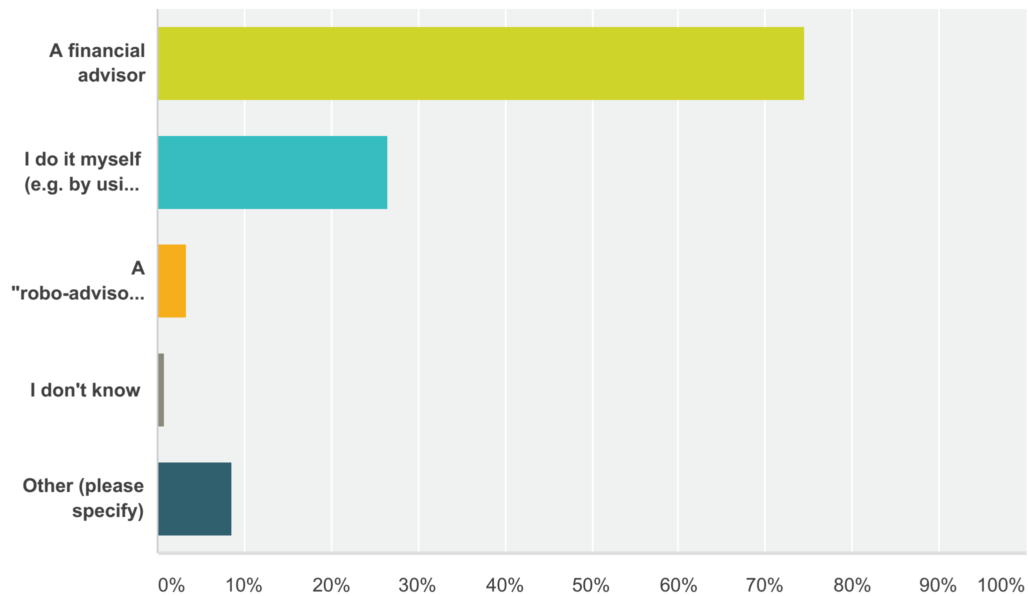
Answered: 1,873 Skipped: 738



Answer Choices	Responses	
I live in a one-person household, and manage my own finances.	**26.05%**	488
I live in a multi-person household and take care of the whole household's finances.	**39.51%**	740
I live in a multi-person household and take care of my own finances but no one else's.	**14.58%**	273
I live in a multi-person household, and another member of the household takes care of my finances.	**3.36%**	63
Other	**16.50%**	309
Total		**1,873**

Q25 Who manages (i.e. buys/sells) your financial investments? Please tick all that apply.

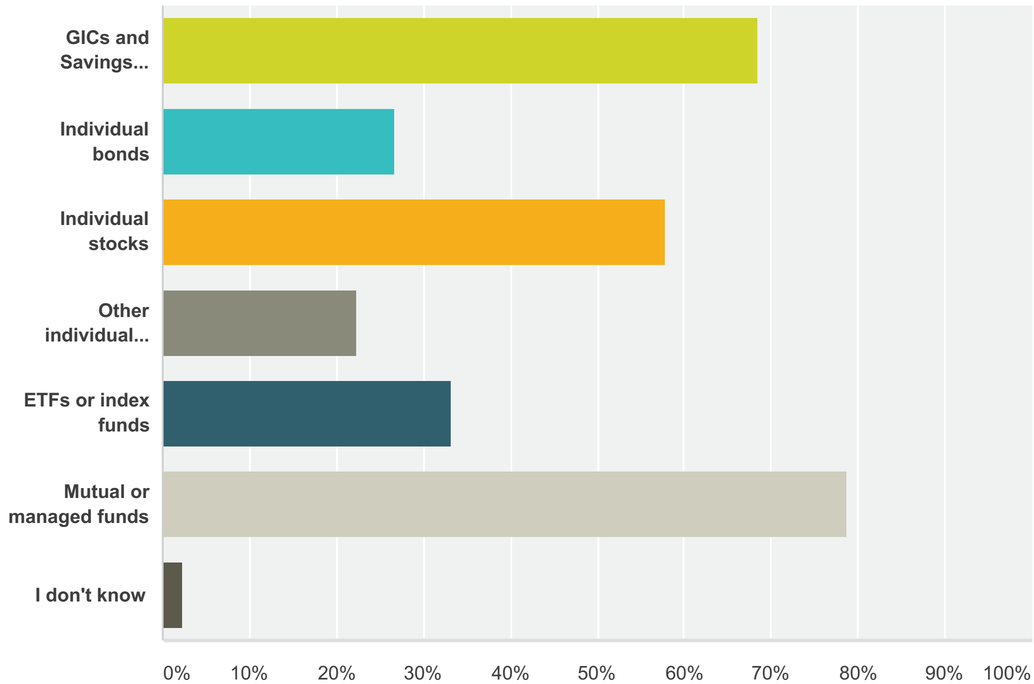
Answered: 1,529   Skipped: 1,082



Answer Choices	Responses	
A financial advisor	**74.62%**	1,141
I do it myself (e.g. by using an online service)	**26.49%**	405
A "robo-advisor" (i.e. a portfolio that you were involved in setting up, but is now managed automatically)	**3.34%**	51
I don't know	**0.78%**	12
Other (please specify)	**8.57%**	131
Total Respondents: 1,529		

Q26 Which of the following financial products do you own? (Tick all that apply.)

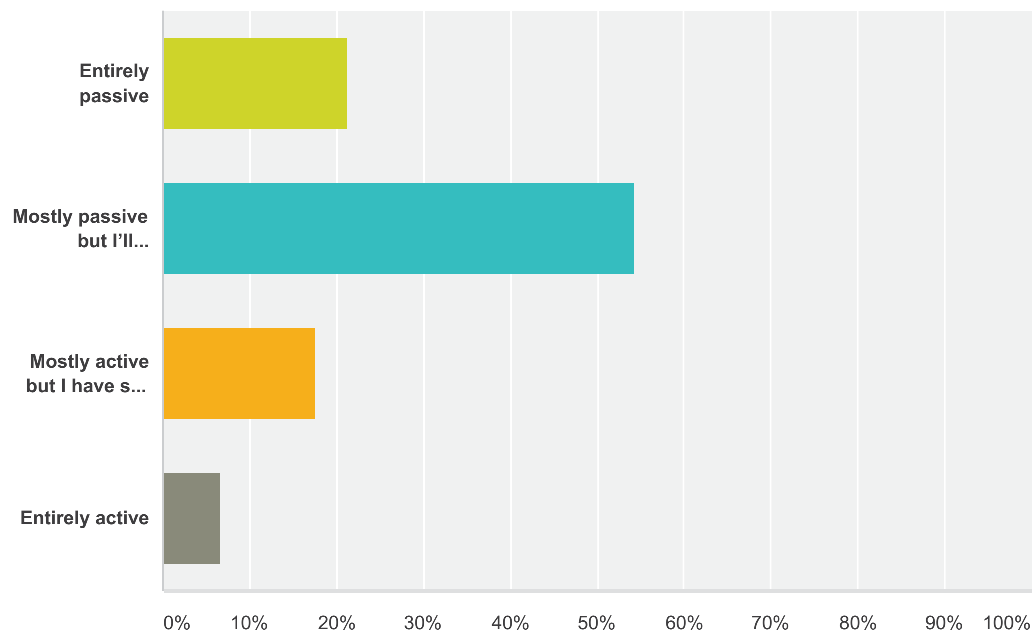
Answered: 1,514 Skipped: 1,097



Answer Choices	Responses	
GICs and Savings Accounts	**68.49%**	1,037
Individual bonds	**26.82%**	406
Individual stocks	**57.79%**	875
Other individual securities	**22.32%**	338
ETFs or index funds	**33.16%**	502
Mutual or managed funds	**78.73%**	1,192
I don't know	**2.25%**	34
Total Respondents: 1,514		

Q27 Active investors believe they (or their advisors) can outperform the market. They buy and sell stocks or funds based on their predictions about future market movements. Passive investors believe they will earn the best returns by following the market. They buy into market indexes or mutual funds that are recommended for them and ride out the ups and downs.Would you describe yourself as an active or passive investor?

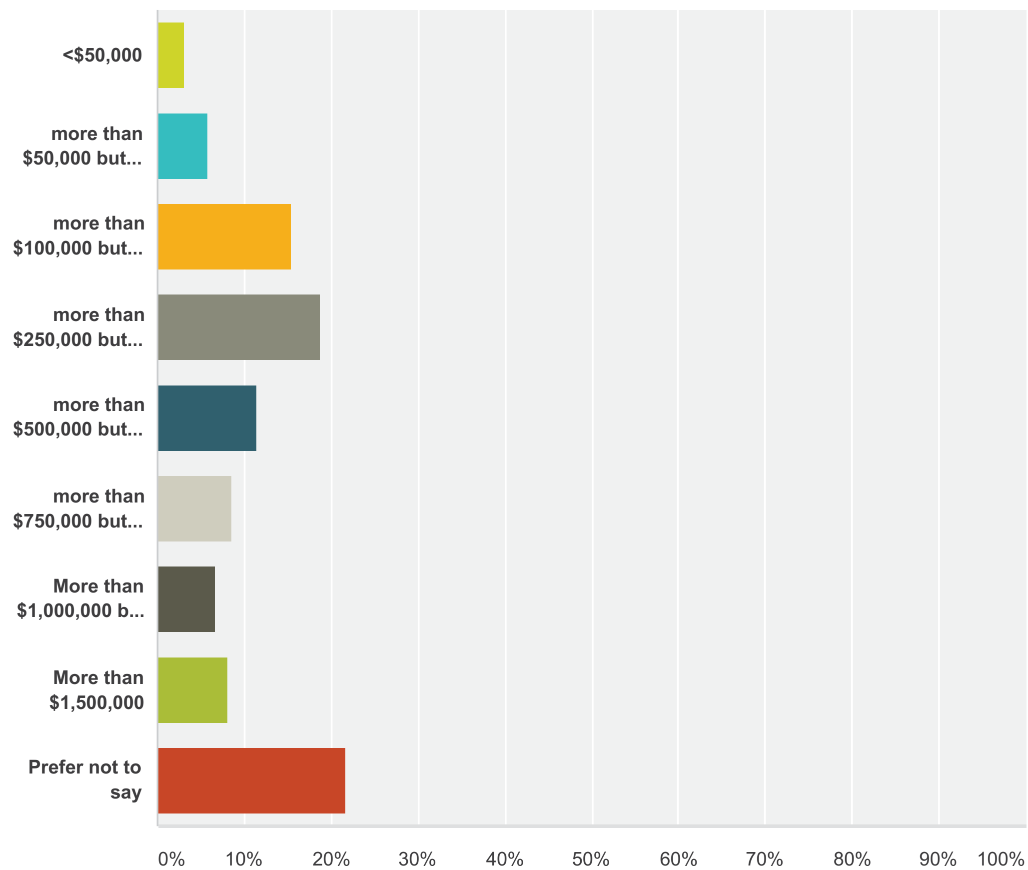
Answered: 1,523   Skipped: 1,088



Answer Choices	Responses	
Entirely passive	**21.34%**	325
Mostly passive but I'll occasionally intervene	**54.37%**	828
Mostly active but I have some market based investments	**17.60%**	268
Entirely active	**6.70%**	102
Total		**1,523**

Q28 What is the total value of household assets that you have in financial products? (Do not include the value of your home or any other real estate.)

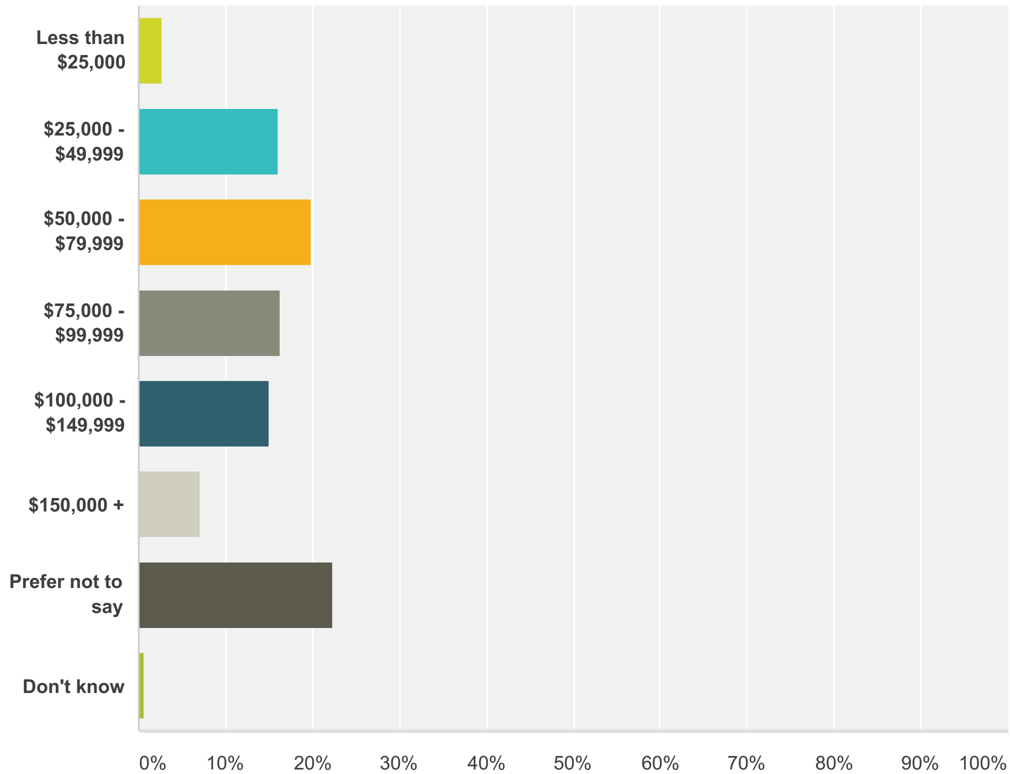
Answered: 1,530 Skipped: 1,081



Answer Choices	Responses	
<$50,000	**3.20%**	49
more than $50,000 but less than $100,000	**5.95%**	91
more than $100,000 but less than $250,000	**15.42%**	236
more than $250,000 but less than $500,000	**18.89%**	289
more than $500,000 but less than $750,000	**11.50%**	176
more than $750,000 but less than $1,000,000	**8.56%**	131
More than $1,000,000 but less than $1,500,000	**6.67%**	102
More than $1,500,000	**8.04%**	123
Prefer not to say	**21.76%**	333
Total		**1,530**

Q29 What is your current household yearly income?

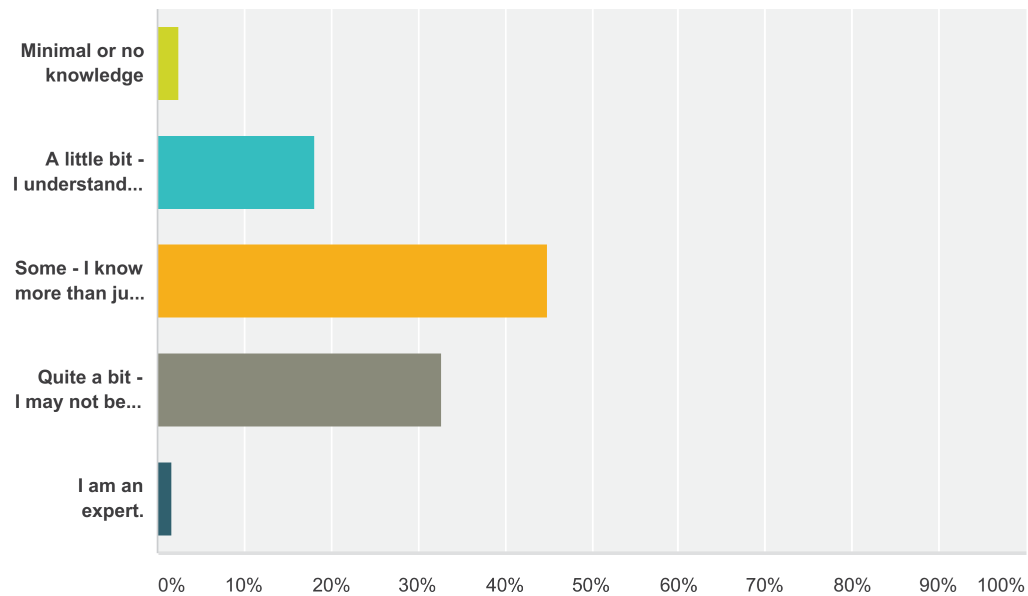
Answered: 1,962 Skipped: 649



Answer Choices	Responses	
Less than $25,000	**2.80%**	55
$25,000 - $49,999	**16.16%**	317
$50,000 - $79,999	**19.93%**	391
$75,000 - $99,999	**16.21%**	318
$100,000 - $149,999	**14.93%**	293
$150,000 +	**7.03%**	138
Prefer not to say	**22.32%**	438
Don't know	**0.61%**	12
Total		**1,962**

Q30 How knowledgable are you about financial products, investing, and retirement planning?

Answered: 1,967 Skipped: 644



Answer Choices	Responses	
Minimal or no knowledge	2.44%	48
A little bit - I understand the very basics	18.25%	359
Some - I know more than just the basics, but am far from being an expert	44.84%	882
Quite a bit - I may not be an expert, but I have a fairly sophisticated understanding of how things work	32.74%	644
I am an expert.	1.73%	34
Total		**1,967**

Hi Jason,

I have a few brief thoughts on embedded commissions and would like to share them with the CSA.

First, I would comment that as an wealth advisor, I am seemingly in a small minority in agreeing with the CSA that for the most part, embedded commissions should be banned.

Perhaps the most flagrantly offensive embedded commission structure is the Deferred Sales Charge (DSC). I would contend that DSC's serve as handcuffs to lock-in investors to a particular fundco for 5-7 years. Fund companies overcompensate advisors to place clients in DSC structure, by paying them 5-7 years in advance (unearned) commissions. Fundco's would argue that they are fronting the investor's fees, so it is only fair that they can protect their interests by retaining the investor's funds for the 5-7 year period, allowing the fundco to recover its advance. However when an investor leaves the fundco, the early redemption fee charged to the investor simply repays the fundco for monies it has paid to the representative as an upfront, unearned commission. Where is the fairness in that? Why isn't the representative forced to reimburse the fundco (or the investor) for unearned commissions? In effect, under the current DSC structure, the representative is paid in advance for work that has yet to be performed. If the client elects to move to a different fund company within the 5-7 years, the client – and not the advisor – is required to pay DSC fees (early redemption charges), which can amount to a considerable cost. Grossly unfair…

Furthermore, DSC structure also invites blatant skirting of the rules, as a small percentage of advisors actually move DSC expiring funds into a new DSC schedule with a different firm, effectively churning the client's money into another locked-in period. Of course, DSC structure also fetches the highest fund management fees (MER's). It's a double-whammy for the client. I appreciate that this is a flagrant violation of the rules, however I contend that this practice is quite prevalent. Possibly with CRM II and newly required disclosures, this practice may slowly ebb.

Notwithstanding my condemnation of DSC's above, I would point out that I believe embedded commissions as such may have a useful purpose to serve – in very a restricted context. Read on…

In the CSA report, it acknowledges that many stakeholders contend that the small investor may be left to fend for themselves if embedded commissions were banned. The CSA suggests that these folks would be able to acquire services somewhere in some fashion. I'm not certain the CSA is completely correct on this point. To my mind, the issue is a very legitimate concern. Most advisors that I know would have little to no interest in working with a client who had less than $150,000 to invest.

As most stakeholders will acknowledge, new advisors typically experience considerable difficulty in generating an income stream. Being new, they have a great deal to learn before larger clients might have an interest in working with them. This puts them in a difficult position… how to bring in clients and learn the ropes, while paying the heat and rent.

So my thought is that possibly new advisors could be given a specific Rep code that would remain in effect for 5 years (the 5-year code), afterwhich it would automatically convert into a new "permanent" code. Under the 5-year code, advisors would be permitted to invest client money into funds with embedded commissions, including the DSC structure. An appropriate, but simply-phrased and easy-to-understand disclosure form would be required to be signed by all clients being placed into fund with embedded commissions. After 5 years, no new embedded commission funds would be allowed, by virtue of the advisor's new code. Codes would be programmed to allow embedded commissions (under the 5-

year code), or prohibit embedded commissions (under the "permanent" code). Obviously, existing DSC's would be allowed to run their course.

The multi-purpose effect of this recommendation is to hopefully:

- Create an advisory "field" that is ready, willing and able to service small clients (clients who would not meet the minimum investment threshold of intermediate and senior advisors)
- Provide small investors with a cohort of advisors from which to choose to service their requirements. This cohort might also be subject to minimum educational requirements to help them get their footing in the industry and foster professionalism. (This aspect could be an add-on for a future time)
- Promote new entrants into the industry by allowing them to earn an income while building their business
- Minimize unintended consequences

This proposed structure, or something akin to it, could be time-limited to measure its benefits and drawbacks – and as well could serve to ease the move away from embedded commissions.

Thank you for your time in considering this writing.

Kind rgds,

Joel Attis

Nurturing wealth. Managing risk…

Joel Attis, B.Comm, LL.B, CFP, CLU, TEP, FCSI, CIM
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AttisCorp Financial Advisory & Insurance Services
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TD Canada Trust Building
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E1C 1G2

March 9, 2017

To Whom it May Concern,

I am not an active advisor but I am a Branch manager of some. I also spent a considerable portion of my life wholesaling for a major Mutual fund company. In my wholesaling role I met advisors in Southwest Ontario, the Maritimes, Saskatchewan, Alberta and British Columbia. Although there were many reps I met I wouldn't let wash my car (this is a licencing and competency issue) I believe the vast majority were in this business to truly help their clients develop and meet their individual financial goals. By providing choice of compensation I believe we are serving the public interest. This allows advisers and their clients to determine which method works for them. The first Mutual Fund I purchased was a 9% Front end. The 9 % difference, compounded, makes a dramatic difference in the ultimate return of the investment. The market took care of this issue. By allowing clients to pay a small fee or no fee upfront we provide them a better chance at meeting their investment goals.

This industry currently has a demographic issue. Many advisors are Baby Boomers and they and their clients are getting older. If we do not allow new independent advisors to be fairly compensated for the effort that goes into finding and servicing clients we will have no new young people coming into the industry. Young entrants will be compelled to follow a career in which salary makes up their compensation such as the banks or be forced to work in career or captive shops.

Consider this: Scotiamcleod fired most of their IA's with over 10 years' experience who grossed under $ 600k in commission. In what any other business does earning $ 600k a year make someone an "underperformer" ? It seems to me basing someone's worth in this business in any other way than ethics, expertise and client satisfaction is the real problem.

If the CSA truly wants to ensure clients are treated fairly I would suggest they CAP the compensation manufacturers can offer advisors. For example, I learned today Empire Life offers a 1.25% trailer fee on FE business. The CSA should cap ALL FE trailers at 1%, DSC at 5% and limit FE to 3 % (all the advisors I am associated charge 0-1% FE). By limiting the compensation OFFERED the CSA can protect investors while ensuring this industry, which I believe gets a very bad rap, is allowed to offer Canadian Investors, big and small, the opportunity to obtain non-biased independent advice.

I clearly have a vested interest in this debate. I will also freely admit no one has been able to explain, let alone convince me we are going the way of Britain and Australia. I also believe this industry needed to get cleaned up and am happy about CRM II and look forward to its effects.

As someone who has spent the majority of his working life in the securities industry and as someone who now looks after Tier 1 compliance at my branch, I am proud of the great work our independent, commission based advisors do for their clients. To drive them out of the industry thus leaving those who actually need help at the mercy of the banks, the Investors and the London Life's of the world is, in my opinion, contrary to the goals the CSA, the MFDA etc.. are trying to accomplish. I think building on the findings and spirit of the Stromberg Commission makes a lot more sense.

Regards,

David Rupert

Branch Manager-Mutual Funds

Desjardins Financial Securities Independent Network

Calgary, Alberta

Thursday, March 9, 2017

To the CSA,

I am a financial representative with Desjardins Insurance and wish to speak regarding your assessment of embedded fees and trailers. I understand you are trying to do what you feel is best for the general public but I feel there will be serious negative effects for the average person.

My business is made up of mainly smaller clients who have less than $100,000 in investments. I spend a great deal of time with these people and do thngs like creating quarterly budgets, tax planning, needs assessments, estate planning and much, much more. I am very worried about how things will negatively impact my small clients with this change as I will be forced to either charge an hourly rate or fees will come straight out of their investments which will hamper their progress. As well, most advisors will not be able to afford to take on small clients under 100k.

I've read many opinions that small clients can either go to the bank or use robo advisors which in my opinion makes them second class citizens when it comes to access to financial advise and help. The vast majority of my clients didn't know how a fund works, what dollar cost averaging is, the rule of 72 or what an MER even was before I sat with them and explained it all. Despite having investments for years with the bank!!

I also fear that this will change the nature of my relationship with my clients. My clients know they can call me for any reason and often do and this is one of the reasons I love my career. This is NOT just a business, I am invested in these people on an intimate level. My clients call to get my opinion about whether they should lease or buy a car, that they got a promotion or raise at work, that they just had a baby or share other good news. I am part of the family. They also call when they don't understand something like their pension plan at work and I do many hours of research to get them answers. I have read the pension act of BC! I have read the power of attorney act of BC! Why? Because my clients needed answers. If my clients had to pay an hourly rate for that they just wouldn't do it and they certainly wouldn't know how to do it on their own. I don't get paid to do these things for my clients so trailers is my compensation for this extra and ongoing service.

I realize there are many faults within this industry, we need to focus more on the qualifications of the individual representatives and to ensure clients are protected from unscrupulous people. I have clients who have lost tens of thousands of dollars to Ponzi schemes, phishing scams and online dating scams before they met me.

In closing, my clients currently have the option of paying an up front sales fee, a low load or a 6 year DSC. They consistently choose the low load option as they don't want costs coming directly out of their pocket. I explain how I get paid through the MER and trailer fees. My clients have no problem with me being paid a trailer for ongoing service and they have made it clear they don't want the current set up changed.

Please reconsider where you are headed with your policies as I have gotten a resounding NO to these changes from my client base.

Barbara Nash

Desjardins Financial Security and Independent Network

Monday, March 20, 2017

Dear secretary

My practice as a financial planner provides consumers with direction that no robo advisor could do. The biggest assumption you make based on your consultation paper is that the consumer is not happy with embedded commissions. You are very wrong as those commissions are communicated and I have never had a complaint based on the service we provide. You readily admit that there will be a large segment of investors that will no longer have availability to an advise channel if you eliminate embedded commissions.. You assume that that is alright. The reality is that people need more help and advice then ever and how you missed that is beyond my understanding because it's very obvious everywhere you look. The other very important part to your out of line assumptions is that all advisor do is transact investments. You are in the process of causing substantial damage to Canadians and a whole industry of advise channels. Which I might add provided thousands of jobs to people who pay taxes and support their families. What gives you the right to do this much damage because it's certainly not in the best interest of consumers.

Give the consumer some credit to having some intelligent, big brother as you are attempting to be, has no position do what you are doing.
Stop this movement now.

Rob Reid ***CLU, ChFC,CFP***
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"The Financial Planning Company"

REID & ASSOCIATES
FINANCIAL SOLUTIONS LTD.

Tuesday, March 21, 2017

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

RE: Embedded Commissions (CSA consulting paper 81-408)

To whom it may concern:

I am an IIROC licensed Certified Financial Planner who has been in this industry for 20 years. I am writing in response to the proposed banning of embedded commissions in the financial services industry. I firmly agree that this ban should take place, this is a change that is long overdue in Canada and the sooner it occurs the better.

Currently a large number of my clients are already on a fee based platform where their fees are debited from their individual accounts on a monthly basis. Presenting the fee to the client and charging them directly is a more transparent and fair approach. This type of direct fee approach mimics the experience and treatment a client would receive through any other professional service such as a lawyer, doctor, accountant, ect.

The only concern I would like to express when considering this ban is how it would affect the Canadian banks. I strongly believe it is prudent that the banks be given the same treatment and not be exempt from this ban in any way. If the banks were to be exempt it could be detrimental to independent advisors, and as a result to clients as well. It is no secret that banks build their business model with sales revenue as their top priority, and the front line staff often lack the knowledge to properly address the needs of investors. An exemption for the banks would cause investors to gravitate towards banks as an investment option. Many investors would be under the misinformed belief that when they invest at their bank it is free or at least cheaper. Ultimately, this will mean that investors are receiving, in most cases, low quality advice while still paying embedded commissions.

Furthermore, It is my belief that those who are against the ban on embedded commissions are simply trying to avoid changing the way they currently run their business, and would prefer to protect the 'status quo'. The reality is that embedded fees often misalign with the best interests of the investor. I have heard the argument that banning embedded fees will cause investors with smaller portfolios to lose access to affordable advice and I strongly disagree with this rationale. There are many alternative options available to less sophisticated investors and it is also reasonable to believe that if this ban is put into place further options will be developed.

Having a fair and ethical industry should be placed as a higher priority than making business operations easy for advisors.

Sincerely,

Waterloo Advisor

Hello,

I have worked as a financial planner in Listowel, Ontario for the past 22 years, partnering with independent mutual fund dealers to provide financial and retirement planning advice to a wide range of clients.

I applaud the direction of the CRM disclosure rules to ensure that clients are aware of the costs of the financial advice they receive. Individual investors should always be made aware of the cost of the advice they receive. While our preference would have been to provide full disclosure of all costs to investors (full cost of both MER and TER), this dealer compensation disclosure is a step in the right direction. We have been providing this disclosure (both in percentage and dollar terms) to our clients for many years.

We operate almost exclusively on a fee based model but with a combination of embedded trailer on no-load funds and transparent fee with “F” class funds. We have always felt that it is important to provide excellent advice to all of our clients, including those with less financial assets. Many of our clients don’t initially have an investment portfolio of sufficient size for a transparent fee model. Burdening them with either a minimum account fee or an hourly fee wouldn’t be in their best interest. The choice of an embedded trailer fee with appropriate disclosure allows us to form a long term partnership to help them achieve their financial goals. Removing this choice of compensation models could potentially severely limit the investment options for these small accounts and could either force smaller investors into a choice between trying to invest without any advice or have higher costs. The concept of capping the maximum embedded compensation (1% for equity/balanced, 0.5% for fixed income) eliminates any perceived conflict of interest for choosing different solutions and is an easily implemented solution and reduces the possibility of unintended consequences.

In conclusion, since the regulators have already made the step of requiring disclosure of fees paid to investment dealers, would it not make sense to wait until they can measure the effect of that disclosure before deciding their next course of action? Making a decision without that information makes the whole CRM II disclosure a waste of time and resources for investment management firms and investment dealers.

I appreciate the opportunity to comment and hope it provides some insight into the concerns of ourselves and our clients.

Thanks,
Trent Stanley CFP PFP CFSB

Oak Tree Financial Services/Peak Investment Services

Assante
WEALTH MANAGEMENT

Assante Financial
Management Ltd.

Hein Financial Group
WEALTH MANAGEMENT AND FINANCIAL ADVISORY

April 3, 2017

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

Dear Sirs,

I appreciate the opportunity to address the Canadian Securities Administrator's (CSA) recently released consultation paper on the potential elimination of embedded commission. While I understand the stated potential for conflicts of interest, there is something that is not being discussed in the paper, or in the comments on the report that I have read from the various interest group and regulatory bodies that have addressed this issue so far.

Before I get into that, let me state for the record that I strongly agree with complete transparency. Not only on TOTAL fees paid by investors, but also inherent conflicts of interest and advisor qualifications. Having been an advisor for the past 37 years, I have seen a lot of regulatory change, (especially in the last few years) and most of it for the betterment of investor protection, but none of it makes investors better investors. And there in-lies the disconnect.

I have no dog in this fight. My business is predominantly fee based, with the total fees fully transparent, and it has been that way for a number of years. So, the banning of embedded commission is not something that would affect me personally. However, I have been around long enough to know that it will have a significant impact, not only on the financial advice industry, but also for the individual investor in a less than positive way. I'm sure you have all heard that this type of a ban would produce an "advice gap" as experienced in the U.K., therefore I defer that very valid argument to others. But I think an even more significant impact and far more devastating to investors, and the Canadian economy, will be the "apathy gap" that will be created. Banning any form of advice compensation option for consumers, will not help in any way increase the number of investors that will seek out the advice they desperately need. You can't regulate consumer apathy for action, inaction, or a disciplined approach to personal financial management. This has been proven time, and time again, in the massive under use of RRSP's and TFSA's by average Canadians.

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There is a reason investors save 45% more when they have an advisor (as stated in a report from the University of Calgary's School of Public Policy). It's because they have an advisor calling on them to put money into things; to save for their future; to save for their kids' education; to save for their retirement. Is this in the advisor's best interest?...Yes of course it is...more money under management means more compensation. Is it in the investor's best interest?....Yes, of course it is...because the average Canadian simply does not go out and do financial things that are in their best interest. There is a huge "apathy gap" with the average Canadian in all things financial.

Look at the statistics; Canadians are spending and borrowing more and saving less. The latest RBC poll shows nearly half of all Canadians over 55 say they are not saving enough for retirement. And in fact, people are withdrawing money from their RRSP's before retirement at an alarming rate. People need more options to obtain financial advice....certainly not less. This is what is missing in this debate. In the end, what are we as an industry (CSA included here) hoping to do? I would trust that we are trying to make the Canadian public better, more informed, investors. As such we should be looking at more options to engage advisors, not less.

The consultation paper outlines six benefits to eliminating embedded compensation. Three of those six are basically the same thing, lowering costs. Two of the benefits are related to reducing the number of funds (series types and managers) and one is product distribution and "advice improvement", with the assumption that more advisors would become discretionary managers.

Let's talk about this latter "benefit" first. Discretionary managers don't create anymore "savings discipline" or "simplify an investor's life", any more than a good advisor that receives embedded compensation does. And, I would argue that, turning more advisors into discretionary money managers is a mistake. This would create an environment ripe for client abuse and fraud. Clients need planning services and education, they do not need more "stock, ETF and fund" pickers. After almost 4 decades in this business I can easily name a half dozen ways to really rip off a client and none of them are related to embedded commission. But every way to do it is made that much easier if you are a discretionary manger. The CSA would be acting truly in the consumer's best interest if it focused on those aspects and strongly enforced existing rules before proposing a ban on something that will have questionable results.

Now let's talk about lower fees. (Which, as I mentioned above, are three of the six "benefits" of an embedded ban as outlined in the report.) I think we are seeing the movement to lower fees begin already. Advisors and dealers are moving fees downward in the wake of CRM2 disclosure and the pressure is now on the manufacturers to do the same. However, CRM2 does not go far enough. The full and complete disclosure of all fees and taxes needs to be mandated and the CSA has a responsibility and major role in getting that done. CRM2 is a start, but it creates more investor confusion and little more than a "shell game" between some captive advisors and their product manufacturers. This one rule, the complete, full disclosure of all fees and taxes on investment funds will be good for the investor and will undoubtedly drive down total investor fees. It will allow the consumer to have all the relevant fee data to truly "shop around".

It seems very obvious in the report that the CSA favors ETF and index fund investing for Canadian consumers over anything else, simply because of the "perceived" lower fees. I say "perceived" because I've read for a number of years now how these types of investments are so much cheaper compared to a mutual fund. Yet many times the cost of advice, or trading fees, or extra tax preparation cost and so forth are never mentioned. Why is that? It truly reminds me of the airline industry advertising cheep fares only to discover when you go to book the flight, that when you add all the other fees and taxes on top, that it's not any cheaper than another advertised fare that includes everything you want. Yes, I'm sure that some investors would benefit from a cheap "do-it-yourself" approach. That option already exists. I'm also sure it's far less expensive for my clients to change the oil in their cars also, rather than take it to a car dealership to do it. But they don't. Therefore, while I also have my thoughts on whether an investing world made up of only ETF's or index funds would lead to market chaos, or at the very least rampant market inefficiencies, those comments are beyond the scope of this discussion and are saved for future debate. Currently, what does concern me is the CSA's obvious endorsement of one type of investment for seeming all clients over another. That, I would suspect, ironically flies in the face of the fundamental mantra of "Knowing your Client". Does the CSA believes the perceived cheapest is always best? I have my doubts.

I would also like to touch on the aspect of Robo-advisors and fin-tech firms filling in the "advice gaps" and providing increased competition to again...bring down investor costs. I think this is inevitable given the advancement in technology. I also think it is a good idea. Smaller clients can use these services to design portfolios for themselves and save costs. However, this is nothing really that new. In fact, the insurance industry has been doing this for decades in the employee pension area. The advantage the pension industry has is that, 1) the employees are for the most part forced to make a choice and, 2) employees are forced (mandated in most cases) to save the money. Yet, even with these two massive advantages to combat the "apathy gap" there are still many concerns regarding robo-advice that can be learned from the pension industry. First being that, people are still reluctant do anything if it's not top of mind and forced upon them (they will sit in cash accounts forever sometimes). Secondly, if they do choose a portfolio, they rarely ever change their portfolios when their life situations change. And third, (and this only comes with years of advisor experience), investors assume they are larger risk takers than they actually are. A simple risk profile that is done without complete knowledge of the client is a formula for disaster. The next big market down turn (and I've seen a lot of them) will shake the robo-advice industry to it's very core.

I see reports now that at least one robo-advisor firm wants to have no human contact at all to onboard clients. This will be another interesting decision that the regulators will have to make. Robo advice is here and it will grow, but it's yet to be determined if this will make for better investors. Sometimes the best advice an advisor can give a client is not to invest in the latest investment that looks "to good to be true". The adviser, regardless of their compensation is many times the only thing standing in between an investor and a life altering really bad investment decision.

The other one benefit the CSA paper outlines is that the aspect that the banning of embedded commission will reduce the number of fund series. Halleluiah! Here is something I can really get on board with. I think the CSA can solve a number of different issues at one time here with a very simple step. A complete ban on all DSC and Low-Load funds. Period. Get rid of them all.

On the numerous industry boards I have sat on over the years, I have been told that the number one consumer complaint, which number twice as many as all other investor complaints combined has to do with DSC fees. There is a simple solution...get rid of them. In addition to reducing complaints, by banning the use of DSC funds will also purge the industry of many of the conflicts of interest, and bad actors we all desire to get rid of. Plus, the abolishing of both DSC and Low-load funds will bring about an automatic substantial reduction in the number of fund series.

In summary, I do not believe that embedded compensation is THE issue. Far from it in fact. Investor apathy and financial education are far bigger issues. Consumers need to be left with that option of embedded compensation to engage with an advisor and have that advisor combat that "apathy gap." However, at the same time, advisors, and the industry, need to be totally transparent on fees. Embedded compensation does not, and should not, mean hidden fees. All the fees and taxes need to be transparent not just the current CRM2 mandated dealer fees. And finally, I recommend the banning of DSC and low-load fund options for the reasons I have stated above. Those three items and the implementation of the existing rules will have a much greater impact in assisting investors be better investors.

Don't carpet bomb and risk a lot of collateral damage when a surgical strike will yield you far better results.

Yours truly,

Brian Hein *CLU, CHFC, CFP, RFP*

Luc Paiement
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April 10, 2017

Ms. Kim Lachapelle
General Secretary
CSA
Tour de la Bourse
800 Square Victoria, Suite 2510
Montreal, QC H4Z 1J2

Dear Madam:

I wish to share a short comment on CSA Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions.

Please take note that these are my personal views and should not be attributed to my employer, National Bank of Canada, nor to IIROC, where I serve as a board member.

My views are based on 35 years in the investment industry as an Investment Advisor, a Branch Manager, Head of full service brokerage services, Head of Wealth Management at National Bank (including direct brokerage, mutual funds, NB Corresponding Network, NB Trust, Private Wealth). Furthermore, over the years, I've led the Investment Banking and Institutional Sales and Trading divisions. I have seen a lot and wish to share my opinion on the topic.

1. The trailers should be capped, thus eliminating temptation by a few to propose one product more than another.

2. I would let them be paid to advisors IF, AND ONLY IF, the IAs commit to meet with their clients at least once a year, and this should be tracked, that the KYC form be updated, the portfolio be reviewed and a plan made up with retirement as the goal.

Transparency should rule. Clients want financial, wealth and estate planning advice, but they do not want to pay directly for it. Unfortunately, they do not understand planning advice is more important than investment advice.

They expect to get free wealth advice through what they pay directly or indirectly to IAs.

The bigger picture issue here is: MOST CLIENTS REALLY NEED ADVICE.

By capping, but paying the trailers against forcing the IAs to revise the clients' position once a year, potential source of conflict would be eliminated and more positively IAs would provide advice on investments and, more importantly, on wealth in general.

If we do not take this opportunity to force the issue and simply cut the trailers, we will create orphan investors, with no advice at all, because they will just not pay for it.

IAs who are not willing to commit, don't get trailers.

Thank you,

Luc Paiement

LP/kat

Cc: Mr. Andrew Kriegler, IIROC
Mr. Martin Gagnon, BNC
Ms. Maureen Jensen, OSC
Mr. Louis Morisset, AMF
Mr. Ian Russell, IIAC
Ms. Judith Menard, BNC

The Secretary

Ontario Securities Commission

20 Queen Street West

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Me Anne-Marie Beaudoin

Corporate Secretary

Autorité des marchés financiers

800, square Victoria, 22e étage

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April 18, 2017

Overview:

There is an old saying that goes something like "walk a mile in my shoes before..."

Few truly successful Advisers leave our industry. All others have not walked in their shoes and the bulk of the negative conversation directed at embedded compensation models comes from those who do not know our industry.

Including the relatively few (by percentage) consumers that have had negative experiences in the financial world. There should be none, but that is perfection and not realistic.

For example, once again, the most recent outing of Bank practices by CBC News. Imagine, over 1,000 staff, lower management and securities sales people admitting to corrupt and reprehensible behaviour...in one week!

Tens of thousands of innocent Canadians affected. Yet the focus is to destroy an efficient and age-old compensation system and drive even more of the most vulnerable Canadians directly into the Bank compensation model.

If successful the CSA will be applauded by Bank executives and shareholders alike who have been trying for decades (1992) to capture the independent adviser "market share".

Facts of Vested and Non Vested (and embedded) Commissions and/or Trailer Fees:

1/ The CSA has surely done its homework so it knows that 75% of all new financial advisers fail in the business the first 4 years. Even fewer remain at the 10-year mark.

2/ Almost without exception the ones who remain are among the highest quality, ethical and moral individuals in the country. It's embarrassing to see them attacked without any significant public backing (optics) from stakeholders around the country including the CSA.

- Obviously, ethical and experienced advisers have an acceptable compensation model. One accepted by millions of happy Canadian investors over numerous decades. The health and robust positive results of successful advisers and their clients prove the point.

3/ Accountants, Doctor's and Lawyers currently have a fee for service model and yet are regularly in the news for unsavoury practices. Case in point, billionaire clients of KPMG enjoying a tax pass by the CRA on back taxes (CBC News) for tax-free offshore investments. We all know the result if it was regular Canadians involved.

The CSA's proposed core compensation model (fee for service) looks shady in this light and does not solve what the CSA has positioned as a problem with the embedded compensation model.

4/ It is "known" that accountants, lawyers and financial advisers are "underpaid" in the first half of their careers and "overpaid" in their second half. In the first half successful advisers have worked up to 60 -90 hours weekly for 10 -20 years while being underpaid and a sacrificed family life. Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

5/ In lieu of pension plans including DBP, and DCP and Group RRSP plans not being available to advisers. Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

6/ In lieu of "Employment Insurance" (not available to advisers) along with Health, Dental and Long Term Disability and even sick leave Benefits are 100% out of advisers pockets. Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

7/ In lieu of a retirement age. When advisers stop working the value of vested revenues shrinks due to market forces. Many advisers work into their 80's or later as a result. Would public appointee's, management and staff at CSA offices like to trade? Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

8/ Canada Pension Plan premiums are double the cost to advisers as they pay both their portion and what is called the matching Employer portion of CPP premiums. Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

9/ Statutory Holidays, overtime pay and minimum wage are all benefits that have not been available to advisers. Unlike business owners they do not build up physical equity within their business that can be sold later. Therefore:

Embedded commissions and/or trailer fees are earned and owed to advisors.

10/ Historically, advisers have been assured they will not be paid 100% of their compensation earned so that money could be set aside to encourage above average job performance by rewarding those advisers with special perks, including travel.

Above average job performance, in reality, means that the adviser treats the job as a business and shows up for work every day. It is commonly called motivation.

- Perception or optics have nothing to do with it. Any individual or organization that twists the meaning of this type of compensation is wrong. Including the general public and the CSA.

The statements "these facts are mostly unproven" and "these facts are mostly true" along with "there may be a perception" is called political correctness and distorts the truth.

Note: Corporate Canada moved very quickly on this subject, not because it was right, but rather that it saves money by stealing promised compensation from advisers to enrich executive compensation and shareholder profit. Consumers saved nothing.

11/ Financial advisers are not compensated by the hour, rather by the project. They construct financial projects that house the finances of grandparents, parents, children and grandchildren. Not unlike a multi-family housing project.

They also build or are part of intricate corporate structures that range from Key Person compensation to Corporate expansion, restructuring, and acquisitions. Obviously, with this type of work, Advisers may make more than Doctors, at least in the year the deal closes.

In both of these examples, only the embedded compensation model can pay for the intellectual property offered in consumer/adviser relationships at a reasonable cost. Especially given the amount of "un-billable" intellectual knowledge and time required to complete any financial project. Note: the business is 24/7 and has never been 9 - 5.

12/ Canadians have choice of all the compensation models right now, upfront commissions, flat fees, hourly fees, fees based on a percentage of assets under administration or other arrangements. They need only search for the Adviser practice that offers it.

13/ Much of the CSA position on the matter of banning the embedded compensation model is sourced from the Australian and British compensation models.

We all know that both those countries compliance and regulatory regimes were weak, even non-existent compared to long standing Canadian standards.

Their problems have not been Canada's problems. One wonders at the motive behind the insistence of using them as an example.

14/ How much sympathy would the general public, given unbiased information, let alone a judge in a court of law view the banning of vested and non-vested revenues given the facts noted in this submission?

Failure to address the points in this submission opens up the very real possibility of a Class Action Lawsuit by affected advisers.

Summary

Embedded compensation such as commissions and trailers is the cheapest compensation model available to consumers. For them to pay advisers for the generally accepted employee rights that they themselves enjoy it would cost them significantly more.

Those that have not successfully worked in the financial services industry cannot claim to have "an inside perspective". Those that do only succeed to pass on negative if well-meaning and misdirected information. The knowledge gap and understanding of the business between failed and successful Advisers is to large to weight equally.

If the CSA truly believes good advisors, who provide value to their clients in exchange for compensation, will be able to transition away from embedded commissions and negotiate directly with their clients based on the value they provide are selectively ignoring the key points noted in this submission.

a Class Action Lawsuit would be advisers only recourse should a ban on commissions and trailers become an actuality.

Advisers deserve:

1/ Fair compensation for past years of service, pension and employment benefits that only the existing embedded compensation system provides.

2/ Recognition/compensation for hours worked and intellectual property that consumers and industry access that is not realistically billable.

3/ Stakeholder recognition that above average advisers should be paid more as they provide a higher level of intellectual knowledge enriching their clients and their country.

4/ The missing piece:

Compensation models are not part of the application process. They should be, including the embedded commission/trailer model.

Reviewed annually with the client, similar to an accountants practice. Along with mandatory disclosure and transparency rules in simple English/French.

Let the consumer decide what model they would like. It must not be dictated by third parties.

5/ Transition costs from one compensation model to another be born by the agency or organization driving the change if the end result is the banning of the embedded compensation model despite the facts noted in this submission.

6/ In the spirit of disclosure CSA should provide the names, job descriptions, work contact points income, benefit packages, and bonuses, including perks (like government hotel rates) of the entire CSA staff, management and stakeholders so that we can prove to Canadian consumers, that the agencies regulating our industry are acting fairly, transparently and in consumers best interests.

For further information or clarification please do not hesitate to contact the writer at the contact points noted below.

E. & O. E.

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April 20, 2017

Excellent points.

It seems to me that what the CSA and others overlook is proper compensation for independent advisers. And if they were to be paid typical levels of benefits most Canadians automatically qualify for, including minimum wage especially in the early years of an advisers development, the benefit value of at least 25% increase would be added to consumers costs.

That 25% benefit annually compounded up to the YMPE, increasing each year would be far more expensive than the 2% fee for service model applied to small accounts. Let alone the 1% fee for service for large accounts. Yes, these fee's will drop with market pressures just like the CSA proposes creating an even larger gap in proper compensation.

Of course the embedded commission and trailer model if FEL zero is the cheapest consumer choice. Small accounts would attract Low Load or Back End Load which over a 8 year period is tyically the same cost as FEL zero. Considering investments should be a 10 year cycle a properly managed account is an excellent choice which saves considerable costs to the investor over the Benefits costs that a regular working Canadian enjoys.

CSA's proposals for banning commissions show an impressive lack of knowledge and understanding of even basic economic princples. Either that or its a masked attempt to eliminate the independent adviser market simply to enrich share holder value and management compensation of the Big Banks. I suspect pick one or the other depending upon who you talk to at the CSA and who will give an honest answer.

Obviously a strong case for a successful litigation within a Class Action lawsuit. There would be a long list of lawyers lining up as this would be a massive windfall for them.

Mark A. Schneider

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April 20, 2017

A long list of lawyers lining up for a huge windfall from a class action suit?

Now there is a point that I missed in my comment on a new legal payment mandate. Perhaps we should ban all commissions (contingency fees) for lawyers as well.

The hypocrisy involved here is staggering.

Jonathan Hunt

Kenmar Associates
The Voice of the retail Investor

Via email April 25, 2017

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS
http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Kenmar is an Ontario- based privately-funded organization focused on investment fund investor education via on-line research papers hosted at www.canadianfundwatch.com. Kenmar also publishes *the Fund OBSERVER* on a bi-weekly basis discussing investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio

Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims.

We would be disingenuous if we said we were pleased to once again provide comments on this topic. Quite frankly, we are frustrated and disillusioned by the endless rounds of consultation. While our spirit is not broken, our determination and stamina is being tested to the limit. Nevertheless, Kenmar Associates is providing an input on this Consultation paper.

This CSA Consultation Paper pulls back the curtain to reveal the extent to which embedded commissions and industry structure impedes dealing representatives and others from being able to act in the best interests of their clients. We congratulate the CSA on the detail, statistics, commentary, research references and depth of the background data provided. The plain language exposition and adroit use of charts/tables may encourage more retail investor participation in this important Consultation.

Definition of trailing commission
According to our research there is no widely accepted definition of trailing commission in securities law. We believe that the Commissions and SRO's should agree on a common definition. The definition provided in Appendix B to the CSA Notice and Request for Comments on Proposed Amendments to NI 31-103 published on June 14, 2012 was as follows:
"“trailing commission” means any ongoing payment to a registered firm in respect of a security purchased for a client that is paid out of a management fee or other charge to the investment.” This makes it clear that the money is coming out of the investment which is key and that the dealer received such commissions directly as a result of sales to the investor. A trailer is just another form of compensation for sales. We take the definition of ***embedded commission*** to be the remuneration of dealers and their representatives for investment fund sales through commissions, including sales and trailing commissions, paid by investment fund managers .There is no reference to advice or services in this definition nor is there a definition of regulated advice. There is certainly not any disclosure of the services that dealers/advisors are to provide in exchange for the trailing commission.

Stated Rationale for consultation : The CSA's paper notes that embedded commissions incentivize dealers and reps to sell funds that pay higher trailers, such as "higher-risk actively- managed funds"; prevent investors from assessing the value they receive from their dealers; and "the cost of the advice and service provided may exceed its benefit to investors," among other things. These compensation structures also encourage fund management firms and fund managers to rely on payments to dealers to gather assets rather than investment performance. "This incentive can, in turn, lead to underperformance and drive up retail prices for investment products due to a competition between investment fund managers to offer attractive commissions to secure distribution." There is no question embedded commissions cause harm to clients.

The CSA has concluded that because these conflicts are both pervasive and difficult to manage, "a change to a different compensation model must be considered. Investors should be provided with a compensation model that empowers them and that better aligns the interests of investment fund managers, dealers and representatives with those of investors. The CSA's consultation paper also indicates that a ban on embedded commissions could also lead to increased price competition; lower fund management costs; a shift to lower-cost products, including passively-managed products; and, further innovation, among other effects, in addition to addressing concerns about conflicts-of-interest. The CSA wants direct payment for advice/service. Under direct pay arrangements, dealers and representatives could adopt various compensation arrangements, including upfront commissions, an hourly fee, a flat fee, a fee-based arrangement, or another suitable compensation arrangement, as long as the compensation is not embedded within the product and is paid exclusively by the investor.

In a 2014 survey of CFA Institute members representing a broad cross-section of investment professionals, Canadian CFA Institute members cited “misaligned incentives of investment management services” and “mis-selling by financial advisers” as the two most serious ethical issues facing the Canadian market in 2015. https://www.cfainstitute.org/Survey/gmss_2015_detailed_results.pdf

In NI81-408 there is no proposed rule or definitive plan of action. The CSA have stated that “what we are considering is eliminating embedded compensation on any "investment fund" under securities legislation, which would include mutual funds (MF), ETFs, closed end funds, pooled funds and structured notes. This would include any of these products, whether sold to retail investors under a prospectus or Fund Fact document, or whether sold on an exempt basis”.

At 2012, 39% of all households that owned investment funds were small investors (mass market households), 49% were midmarket households and the remaining 12% of fund owning households were affluent households.

Executive Summary

- Kenmar agree with the CSA on the harm a conflicted “advice” structure like embedded commissions cause retail investors. Any ffinancial incentives, including embedded commissions, that pay advisors/ dealers more to recommend one product rather than another compromise the quality, integrity and independence of advice. The advice gap that must be closed is the one between independent and compromised advice.The objective of breaking the link between conflicted investment advice and product ownership by discontinuing embedded commissions is a huge positive. We disagree however that co-operative marketing (funded by fund assets) should continue as it creates/maintains an unhealthy relationship between advice givers and product suppliers. We can see no rationale for retaining referral arrangements either as explained later in our detailed response.

- While we believe there will not be an expanded investment advice gap for small investors (defined by the CSA as mass market -less than $100k of investable assets) , the advice available may not be in the form that some small investors might prefer and it will still be subject to other conflicts-of-interest and product and service shelf limitations.
- DIY investors using discount brokers should benefit by paying a small transaction fee instead of an embedded commission ranging from 0.25% - I.25% for advice that is never provided.
- Mutual fund investors who do not engage with an advisor will benefit from a commission ban because they will no longer be involuntarily paying for advice they do not want, need or receive.
- Isolating the cost of advice from the product cost is a positive step but our anecdotal experience indicates a not insignificant segment of small investors is not uncomfortable with a tied-advice model and prefer it. A number feel that simply including the notional "advice" cost on monthly account statements as a footnote would satisfy their information needs. We believe a combination of convenience, complacency, detachment, a lack of understanding of the impact of conflict-of-interest on recommendations and unbridled trust in their advisor contribute to this attitude. It is about framing....how the deduction, the payment is framed and presented to clients.
- Small investors will be able to comparison shop but given the limited leverage, may not be able to negotiate advisory/account fees to a significant degree.
- The advice provided will still be subject to conflicts-of-interest, the suitability standard (where product cost is not an explicit factor), weak risk profiling and dealing representative proficiency shortcomings unless other regulatory reforms in CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* are simultaneously introduced. We agree with the CSA that discontinuing embedded commissions is complementary to CP 33-404.
- Integrated firms will be the big winners as the market share of independent fundcos without a dedicated distribution network could be adversely impacted with the elimination of embedded commissions. This leads us to the conclusion that (a) the percentage and number of non -proprietary funds available to retail investors will decline (b) a bias towards actively-managed mutual funds and closed-end funds will be maintained and (c) the migration to low-cost passive investing products such as Index funds and ETF’s will continue to be very slow among small investors.
- Advice fees would be unconstrained subject of course to market competition forces. Fee-based accounts could lead to higher fees but with the potential of lower product costs. Investor-abusing reverse churning, now in progress, will accelerate in the absence of a statutory Best interest advice standard and robust supervision/ compliance and regulatory enforcement. Basic elements of a best-interest process standard, include a clear definition of advice scope, advisor competency, a defined investment process, avoiding or controlling conflicts-of-interest; providing full, clear, meaningful and timely disclosure; interpreting laws and agreements in

manners favourable to clients' interests where conflicting interpretations arise; acting "with care", clear cost and performance reporting and a fair, responsive complaint handling system.

- Regulatory arbitrage with insurance products and some banking products will occur but will be limited assuming regulators make cooperation arrangements with their regulatory counterparts.
- The impact on portfolio managers' behaviour and fund performance is expected to be a positive for investors but we have no hard facts, research or evidence to make such a projection other than logic. (except for the obvious performance improvement resulting from removing embedded trailer costs from fund overheads)
- *NI81-105 Mutual Fund Sales Practices* needs an overhaul and expanded scope beyond mutual funds.
- Digital and online advice will be provided a positive environment for development and growth.
- In Ontario, new laws on financial planning, investment advice and title usage may amplify and accelerate the benefits of embedded commission prohibition in Ontario.
- Improved complaint handling rules and an OBSI with binding powers would be a powerful adjunct to this proposed rule.
- Robust and timely regulatory enforcement is a critical success factor. We cannot overemphasize the importance of enforcement by CSA members and especially the SRO'S. When regulations are added frequently but existing regulations are not enforced, this leads one to question the effectiveness of regulation and ultimately impacts confidence in the system both by the regulated and the general public. That is, until enforcement is carried out with the same vigour as new regulatory proposals, we are skeptical that the CSA's goals will be achieved.

Introduction

We treat this consultation on a stand-alone basis because there is no assurance that the CSA will move forward with targeted reforms or a Best interests standard. Indeed, without a clear idea of the CSA vision for the regulation of the Canadian investment advice industry, it is difficult to make robust commentary.

The consultation paper is not considering eliminating embedded commissions on any other products. Segregated funds, an insurance industry product, would be immunized from the prohibition but the CSA says it is working with insurance regulators to harmonize requirements where possible.

We would also recommend that the CSA task the MFDA and IIROC with forming partnerships with provincial insurance regulators as IIROC has done with the Ontario FSCO [Under the Memorandum of Understanding (MOU) agreed by IIROC and FSCO, the two regulators will share the decisions and sanctions of their respective disciplinary processes. Disciplinary decisions or actions taken by one regulator will trigger a review of the sanctioned individual's activities by the other regulator, including consideration of the suitability of the individual for approval, licensing or registration. This may result in an investigation or other appropriate disciplinary action. According to the MOU, IIROC and FSCO will also, where appropriate, conduct joint investigations and share relevant records and documents when both regulators are investigating the same individuals http://www.iiroc.ca/Documents/2016/5a43d68b-9b33-41b6-b426-87752566ae2b_en.pdf **We urge the CSA to consider this a major issue and take concrete steps to mitigate the risks of such regulatory arbitrage.**

Regulatory failures of the past have impaired the retirement income security of Canadians. If regulators had acted on the 1995 and 1998 Stromberg reports on the mutual fund industry, we wouldn't have the mess we have today. If the Fair Dealing Model proposed by the OSC in 2004 had been accepted by the CSA, Canadians would by now have a world class advice - based system. CSA characteristics include slow policy making, never-ending consultations and talking and continued "monitoring".

The Dec.15, 2016 announcements from the CSA, MFDA and IIROC portray a comprehensive system of incentives and inducements whose basic intent is to thwart the fundamental principle that registrants are required to deal fairly, honestly and in good faith with clients. That they have been allowed to exist is a reflection on the failure of regulators to protect investors.

Even as we prepare to respond to this consultation, we remain acutely aware that the CSA is a house divided on the Best interests standard for advice, even its definition. The portfolio construction, planning and management process (irrespective of its sophistication) and related financial planning should be conducted solely in the client's best interests. One hundred percent loyalty/focus should be dedicated to this objective. The dealing representative ("advisor ") should be responsible for the process and while the exchange, the point at which the client accepts the recommendation, in advisory relationships, remains the client's responsibility, this responsibility depends wholly on the integrity of the advisor's process. No conflict-of- interest should be allowed to impair the process. Canadian securities regulators remain stubbornly anchored around the transaction so the regulation of financial advice is sub-optimal.

If the pattern of the past is repeated, the new CMRA could be established and this initiative along with Best interests will die stillborn. We urge the CSA to make some firm decisions without undue delay.

Fees/Fee structures and their impact on advice and investors

With the evolution of the investment markets, technological change, an aging population, complex structured products, record high personal debt the key "RRSP rollover" decision point and increased longevity, investor risks and vulnerabilities are much greater than ever before. Canadian investors are highly vulnerable due to low financial literacy, information asymmetry vs. dealers/dealing Reps ("advisors"), investor overconfidence in their investing skills, blind trust in advice givers and a desperate search for yield in a low interest environment. Therefore, fee structures that exploit this vulnerability should be eliminated to the greatest extent practicable.

Based on the CSA review of current actively- managed fee-based (series F) fund offerings and their five year alphas, the data suggests that 87% of investment fund managers offering actively-managed funds today have some funds with negative alphas which could be at risk of redemption if embedded commissions were discontinued and these managers were not able to adjust their fees or improve performance. For active investment fund managers that manage funds with negative alphas, the proportion of assets at risk or redemption could be on average 53% of firm assets. This is truly a startling statistic given that "advisors" are the ones recommending these funds.

Independent academic research resoundingly supports the contention that mutual fund fees in Canada are among the highest in the world. A June 2015 **Morningstar report *Global Fund Investor Experience Study*** https://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf shows that for Fees and Expenses, the highest-scoring country (that is, the country with the lowest costs) is the U.S., a position held since the start of this study in 2009 and reflective of the scale of this market and, as discussed later, sales practices. Australia and the Netherlands join the U.S. with an A grade. Among the lowest-scoring markets are Canada and China, which, while not the most expensive in all categories, do not have any category where fees are at an average or better level. Canada received a D- grade. This has a dramatic adverse impact on the savings and retirement income security for Canadians.

The CSA cited research has shown that mutual fund investors tend not to review disclosure documents for cost information and instead primarily rely on advisors to tell them about costs .Further research indicates that many advisors do not tell their clients about costs although this information gap may be partially closed by CRM2 reporting. While CRM2 reporting reforms are beneficial, they omit product costs, the TER and any DSC early redemption penalty payments. We therefore do not feel this reporting will get at the root of the problem .Further, most small retail clients will not be in any position to negotiate fees and perhaps most importantly, account/product cost(s) will not be an explicit factor in suitability assessments.

We therefore recommend that account and product cost(s) be made an explicit element of a suitability determination consistent with the targeted reforms.

We need to stand back and look at what we are actually paying for. If this is purely a transaction with the fee coming for the advice on the transaction, then in a competitive market place you should be able to buy mutual funds without the load and without the embedded trailer if an investor does not need or want the transaction advice. That is unfortunately not the prevailing model and therein lies the core of the issue [we are aware that a few online brokers may rebate trailers for a modest fee].

As independent research clearly shows, fees are the primary cause of sub-benchmark fund performance for A series units**.** RE Morningstar research: **How Expense Ratios and Star Ratings Predict Success** The report states **"***If there's anything in the whole world of mutual funds that you can take to the bank, it's that expense ratios help you make a better [purchase] decision. In every single time period and data point tested, low-cost funds beat high-cost funds.*" http://factualfin.com/blog/blog2.php/how-expense-ratios-and-star-ratings-pred To the extent that the breakdown of fund fee (and services) components are isolable, it is to that extent that investors will be better able to assess value for money for the advice and fund management components.

Embedded commissions are, in our view, primarily designed as a financial inducement for dealers to sell product (rather than advice), thereby increasing fee-attracting fund assets.

Embedded commissions constitute a fundamental conflict-of-interest. The conflict exists because it is the fund manufacturer that is paying the dealer conditional on a transaction taking place. In the first CSA consultation paper on fund fees (81-407, published Dec. 13, 2012) the CSA stated that using fund assets to pay for distribution gives rise to a conflict-of-interest for the investment fund manager. More specifically, the investment fund manager's use of fund assets (which are ultimately investor money) to pay for distribution and increase assets under management can benefit the investment fund manager by increasing their management fee revenue, but may not yield any benefit for the investor. The CSA are of the view that to the extent the investment fund manager would be the primary beneficiary of such a practice, and no corresponding benefit is passed on to investors, the investment fund manager may be at odds with their statutory duty to act in the best interests of the mutual fund and its investors. We agree with this assessment.

And of course trailers create a conflict for advisors in that funds with trailers may be more lucrative than other products and funds with higher trailers may skew recommendations even further. Embedded commissions can lead to mis-selling, thus reducing returns. e.g. use of high cost products, account churning, defective asset allocation and excessive leveraging. Excessive leveraging for example, creates a larger asset base which generates a larger trailer commission cash flow but dramatically increases investor risk exposure. It should be noted however that this same risk can occur in a fee-based account in the absence of a Best interests standard and robust compliance/enforcement.

The CSA also note there's no evidence to substantiate that investors can expect an increase in services and advice if their fund's trailer commissions rise. Trailer commissions paid are very loosely correlated with level of effort received if at all. Because of pooling of assets, large investors (affluent investors per CSA) subsidize smaller investors. With regards to affluent investors (more than $500k of investable assets), the CSA expect that they will be the least affected by the discontinuance of embedded commissions and would likely benefit from the expected decrease in fund management costs and the change in the habits of dealers.

The CSA state (pgs. 52/53)" Based on an analysis of low-cost fund product provider pricing in other markets, while taking into account pricing practices specific to Canada (e.g. tax differences such as the HST etc.), the estimates suggest that management expense ratios (MER) for index funds offered by these new entrants could be up to 40 bps lower than average index fund costs today. Also, MERs for actively- managed funds offered by these new entrants could be up to 75 bps lower than average actively-managed fund costs today. "If these numbers can be believed, such a reduction in A series fees would have a dramatic positive impact on the retirement income security of Canadians.

However, we must examine these claims since the details for making them are not revealed. Actively- managed funds, in their simplest form are offered as Series A and F. Series A is typically 2% and Series F is 1%. From the fundco perspective, 2% is 1% since fundcos are giving up 1% off the top, which is why F is 1%. So the paper seems to be saying the effect of these new entrants could be to reduce Series F management fees on equity funds to as low as 25 bps. That seems to be very ambitious. It is our understanding that even institutional investors don't pay that low on most strategies. And an institutional manager has much lower costs. We leave it to industry participants, fund analysts and others to assess this claim. In any event, we do expect product costs to continue to decline due to competition, the potential arrival of a Best interests standard, relentless media attention on fund costs and increased use of passively-managed products / actively- managed ETF's.

Embedded commissions are one among several causes of abusive salesperson behaviour, although lack of proficiency is also a major factor in the provision of bad advice (the UK RDR review came to a similar conclusion). In fact, Kenmar have been successful in a significant number of complaint cases against dealers/Reps based on incorrect advice on RRSP loan interest deductibility , misunderstanding ROC funds, mis-selling of leveraged ETF's, incorrect interpretation of TFSA rules and undifferentiated advice on RRSP's.

These examples are well delineated in MFDA and IIROC hearing panel decisions, media reports and in our quarterly *INVESTOR PROTECTION in Canada* reports going back over 5 years. **We therefore recommend that dealing representative proficiency be improved as integral to any decision prohibiting embedded commissions.**

There is surprisingly little statutory regulation of the financial advisor industry. Beyond the basic requirements arising from securities legislation across Canada, a wide range of *industry-based* rules and principles guide financial advisors. To achieve the desired outcomes sought by investors, we think the CSA constituents really have to amend the Securities Act(s) or set up a financial conduct or retail financial services regulator dedicated to regulating financial advice to retail investors. The targeted reforms appear to be an uncomfortable patch on a system really focussed on securities distribution not trusted investment advice.

Advisors and Advice

When we consult the rules, regulations and Bulletins of the CSA and the MFDA/IIROC we do not find regulations defining "advice" or the parameters in which that advice should be delivered, monitored and reported. Regulations relate mainly to issuance of securities and the rules and regulations governing their transactions and the rules and regulations governing the disclosure, sale and purchase of securities for individuals.

The CSA state "The term "advisor", as used in this Consultation Paper, is not indicative of an individual's category of registration with Canadian securities regulators, but is rather a plain language term that is commonly used by the public, including fund industry participants and investors, to refer to a representative" .In fact, it is a made up title that has deceived investors into believing that registrants have a best interests duty.

It is interesting to note that the CSA refer to a Dealing Representative, the official registration category, as a "salesperson " http://www.securities-administrators.ca/uploadedFiles/General/pdfs/UnderstandingRegistration_EN.pdf The ASC is more graphic: Persons who are registered under the Securities Act (Alberta) as Dealing Representatives (for example) are generally licensed to sell you products sold by the investment firm they work for, and are obligated to provide you with advice on the suitability of those products for your circumstances. In that sense, it's not unlike purchasing a car from a dealership. If you walk into a Volvo dealership, and explain your needs (four-door, certain horsepower) the person working there will suggest the most suitable Volvo for your needs. While they might have a small selection of other makes and models in their inventory, they are not required to know about, or recommend, any make or model that is not in their inventory that might meet your needs as well, or better. This is true no matter what job title they use, be that "personal banking associate," "investment representative," "investment specialist" or any other title. http://www.albertasecurities.com/investor/investor-resources/you-ascd-blog/Lists/Posts/Post.aspx?ID=63 These regulatory descriptions of dealing Representatives as salespersons are quite different than the descriptions portrayed by industry marketing materials to investors. See SIPA Report *Financial Advisor Fiduciary Illusion* http://www.sipa.ca/library/SIPAsubmissions/500%20SIPA%20REPORT%20-%20Financial%20Advisor%20Fiduciary%20Illusion%2020150502.pdf

Registrants are expected to recommend "suitable" investments per KYC / risk profiling and recommend "suitable" asset allocations. There does not appear to be any legal or other obligation to assist in budget/ debt management, provide lowest cost portfolio solutions, prepare an IPS, monitor the portfolio after the transaction or prepare a meaningful financial plan. Any advice relevant to income tax matters appears to be tilted to promote investment (e.g. RRSP loans) rather than providing a professional, well informed knowledge of tax laws. Marketing literature however suggests that such services may be provided but the real world is something else altogether.

Investors who unknowingly rely on conflicted salespersons as if they were trusted advisors can suffer real financial harm as such salespersons do not owe a fiduciary duty to investors. The cost on an individual basis, in the form of lost retirement savings, can amount to tens or even hundreds of thousands of dollars over a lifetime of investing, money that retirees struggling to make ends meet can ill afford to do without. In addition to paying higher costs, investors who rely on conflicted sales recommendations as if it were unbiased advice can end up facing unnecessary risks or receiving substandard returns as a result of numerous incentives that pervade the compensation system for "advisors". A major problem is that the CSA /IIROC/MFDA have allowed Approved Persons to hold themselves out as "advisors" and "financial planners" when there is no statutory obligation to act in the client's best interest- this is inherently misleading to financial consumers. **We recommend that the CSA take action that will address title misrepresentation.**

The mutual fund industry employs an arsenal of sophisticated techniques to market and sell mutual funds so it is understandable, in the absence of enforced protective regulations, that Canadians are paying a premium price for mutual funds. The bottom line is that the so-called "Wealth management "industry is not providing a robust or economic path for Canadians to accumulate wealth for retirement. Regulatory reforms are required and have been required for many years since the Stromberg Reports identified the key mis-selling issues in the late nineteen nineties.

It should also be noted that while embedded commissions are one cause of mutual fund under-performance, other so-called optional fees are not immaterial-sales loads, early redemption penalty fees, switch fees, currency conversion fees (in some registered accounts) and account transfer charges also take a nasty bite out of retail investor nest eggs.These fees are not regulated and could be increased to mitigate the loss of trailers.

But embedded commissions amount to about half the cost of owning an actively-managed equity mutual fund so rightfully draw the most attention. Across all mutual fund classes, prior CSA research found mutual fund management fees totaled $13.4-billion in 2011, with trailer commissions accounting for $4.6-billion or 34 % of the cost. At the end of 2011, the mutual fund industry managed $762 billion in assets on behalf of an estimated 12 million Canadians. The CSA now inform us that trailing commission paying fund series make up the bulk of mutual fund assets in Canada. At the end of 2015, trailing commission paying purchase options – back-end, low load, front end, and retail no load – made up 67% of assets and increased by 58% over the five years ending 2015. At 2016 the AUM figure has exploded to $1.3 trillion with an increase in trailers. Fundco trailer commissions provide a significant income stream to dealers for distribution of the funds to the retail market. Separating out the cost of "advice" should prompt attentive investors to assess the value of the "advice" obtained .This transparency would help explain some of the fierce industry opposition to a ban on embedded commissions.

As we shall demonstrate, Kenmar do not believe that a prohibition on trailers alone will put investors in a materially safer place. We support a statutory " Best interests " regime but suspect it is probably years away from reality given the lukewarm CSA support (except for the OSC and NBSC) and intense industry lobbying to prevent, delay or water down implementation. Continued use of the lowly suitability standard, prevailing dealer compensation practices and lax enforcement pretty well guarantees sub-optimal investor outcomes even if trailers are prohibited.

"Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks"-- Warren Buffett

It is our conviction that conflicts-of-interest are so fundamentally harmful that they should be dealt with now by regulators. Even with heightened investor awareness, the limited financial literacy and numeracy of Canadian mutual fund investors, information/knowledge asymmetry and perfected advisor sales pitches will keep ordinary Canadians vulnerable to mis-selling.

The Canadian experience and studies elsewhere in the world such as in the U.K. and Australia provide clear and convincing evidence that the standards for advice giving need to be upgraded**. We recommend that the CSA take action to enhance dealer rep proficiency per *CSA CP 33-404.***

In view of all the issues facing the fund industry the CSA is now , to our dismay, proposing to add alternative funds to the brew .Kenmar argues that no part of the CSA's Alt proposal should be allowed to proceed until salesperson proficiency, KYC tools , risk profiling and conduct standards in the industry are raised: The present securities regulatory framework does not provide adequate investor protection for mainstream products such as mutual funds, let alone complex products such as alternative funds. That being said, Kenmar do not oppose the introduction of Alt funds if they can help improve the risk-adjusted returns of clients. But first, the advice process needs to be more robust in order to recommend them to unsophisticated retail clients.

The Ontario Expert Committee's FINAL report
http://www.fin.gov.on.ca/en/consultations/fpfa/fpfa-final-report.pdf
describes the scheme of the recommendations as a "tripartite approach." Its three main pillars include: a new, harmonized regulatory framework for those who work in the industry; imposition of a duty to act in the best interests of clients; and upgraded and simplified titles and credentials for advisors based on heightened proficiency requirements. We feel the Ontario initiative on financial planning and advice and associated planner/ advisor registration could pay dividends for Ontarions. We urge the Ontario government to follow through as it would bring financial planning under regulation (as in Quebec) and have a common standard for insurance and investment advisors. It would improve investor protection and serve as a beacon for change for the other CSA members.

An Australian study ***Characteristics of trust in Personal financial planning***
https://www.griffith.edu.au/__data/assets/pdf_file/0004/868081/FPRJ-V2-ISS1-pp12-35-characteristics-of-trust-in-personal-financial-planning.pdf
utilises quantitative and qualitative research planning. The authors define trust in financial planning as "the expectation that the advisor (trustee) can be relied on to act

honestly, competently and in the best interests of the client (trustor) and thereby reduce the trustor's risk of loss" (Cull, 2015, p. 10). The paper identified seven primary characteristics of trust that were found to be essential to the client-advisor relationship in personal financial planning. Affective characteristics of trust were found to be essential to the client-advisor relationship. Increased legislation and specific behavioural and technical competencies of advisors were also found to build consumer trust in financial advice. The study's results provide guidance to financial advisors [and regulators] with regards to the skills and factors that build and maintain trust with clients.

This is why we argue that when advice is provided it must be free of conflicts –of-interest and be in the Best interests of the client. Trust in the financial advice process ultimately impacts on public confidence in Canadian capital markets and participation in the economy which assists in meeting broader economic and social objectives.

The CSA must deal with the conflicts issue holistically and not piece-meal. Trailers are the tip of the iceberg of a far larger problem in the wealth management industry. That is why we continue to insist on a statutory Best interests duty to clients and nothing less.

Until advice is actually regulated in some shape or form, financial advice standards are raised and financial advisors have a real professional body to define the proficiency, rules and regulations governing the provision of advice and to discipline and punish those who ignore them, the retail investor will need to be responsible for policing his/her own financial position- a Caveat Emptor environment.

The Canadian Retail Fund Investor Profile

The Canadian Securities Administrators' (CSA) 2016 edition of its investor education survey found that a growing number of Canadians are relying on advisors, with 56% reporting that they utilize an advisor, up from 43% in 2006 when the CSA first carried out the survey.

Moreover, investors cited advisors as their primary source of investing information and credited their advisors as the reason for reassessing their risk tolerance in the past year. The CSA survey found that 61% reviewed their level of risk tolerance during the year, up from 49% in 2012.

Retail mutual fund investors do not understand the adverse impact of fees over time i.e. the de- compounding of returns [studies show that the majority of series A mutual funds do not meet their benchmark over 10 or even 5 years]. This results in clients losing a significant amount of market returns over a 30-40 year investment horizon due to fees.

The 2012 OSC IEF study (pg. 28) found that 51% of investors had no view as to whether there was a conflict- of-interest or not. Among this group, the majority (29% not aware, 22% aware) indicated that they were not aware of all these sales commissions prior to the survey. Others said they were aware, but hadn't formed an opinion. Among the half of investors with an opinion on conflict -of-interest, an astonishing 73 % [36/49] believed that their advisor would look out for their best interest regardless of how the advisor was paid. This should be a BIG Red flag for regulators.

The study concluded "..Two-thirds of investors know little about their advisor when they enter into a relationship with that advisor. Only one-third gets to an advisor through a referral. The most common way to get an advisor is to have one assigned by a bank or financial institution. Investors trust this assigned advisor, because they trust their financial institution to do what is best for them..."

The sad fact is that most "advisors" are executing as salespersons with no regulatory requirement to provide financial planning, tax advice or indeed, any particular advisory service other than ensuring investment recommendations are "suitable".

At the end of 2012 just 37% of Canadian households held investment funds while the balance did not. In other words, two thirds of households would not be impacted in any way by a prohibition of embedded commissions. Further, at the end of 2012, just 22% of small investors (mass market) households held investment funds. These households will typically hold more conservative financial products instead such as cash GICs etc. Thus nearly four out of 5 small investors would be invariant to a ban on embedded commissions.

It should also be noted that mass market households are less likely to purchase their funds through an independent/ other fund distributor. At the end of 2012 only 14% of mass market households purchased their funds through an independent/ other fund distributor compared to 18% of households overall and 21% of affluent households. Mass market households were also much more likely to be solely purchasing their funds through a deposit taker/insurer owned dealer (83%) then were households with higher level of investable assets (i.e. 76% and 75% respectively for mid market and affluent households) .

As regards fees, a BCSC study confirms investors need to learn more about fees .The first phase of the research, which Innovative Research Group conducted on behalf of the BCSC, found that 28% of survey participants don't know how their advisors are paid while 36% are not familiar with the types of fees they pay. The survey also found that 51% of investors say they know what they paid in direct fees over the year, but just 34% know the impact of indirect fees on their investments. Furthermore, the research reveals that only 44% of survey participants understand that paying 1% more, or less, in fees will impact their returns.
http://www.bcsc.bc.ca/News/News_Releases/2017/06_BCSC_study_confirms_investors_need_to_learn_more_about_fees/ **This suggests that securities regulators need to do more targeted investor education on the de- compounding effect of fees on long -term returns**. An advantage of isolating the cost of advice from the product cost would in principle help engaged retail investors get a handle on their investing costs and the value of the advice provided.

The TD bank scandal reveals a lot about corporate culture

A recent CBC report about TD bank employees pressured to meet high sales quotas has touched off a strong reaction from clients, investor advocates and TD employees.

Hundreds of current and former TD Bank Group employees wrote to CBC's Go Public describing a pressure cooker environment they say is "poisoned," "stress inducing," "insane" and has "zero focus on ethics." Some employees admitted they broke the law, claiming they were desperate to earn points towards sales goals they have to reach every three months or risk being fired.

Employees unilaterally increased lines of credit, increased overdraft protection and increased VISA card limits in order to meet sales quotas. One financial advisor admits she acted in her own interest rather than that of her clients after being put on a Performance Improvement Plan - a program that involves coaching and could result in termination of employment - because she wasn't meeting her sales targets. "I have invested clients' savings into funds which were not suitable, because of the SR [sales revenue] pressure" she said. "That's very difficult to admit. I didn't do this lightly." A former TD financial advisor in Calgary says he would downplay the risk of products that gave him a big boost towards his quarterly goal. This is a major systemic issue akin to the Wells Fargo disaster in the U.S.

It will be very interesting to see how banking and securities regulators deal with this mess. Heads should roll, large fines imposed and all victims made whole. NOTES (1) Take a look at this 2013 IE article on TD's planned approach to compensation. ***Lower-producing advisors under fire*** http://www.investmentexecutive.com/-/lower-producing-advisors-under-fire?redirect=%2Fsearch Was this a predictor of the nasty things we see today?; (2) In Nov. 2014, three subsidiaries of Toronto-Dominion Bank agreed to repay at least $13.5-million to clients (10,000 accounts) who were overcharged on fees over the **past 14 years** and paid $650,000 to the OSC in a settlement deal over the wrongdoing and (3) TD Bank was one of the two banks who abandoned independent OBSI as soon as the Minister of Finance provided the opportunity for them to choose their own dispute resolution service.

And yet here we are reading this CSA consultation report on embedded commissions saying deposit –taker (bank) "advisors" work on a salary and are not compensated by trailer commissions. For us this tells us that while trailers are one important conflict of-interest, the real issue is a cultural one. Simply banning trailers will resolve little if there are multiple other sources of advice-skewing incentives backed up by disincentives supported by threats of termination at a branch.

Deposit- taker and insurer owned fund dealers dominate fund distribution in Canada. At the end of 2012, of the 37% of Canadian households that owned investment funds, 87% purchase their funds through a deposit taker/ insurer owned distributor while only 18% purchased their funds to an independent /other fund distributor (a small percentage of households purchase funds from both dealer groups).

To the extent the CSA believes bank branch "advisors" would make up any supposed "advice gap" caused by an embedded commission ban, it is to that extent we urge extreme caution.

Kenmar Response to Specific Consultation Questions

1. *Do you agree with the issues described in this Part? Why or why not?*
Yes, we agree with the embedded commission issues and their importance. CSA and independent research shows that conflicted advice harms investors. If an investor were to invest exclusively in mutual funds, we believe it would make sense to pay a fee if competent ongoing monitoring of the portfolio occurs. The broker or dealer would earn a clear fee as a result of that service. Prohibiting trailers will deal with this issue and will help bring clarity to the advice provided. Some investors may lose access to mutual funds that "advisors" sell with some of the highest fees in the world but will gain access to robo advisors or other direct fee payment methods with higher integrity advice. A recent poll from CARP found that 79% of its members opposed embedded fees with 40% strongly opposed. http://www.carp.ca/2017/04/20/new-poll-older-canadians-want-government-action-protect-life-savings/ When the advice fee is stated as a percentage it should be accompanied with a cost per $1000 metric. For consistency in nomenclature, the charge should be labelled "Service and advice fee" and recorded in dollars and cents on account statements.

We also concur that there is generally no linear or other relationship between the level of embedded trailer commissions set and paid by the investment fund manager to the dealer and the level (and/or quality) of services and advice the dealer and the representative provide to investors in exchange for such compensation .

In **Retail Financial Advice: Does One Size Fit All?** By Stephen Foerster, Juhani T. Linnainmaa, Brian T. Melzer, Alessandro Previtero NBER Working Paper No. 20712 November 2014 the authors conclude:
Using unique data on Canadian households, we assess the impact of financial advisors on their clients' portfolios. We find that advisors induce their clients to take more risk, thereby raising expected returns. On the other hand, we find limited evidence of customization: advisors direct clients into similar portfolios independent of their clients' risk preferences and stage in the life cycle. An advisor's own portfolio is a good predictor of the client's portfolio even after controlling for the client's characteristics. This one-size-fits-all advice does not come cheap. The average client pays more than 2.7% each year in fees and thus gives up all of the equity premium gained through increased risk-taking.
http://fbe.usc.edu/seminars/papers/F_10-3-14_LINNAINMAA.pdf It is important

that Canadians experience positive investment results because they depend on these investments for lifestyle and retirement purposes. If Canadians retire with insufficient wealth, they will ultimately have to be subsidized by the state. Our reading of current economic news suggests that this will lead to a significant deterioration in lifestyle for retirees (with commensurate effects on the economy as a whole, exacerbated by Canada's aging population) and that the state can ill afford to fund the retirement for more Canadians than it does now.

In the case of mutual funds, Fund Facts (FF) adds to the problem. If the CSA had listened to investor advocates, trailer commissions would be a distinct highly visible line item in Fund Facts, not subsumed in the MER - the cost of distribution would have made trailer payouts more visible. If regulators would have not mandated FF wording that the trailing commission involves the provision of "service and advice" we wouldn't now have to talk about the amount or quality of the recommendations. - the Simplified Prospectus merely said the manufacturer made a payment to the dealer without asserting it was for advice.

The CSA has also allowed meaningless disclosure of trailer commissions. As an example, the TD Balanced Growth fund Fund Facts document, says the trailing commission of this fund is 0-1%, not exactly a very informative fee disclosure for making an informed investment decision.
https://www.tdassetmanagement.com/Fund-Document/pdf/Fund-Facts/TD-Mutual-Funds/TDB970E.pdf The actual trailing commission (in effect the advertised cost of "advice") is a material fact that must be revealed in absolute terms not a range .It should tie in with the MER value in Fund Facts. A wide range of values is in fact not a disclosure at all. It is all well and fine to provide a consolidated number in dollars and cents via CRM2 once a year cost disclosure but the real need of the trailer commission disclosure is at the time of the investment decision. **We recommend Fund Facts reveal the actual trailer commission rate associated to the disclosed MER.**

We wish to point out that the CSA Fund Facts (FF) document does not contain a strong cautionary warning re conflict-of-interest as is the case in the equivalent SEC Summary Prospectus document.

Disclosure has noticeable drawbacks according to a recent study titled, "Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective[1]" (European Commission, 2010
http://ec.europa.eu/consumers/archive/strategy/docs/final_report_en.pdf
suggested that: "Our experimental results **raise doubts that disclosure can always be relied upon to help consumers understand that the advice that they are receiving may not necessarily reflect a choice that is solely in their own best interests..**

First, we find that the impact of disclosing conflicts-of-interest is context-dependent. **Online subjects hardly responded at all to disclosure of advisor remuneration**....Only those subjects who took more time over their decisions reacted appropriately **and even then only when the disclosure was flagged in a bold red font,** for the simplest of decisions.
In contrast, laboratory subjects, with more time and fewer distractions, exhibited a strong reaction to the disclosure of biased incentives, showing evident mistrust of advice. **Second, we find that full and transparent disclosure and/or a health warning may be necessary for people to properly understand the implications of the information being disclosed to them**. Online subjects, who were only told that their advisor was paid a commission, did not react to this disclosure unless it was accompanied by a health warning. **Laboratory subjects who were told the exact details of their advisor's remuneration structure responded to disclosure without such a warning**. Thus, the effectiveness of conflict-of-interest disclosure as a policy lever crucially depends on the precise form and content of that disclosure. **People do not appear to naturally recognise conflicts- of- interest and respond appropriately unless the implications are clearly spelled out to them in some fashion.**
Third, we find that disclosing conflicts-of- interest sometimes simply elicits a kneejerk reaction that can be harmful as well as helpful. Subjects in the laboratory exhibited contrarian behaviour in their investment choices when biased incentives were disclosed, investing significantly less in the recommended alternative."

Accordingly, we suggest something like the SEC disclosure: *"Payments to Broker-Dealers and Other Financial Intermediaries:* ***If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information. Also see Distribution and Shareholder Servicing Plans in the prospectus and Distribution Agreement, Distribution Plan and Shareholder Servicing Plan and Additional Marketing and Support Payments in the Statement of Additional Information."***
We are well aware of the limitations of disclosure but feel a more powerful conflict-of-interest disclosure may have value. **Kenmar recommend the FF warning be significantly tightened up whether or not trailers are prohibited.**

Are Canadians receiving unbiased advice? It is interesting to note that at the end of 2015, just 1.5% of total mutual fund assets (excluding ETFs) were held in passively-managed lower cost funds. Despite all the available performance data and other virtues of indexing, the Index fund market share (advised accounts) has remained essentially unchanged over the last 10 years. However, among Discount/DIY fund series (non-advised), index funds made up a much larger share of assets (16% or $2 billion) that has been growing steadily over time. Why is this?

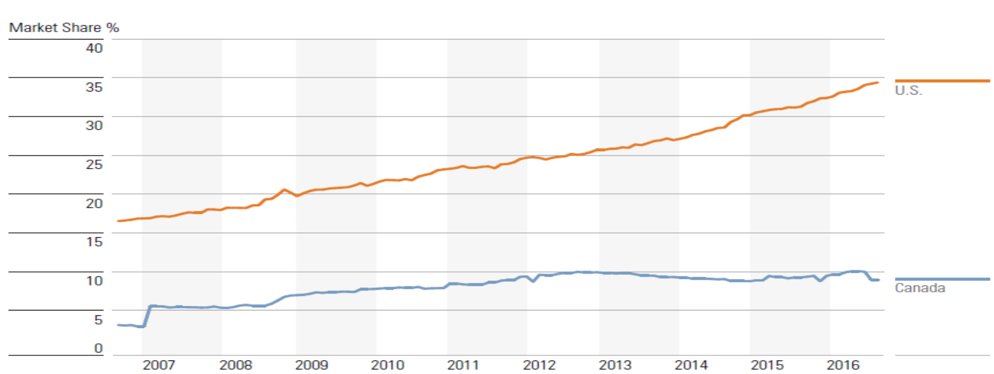
In **Why hasn't indexing taken root in Canada?** Morningstar Canada's Christopher Davis provides an aswer "...It's the incentives, stupid The same fund companies that have little incentive to offer index funds have given advisors little reason to use them. Paying advisors far larger commissions to sell clients active funds tilts the field against index funds. The commissions, which are built into the management-expense ratio (MER) and are commonly known as trailer fees, generally add another percentage point to the management fees paid to active stock funds but add half that amount (or less) to the price tag of index funds. (Commission-based series from ETF providers like iShares, PowerShares and Purpose Investments, which have 1% trailer fees, are an exception.) The commission-based business model is on the decline, but historically fund companies have paid advisors to sell costlier funds, and they've gotten their wish...." http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=781441

After the United Kingdom banned trailing commissions in 2012, the trickle into passive funds turned into a flood. As Morningstar equity analyst Michael Wong noted in October 2015, passively managed UK assets increased approximately 140% from 2011 to June 2015, and market share significantly increased from about 7.4% to over 12%.

Why are low cost ETF's so small a fraction of Canadian portfolios? The main reason is that, with a few minor exceptions, they don't pay trailers. Another reason is that MFDA dealers aren't set up to sell them. That takes about 83,000 salespersons out of the picture. Quite amazingly, more than 25 years after the world's first listed ETF launched in Toronto, a better part of the country's dealer Reps still can't touch them. https://ca.finance.yahoo.com/news/why-hasnt-indexing-taken-root-100000240.html

The embedded commission and regulatory structures are key reasons passive investing isn't making traction in Canada. See this chart for the material difference in adoption rates:

Exhibit 1 Passive Market Share, Canada vs. United States



Source: Morningstar, Inc. Data as of 9/30/2016.

http://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_inputhttp://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_input See also
Active vs. Passive Investing in US and Canada Markets | Equities.com
Mystifying statistics –it appears Canadian advisors really love active management and/ or trailer commissions. https://www.equities.com/news/active-vs-passive-investing-in-us-and-canada-markets
2. *Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.*

Given that most academic studies have found that the best predictor of a fund's return is its expense ratio, (i.e. funds with higher fees tend to underperform their competitors), and given the relatively low interest rate /return environment that is likely to persist, we fail to see how the advisors and dealers can claim to be acting in the client's best interests when profiting from third party payments which create compensation incentives to place consumers in high cost funds /funds-of-funds loaded with high cost proprietary actively-managed mutual funds. FofF funds take much of the load off the advisor so residual benefits of advice, if any, are primarily intangible. According to the consultation (pg 125), for the six years ending December 2015, funds-of-funds net sales totaled $191 billion versus $32 billion for traditional stand-alone funds. They have become the dominant product in the Canadian fund industry.

In some cases, the drive for trailer-commission sales leads to NAAF adulteration, signature forgery or asking clients to sign blank forms. The "signature falsification" (aka forgery) issue has become so bad that the MFDA were compelled to issue a Bulletin http://mfda.ca/notice/msn-0066/
to dealers on the subject. And this is the sales culture which is entrusted with advising on the retirement savings of millions of Canadians.

We provide anecdotal evidence from our friends in the industry concerning business practices that are currently in use or just recently implemented that can harm investors. These are not directly related to trailers and would survive even if trailers were banned. We have not been able to verify but we expect the CSA will want to follow through.

Ba**nk A**

- A branch received a transfer-in of an account that held a Bank B fund, which was one of the best performing funds in the account. The branch manager told the investment and retirement planner (IRP) to write a one page essay for the file on why he or she should keep the Bank B fund in the account. The Rep stated that he did not have the time and ended up selling the Bank B fund for one of Bank A's funds.

- On the dealer side, branch managers encourage their representatives to sell Bank A's funds. This is because the branch manager may get compensated higher if the representative sells proprietary products.

Bank B

- Branch managers promote the use of internal separately managed account (SMA) and unified managed account (UMA) platforms. Advisors charge higher fees and receive higher compensation for selling funds through these platforms as opposed to selling ISC funds.
- Bank B is now paying advisors less (as a percentage) of their mutual fund trailers than they are for their internal products and/or fee- based business. Bank B is considering both its internal platform fee based solutions, but the reality is Bank B is fund-of-funds (and fund of SMAs).
- The SMA platform has highly restricted fund offerings with an outsized number of solutions from the bank's own high fee products.
- Clients are often sold the SMA program with the discussion about the tax deductibility of fees. This is only smoke and mirrors as mutual funds deduct from the gross return as opposed to allowing clients to deduct their taxes on their own.

Bank C

- Bank C's investment advice channel's bonus structure is based on the percentage of Bank C's proprietary products held.
- Trailers are higher on the sales of the bank's managed mutual funds vs. its single fund solutions.

- If a client comes in to a branch with between $100K and $500K, the client will be referred to an FP, who can sell any mutual fund. However, Rep's are encouraged to sell the bank's own funds (80/20 rule). Once the Rep hits a certain amount of revenue, the FP will qualify for a trail (usually between 25 and 35 bps). Reps are encouraged to maintain an average trail of 95 bps, which is one reason why they are more apt to sell a managed fund than a single fund solution.
- If a Rep wants to sell a third party fund, the FP will need to justify to management the reason for doing so.

Bank D

- One wholesaler said that the bank is encouraging its Rep's to use its personal portfolio services program. Rep's get compensated by salary, bonus and other incentives (i.e. achievers' trips).

Bank E

- On the dealer side, advisors make more money from selling its multi-manager fund-of-funds. Performance is mediocre. Lower MER, but higher trailer.
- A branch Rep received a higher bonus because he was able to cross-sell a car loan and a premium credit card.

Dealer A

- Strong incentives in place for advisors to sell proprietary funds.

- If a client has a minimum amount invested in proprietary funds, the dealer will waive the annual account fee ($175). The account fee waiver also applies to TFSA and non-registered accounts.
- A Rep was offered a premium price for his customer book upon his retirement dependent on the amount and percentage of proprietary funds.

Dealer B

- Points program in place with a fund company and a number of other fund companies. For FundCo B's funds, advisors receive 4 points for every $10K invested. Points can be converted to FundCo B's shares or other incentives like trips, conference credits, travel and accommodation to Dealer C's conferences.
- Reps have a quota to sell FundCo B's funds. Once the quota is hit, advisors can sell third party funds.
- Advisors are incented to use managed solutions that are on their recommended list

Dealer C

- Advisors can qualify to buy into shares of FundCo C if a certain amount is invested in FundCo C's funds annually. Advisors can also win cruises.
- Advisors receive additional support through their total client experience. Total client experience includes practice management specialists and marketing tools (preferential treatment to guide their business).

Dealer D

- Advisors are incented to sell dealer funds. Advisors get a $5K bonus if they have $7M to $8M invested in its own funds.

3. *Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.*

Trailers do provide access to conflicted "advice" , such as it is, for small accounts because they leverage cross-subsidization .The nature of the "advice" however is such that investors are sold actively- managed mutual funds that in most cases fail to match the performance of a portfolio of passive index funds AND are NOT sold lower cost products. As a result of conflicted advice, the retail investor return is significantly impaired over the long term.

In a very real sense, advice <u>not provided</u> is also harmful, yet investors are led to believe that representatives using a variety of misleading titles are acting in their best interests. One example we see far too often occurs when a Rep does not recommend that a client exploit the 50-100% contribution match provided by employee's company RSP plans. Another prime example occurs when we see chronic high balances of 18%+ credit card balances even as the Rep promotes increased monthly mutual fund purchases. This is what is passing for advice.

The conclusions of a 2015 Research paper **Is conflicted advice better than no advice?** can be summarized as follows:

ABSTRACT The answer depends on how broker clients would have invested in the absence of broker recommendations. To identify counterfactual retirement portfolios, we exploit time-series variation in access to brokers by new plan participants. When brokers are available, they are chosen by new participants who value recommendations on asset allocation and fund selection because they are less financially experienced. When brokers are no longer available, demand for Target-date funds (TDFs) increases differentially among participants with the highest predicted demand for brokers. Broker client portfolios earn significantly lower risk-adjusted returns and Sharpe ratios than matched portfolios based on TDFs—due in part to broker fees that average 0.90% per year—but offer similar levels of risk. More generally, the portfolios of participants with high predicted demand for brokers who lack access to brokers compares favorably to the portfolios of similar participants who had access to brokers when they joined. Exploiting across-fund variation in the level of broker fees, we find that broker clients allocate more dollars to higher fee funds. This finding increases our confidence that actual broker client portfolios reflect broker recommendations, and it highlights an agency conflict that can be eliminated when TDFs replace brokers.

Notwithstanding the conflicts, some dealing reps do assist clients with good general advice on saving, using TFSA accounts and diversification. We're not so sure about income tax advice, an unlicensed service. As regards tax advice for example, RRSPs are a terrible investment for low-modest income Canadians nearing retirement because most of the proceeds will be lost to taxes and clawbacks, according to a study by the C.D. Howe Institute. Study author Richard Shillington calls the situation "perverse" and urges financial advisors to stop spreading the myth that RRSPs are good for everyone. Many small retail investors are urged to set up an RRSP (using actively- managed mutual funds), without any differentiation or consideration of income tested benefits they might lose in retirement. See **New Poverty Traps: Means-Testing and Modest-Income Seniors** https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/backgrounder_65.pdf . A Best interests standard coupled with increased dealing Rep proficiency would alleviate such bad advice /mis-selling.

We witness, with some notable exceptions, relatively little in professional personalized investment advice. Guidance is provided: "Buy-and-Hold: "Dollar cost averaging is the Best way to reduce risk", and the like but that guidance is only provided if an actively-managed mutual fund, often a proprietary one, is purchased and held. Some guidance is however clearly self-serving -"Invest in your RRSP", "Borrow to Invest" and "Active management is superior to indexing". Tied advice has a number of significant disadvantages for clients as we have articulated in this Comment letter. Cutting credit card debt or paying down the mortgage is rarely seen, at least in our interactions with unsophisticated retail fund investors over the past 15 years. Having client's pay directly for advice would at least in principle (a) provide clients with less biased advice and (b), prompt engaged investors to assess the services provided and results obtained vs the costs incurred. This is because a direct pay system makes the cost of advice more impactful compared to the disclosure of trailers in Fund Facts.

The alleged benefits of conflicted advice are intangible and in our opinion, supported by research, more than offset by the use of high cost products, unsuitable investments, early redemption penalties and the risks associated with undue leveraging. (in addition, the sales driven culture and slack enforcement motivates some dealing Reps to sell risky Off book products, engage in personal financial dealings and even effect outright fraud).

We have not been able to find convincing independent research to demonstrate that "advisors" actually contain bad investor behaviours as often cited by industry participants. In fact, a number of independent research papers suggest the opposite effect:

In their study, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," Daniel Bergstresser (Harvard Business School), John Chalmers (University of Oregon), and Peter Tufano (Harvard Business School) analyze a database of U.S. mutual funds from 1996 to 2004. Their objective was to compare the performance of investors who bought funds through broker-dealers to investors who purchased funds directly. They found that investors with broker-sold mutual funds experienced “lower risk-adjusted returns, even before subtracting distribution costs.” They also found that investors purchasing broker-sold funds were directed into funds with “substantially higher fees” and failed to show superior asset allocation. And as for helping investors avoid behavioral biases, “regrettably, the advisers generally demonstrated all the same biases that the rest of us have.”

According to Do financial advisors improve portfolio performance?, a study of German investors at Vox by university professors Andreas Hackethal, Michalis Haliassos and Tullio Jappelli. says they don't. The reason is the old bugaboo - costs and fees.Advisors add value but ... "*Even if advisors add value to the account, they collect more in fees and commissions than they contribute.*" Apparently the authors found that richer, older people tend to use advisors more which accounts for a preliminary gross conclusion that "*Investors who delegate portfolio management to a financial advisor achieve on average greater returns, lower risk, lower probabilities of losses and of substantial losses, and greater diversification through investments in mutual funds.*" They note that the financial industry would love to grab that statement for publicity. However, the net truth is completely opposite: "*Once we control for different characteristics of investors using financial advisors, we discover that advisors actually tend to lower returns, raise portfolio risk, increase the probabilities of losses, and increase trading frequency and portfolio turnover relative to what account owners of given characteristics tend to achieve on their own.*"

The estimated 6-7 year average hold period for mutual funds in Canada is an indicator of sorts that investor behaviour is not being contained by "advisors, one of the asserted benefits of “advice”. We have seen accounts churned, funds exchanged upon maturation of the DSC hold period, fund portfolios dramatically altered when a new advisor takes over an account etc. The bottom line is that retail investor accounts are not really behaving as long term investments. To be fair, these malpractices are due as much to regulatory failure as the presence of trailer commissions.

4. *For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:*
- mutual fund
- *non-redeemable investment fund*
- *structured note*

should the product be subject to the discontinuation of embedded commissions? If not:
a. What would be the policy rationale for excluding it?
b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?
Regulatory arbitrage is a material threat to the success of banning embedded commissions. Segregated funds in particular can be sold to unsuspecting investors by dual licensed "advisors" They can be portrayed as mutual funds to a novice investor. The problem is that fees are higher, disclosure is weaker, conduct rules are looser, enforcement is lighter and sanctions are lower.

Another important form of regulatory arbitrage occurs now when a complaint involves an investment portfolio containing a Segregated fund. The current system requires the complainant to file two complaints: one to OBSI and the other to OLHI for the Seg portion. This is abusive and likely will lead to a faulty conclusion. The CSA has to act on Recommendation 6 of the Independent Assessor: *That the OBSI and Ombudsman for Life & Health Insurance chief executives develop a joint approach to identifying and quantifying losses associated with segregated funds.* Source: https://www.obsi.ca/en/download/fm/539/filename/2016-Independent-Evaluation-Investment-Mandate-1465218315-e9fa5.pdf
Securities regulators need to take an aggressive pro-active stance to prevent regulatory failure.
5. *Are there specific types of mutual funds, non -redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?*

We are not aware of any. Some PPN’s issued by banks may have embedded commissions but they are not considered securities and do not assert they have any advice component. In any event, such products are protected via regulatory arbitrage since they are outside the mandate of the CSA

6. *Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?*

We do not know .Perhaps it is time for a Segregated fund to be classified as a security under the Securities Act.

7. *Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?*

We agree because it will not be possible to do away with commissions in Canada unless you can break the very strong link between product distribution and the investor, and "advisors" have fiduciary type responsibilities towards their clients. You pay for a service, and you pay for advice, and until you are actually paying for accountable and regulated advice and not the transaction, moving to a fee-only industry cannot happen effectively

We agree because we feel that it removes one significant, but far from exclusive, source of conflicts-of-interest. But, unless all conflicts –of-interest are removed, mis-selling will continue unabated. With trailers removed, at least Fund Facts disclosure will be greatly simplified allowing the document more real estate to better articulate investment strategy and properly disclose fund risks.

8. *Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; b. referral fees; and c. underwriting commissions.*
Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

First off, all the compensation conflicts identified in the Dec. 15th, 2016 CSA/IIROC/MFDA announcements must be eliminated as they are designed to thwart the basic law that dealers must deal fairly, honestly and in good faith with clients. The CSA announcement identified a whopping 18 advice- skewing compensation schemes.

We believe NI81-105 needs a complete update and should be expanded to at least cover all the securities mentioned in this consultation. It is not clear to us why its provisions are not applied to all sales recommendations regardless of product.

Kenmar are of the view that if dealers want to be considered as trusted wealth managers, they should not participate in co-operative marketing programs with suppliers. We see no rationale for fund assets to be used for sales pitches by suppliers. Any "educational" seminars should be presented solely as a wealth manager.

We have a strong view on referral fees. Referral arrangements create an environment where dealer representatives are incented to sell products /loans/services to clients whether they need them or not. *As the CSA paper observes "In the case of related party* *referral arrangements, it may encourage representatives to send their clients to another arm of their firm, even when third party product and/or service options may be more suitable. It may also encourage representatives to shift clients to more profitable business lines within the firm with little or no benefit to the client."* By not addressing referral fees , it just seems to us that regulators have provided dealers with a back-door way to achieve what they have been achieving through the front door. The CSA state "We acknowledge that the above types of payments may give rise to conflicts of interest that may continue to incent registrant behavior that does not favour investor interests". So why in the world would referral fees be allowed to continue? A quick look at the BNS referral disclosure document http://www.scotiabank.com/ca/common/pdf/scotiamcleod/Referral-Disclosures-82014612_eng_0211.pdf presents so many bear traps for the unsuspecting retail investor it is hard to imagine he/she would escape unscathed. People are looking for trusted investment advice on their life savings and it is the duty of regulators to provide them a safe environment for doing so.

If there is one referral fee that should be banned it would be the referral that supports leveraging. It is our understanding that one bank, noted for leveraged lending, counts 27,000 advisors among its clientele. According to the consultation paper, dealers may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction- this encourages undue and risky leveraging recommendations.

This bank offers a 3 for 1 investment loan (!) and loans for RRSP's. Visit https://b2bbank.com/sn_uploads/forms/0817-07-203E_B2B_BANK_Investment_Loan_Application.pdf for details. It is hard to see how such loans could ever be in the retail investors' Best interests. Allowing referral fees for such loans just perpetuates the bad culture that permeates Bay Street. **We therefore recommend (a) that referral fees for investment loans be prohibited and (b) account fees in fee-based accounts should be based on net assets as has been implemented by Australian regulators.**

As for underwriting commissions for closed-end funds, it seems to us that such commissions are clearly for distribution and as such reasonable investor protection can be achieved via quality disclosure and suitability criteria. A problem can arise when an IPO is sold within a fee-based account – we leave it to regulators to decide on such cases. In a closed-end fund, the underwriting is pretty basic yet it still seems to attract a similar fee as for a corporate issuer IPO. That just doesn't make sense. Yet, under the prevailing suitability standard such a transaction would be perfectly acceptable. Under a Best interests standard, we doubt such transactions would pass muster.

Investors today are having a difficult time using and employing the CSA aretheyregistered web site. SIPA have documented the many issues in their report http://www.sipa.ca/library/SIPAsubmissions/500_SIPA_REPORT_REGISTRATION-Above-

the-Law_201611.pdf Should embedded commissions be banned, we would expect an exponential increase in use of the site. In any event, **it is imperative that the CSA repair work begin now**. These points are especially important:
:

- The CSA should ensure that Reg check makes it crystal clear when a person is dually registered.
- Reg check should also be kept up to date in near real time*.
- The CSA should issue an investor ALERT regarding dual registration including potential risks.
- Dealers should be required to inform clients in writing if a registrant is dually registered.
- Regulators should examine all rules to see if provisions are adequate to enforce cases where investment assets are redeemed to purchase Seg funds (or life insurance/ annuities).
- Regulators should have a clear privacy policy that the KYC information can only be used to effect actions regarding securities unless client consent has been obtained to use the information for another purpose.
- Finally, regulators might tighten the criteria for approval of a dual-occupation registrant that would include provisions that mitigate regulatory arbitrage.

* There are major holes in the database's records. As of May 26, 2016, the NRD is missing penalty information for at least 51 people disciplined by IIROC and the MFDA between January 1, 2013 and December 31, 2015—including permanent bans. That's 18% of all reps who faced discipline during that period. http://www.advisor.ca/news/industry-news/hidden-in-plain-sight-how-banned-iiroc-and-mfda-advisors-can-still-sell-insurance-207496

9. *If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?*

We believe such payments and benefits can only lead to trouble and should be prohibited. There should never be financial/non-financial direct relationship of a supplier with staff of an advisory firm. We are told by trusted industry participants that before the Sentry case there had never been any enforcement of this Instrument since its release in 1998. [As we read the April 5, 2017 Sentry Securities Inc. Settlement Agreement http://www.osc.gov.on.ca/en/Proceedings_enr_20170405_sentry.htm our eyes glaze over. The "conference", which was held in September 2015, included a party for advisors at a mansion in Beverly Hills that cost the firm more than US$1,000 per guest; gifts of Dom Perignon champagne and jewelry from Tiffany & Co., along with golf outings, a wine tasting and movie studio tour provided at the firm's expense. In total, the conference cost Sentry $2 million. The OSC settlement agreement also indicates that Sentry spent excessively on gifts for reps, exceeding $4,000 a year for some reps, on items such as tickets to concerts, hockey, baseball and basketball games, along with other gifts. Furthermore, the OSC alleged that Driscoll provided a rep with tickets to the Montreal Grand Prix in 2015 and 2016, which also violated the rules.]

In OSC STAFF NOTICE 33-743 GUIDANCE ON SALES PRACTICES, EXPENSE ALLOCATION AND OTHER RELEVANT AREAS DEVELOPED FROM THE RESULTS OF THE TARGETED REVIEW OF LARGE INVESTMENT FUND MANAGERS http://www.westlawecarswell.com/oscb/on3725/on3725-1.htm the OSC looked closely at certain aspects of sales practices including cooperative marketing practices, mutual fund sales conferences and fund manager participation in the sponsoring of dealer events. What investment fund managers can and cannot do is spelled out in *National Instrument 81-105 Mutual Fund Sales Practices*, which has been around since 1998. Its purpose was to discourage sales practices and compensation arrangements that raised the question as to whether the clients' interests rather than those of the sellers were being addressed. Fund managers can pay a portion of the costs of an investor conference or seminar that a dealer puts on for investors. However, the Staff Notice says there was a 25% incidence rate where "cooperative marketing practices did not meet the primary purpose of promoting or providing educational information concerning a mutual fund, a mutual fund family or mutual funds generally in order to be eligible for support. "Staff also had concerns regarding mutual fund sponsored conferences. Fund managers are prohibited from paying travel and accommodations expenses of sales representatives, yet there was a 50% incidence rate of this occurring. Similarly, non-monetary benefits such as meals and entertainment were deemed excessive.

The CSA is well aware that so-called "Free lunch" educational seminars co-sponsored by fundcos are thinly disguised sales pitches. These seminars may be invitation-only or they may be advertised in local papers or on the internet." Free lunch "seminars are often held at hotels or restaurants and may offer enticements such as free meals, books, or trips for attendees. In effect, they are perceived as "recommendations" by clients. Such Co-operative marketing ventures have been shown to have little real value for investors and in fact have led to several problems. Dealers ("wealth managers") should not receive payments from product suppliers especially using fund assets. See **Free Lunch Seminar Report**: AARP 2009
http://www.aarp.org/work/retirement-planning/info-11-2009/freelunch.html

We expect that if the OSC had performed a compliance sweep on NI81-105 compensation practice provisions, the results would have been jaw-dropping.

10. *With respect to internal transfer payments:*
a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?
Regulation and enforcement of these payments via the 1998 version of NI81-105 would appear to be ineffective based on observed results.

Per a 2013 Invesco Comment letter "*We understand that some dealers construct "recommended lists" of mutual fund investments for their clients and sales of recommended list funds generate a higher grid payout than funds not on the list and that*

some third party funds do appear on recommended lists. However, we suspect that all proprietary funds are also on the list and this enables the dealer to legally evade subsection 4.1(1) of NI81-105. It appears that the CSA has condoned this practice since it makes the assertion regarding grid payments without commenting on the legality or ethics of the practice. To put it mildly, we are disappointed with the CSA in that regard. We also note that lack of enforcement on that point sends the message to all capital markets participants that, under Ontario securities law and the securities laws of other provinces, it is acceptable to do indirectly what you cannot do directly…"
http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130412_81-407_adelsone.pdf

We recommend that dealing representatives from integrated firms exclusively selling proprietary products be given a descriptive label (e.g. "salesperson") that distinguishes them from true independent advisors/wealth managers so that investors know the limitations and constraints of the "advice" provided.

A major finding of the Cumming report was that "Funds that sell more through affiliated dealers tend to perform worse…funds which receive higher levels of affiliated dealer flows experience lower future alpha on average." (page 9). i.e. the research indicates that mutual fund sales through affiliated dealers appear to have weaker connections to past performance, which is associated with weaker future returns.

This suggests that conflicts-of-interest are at play, which lowers incentives to generate flow via improvement in performance (page 63). This appears to demonstrate that when dealer representatives can only sell proprietary products or are incented to sell the product of the manufacturer that the advisor's dealer is affiliated with, the retail investor is worse off. This is not surprising because the Rep, say at a bank-owned dealer (branch), is restricted in the products that he or she can recommend.
b. *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*

We do not have clear visibility on the nature of these transfers but we can say that they effectively transform advice-skewing trailers to dealers into respectable salary plus bonus payments to dealing Reps. Such payouts may not be related to specific transactions but they must surely in aggregate be closely related to the dollar value of the transactions effected by the Rep. They certainly drive the rules, policies and motivations of the affiliated dealer. The CSA should be constructively critical of these internal transfers and the basis upon which they are made. If internal transfer are allowed, then it seems to us that the incentives continue but in a different, more sophisticated form.

c. *Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?*
We do not have sufficient information on which to comment.
11. *If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.*

Continuing to allow payments between affiliated dealers and manufacturers is controversial and shows that regulators need to probe much deeper into these arrangements. Such a system defeats the whole purpose of separating advice from transactions (using fund assets to finance distribution), thereby not empowering the retail investor.

We should mention an Invesco approach to deal with this issue We have been informed that a few years ago they introduced something called Flexible F or an Investment Advisory Fee (IAF). In these arrangements, the dealer and client "negotiate" a fee (to the same extent as for a fee-based account) and sign an agreement with them and Invesco collect the IAF from the investor on behalf of the dealer. So the investor knows they are paying because (a) they agreed to it in a contract, (b) the contract is very simple and short (c) it shows up on their monthly or quarterly statement, as the case may be. Invesco have no participation in the amount of the fee. On the upside, however, Invesco will not honour the IAF – and they say so in the prospectus and otherwise – if the fee exceeds 1.5%. It appears that a client would have to sign an IAF for each fund family of interest which may place a paper burden on clients and dealers. The CSA may wish to examine this approach and assess the issues associated with it.

12. *Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?*
They would address the primary issues <u>but only if the proposed CSA targeted reforms/BI are implemented and meaningful and timely regulatory enforcement is applied</u>.
13. *Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?*
We are unable to provide a better alternative.
14. *Are there other conflicts-of-interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?*
It's not that other conflicts-of-interest will emerge, they exist in plain sight today. The report from the Canadian Securities Administrators (CSA), the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) examined the various compensation arrangements in the retail investment business and the conflicts they can create, including a bias for proprietary

products and incentives to sell products that may violate suitability standards. The long list of advice- skewing incentives and inducements was in our view, quite shocking. Even more shocking was the matter of fact lack of reaction and concern by regulators. These arrangements go well beyond the embedded commission issue and cry out for firm, prompt and decisive regulatory action, not more monitoring. One has to question why there has been so little enforcement.

A glance at the IG Simplified Prospects, pages 31 and 32 shows a large number of non-trailer influencers that could skew the advice provided https://www.investorsgroup.com/en/documents/corp/regulatory/prospectus-guides/c2994.pdf . viz "We may also pay prize awards and performance bonuses to your Investors Group Consultant, or provide credits that may be paid in cash or used towards a variety of business, benefit and education-related expenses, based on the dollar amount of the various products and investments distributed or serviced by the Investors Group Consultant during the year, as well as bonuses for career achievements such as obtaining an educational designation, or licence or for program completion. Some prizes and bonuses paid for Investors Group Funds may be higher than those paid for other products. Also, your Investors Group Consultant may own, directly or indirectly, shares of IGM Financial Inc."

A 2016 IIROC report commented on dealer control over compensation related conflicts It stated: "...However, when it came to compensation-related conflicts, most firms sampled lacked a meaningful process to identify, deal with, monitor and supervise compensation-related conflicts. For example, most firms did not have mechanisms in place to identify advisors who recommend products that yield higher fees and bonuses, when there are other suitable but less expensive alternatives available. They also did not have a process in place for implementing additional monitoring of advisors approaching compensation thresholds based on the amount of revenue generated. Furthermore, we found that there was confusion among some firms regarding the best interest standard as set out in our conflicts of interest rule and guidance. Although most Dealer Members responded that they always put clients' best interests first, we found little supporting documentation as far as compensation-related conflicts were concerned. .."
http://www.iiroc.ca/Documents/2016/F58C9465-AFC5-42F3-A5D1-6C5BFDF19CF3_en.pdf Without a defined process for managing advisor compensation-related conflicts actions and inactions, we fail to see how robust advice can be provided. The best solution is to avoid such conflicts to the greatest extent practicable.

The Brondesbury Group Report, "Mutual Fund Fees Research", Spring 2015, https://www.securitiesadministrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_e_ngwr.pdf was quite clear in one respect: the literature shows trailers generate conflicts but there is insufficient research on conflicts in fee-based accounts, so we really don't know what the conflicts are. Brondesbury had cautioned against shifting to that model without studying the conflicts. To our knowledge no one has done so. We have repeatedly identified two conflicts: higher fees for advice; reverse churning.

According to the Brondesbury report "All forms of compensation affect advice and outcomes". But not all forms of compensation are equal. For instance, advice delivered under a suitability standard and paid for by trailers is likely to have a worse investor outcome than advice delivered under a direct-pay Best interest standard. Advice from a bank branch dealer collecting trailers would on average be expected to be worse than advice coming from a dealer with a suite of competitive non-proprietary products. Advice provided by a direct pay compensation method is more likely than not to lead to better long-term client outcomes because the client will have a better capability to measure results vs. advisory fees and take timely remedial actions.

15. *What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:*

• *Will investors receive advice and financial services that are more aligned with the fees they pay?*

In theory they might if a documented fee and service schedule is provided and clients are alert. Informed clients could then assess whether the services provided are worth the money. They could at least in principle, comparison shop but we do not expect small retail clients to have much leverage in negotiating fees. NOTE: Since a multitude of other conflicts-of-interest will be omnipresent, we remain constructively critical that many unsophisticated retail investors will be able to assess the quality and integrity of the advice provided.

Kenmar is of the view that advisors also have a potential conflict-of-interest due to the possibility of higher trailing commissions from increased sales of a particular category of fund. For example, since trailing commissions on equity mutual funds are typically higher than those on fixed income or money market funds, advisors may have an incentive to favour such equity mutual funds in portfolio allocations. The resulting unbalanced portfolio would not correlate well with the client risk profile, itself based on a flawed process in the majority of cases. The removal of trailers should have a positive impact on investor experience and outcomes with the provisos surrounding fee-based accounts.

• *What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?*

We believe automated investment advice will see an increase in interest once the true cost of investment advice and the services actually provided become clear to investors. This could be beneficial for small investors because of lower costs and avoidance of abusive dealer/advisor sales practices.

• *Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?*

Reversion to discretionary is potentially a real issue. What happens is IIROC-licensed reps end up providing discretionary advice, like a PM would. The wording of the proficiency standard is similar but not quite and leaves the potential for abuse. Discretionary could be positive, but it could also be a negative outcome, depending on fees (and clarity on fiduciary duty). There is also the issue of competency. A PM for a fundco spends almost all of his/her time monitoring the portfolio and researching investments. The discretionary advisor at a dealer does not. They don't have the infrastructure really to do those activities -they tend to rely on dealer research, and have no real investment style. We have a hard time believing clients are better off using discretionary. One should contrast that with Private Investment Counsel shops who do the same things as fundco PMs and who are very open and upfront with potential clients about the investment approach, expectations and fees. The problem is cost – they won't take on accounts under $1 million typically.

• *What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*
From early feedback, we believe that a not insignificant number of people will explore the use of discount brokers as a result of CRM2 sticker shock and unrelenting media reports of advisor wrongdoing. Some will come as orphans as IIROC dealers trim their client base to focus on larger accounts. We believe banning trailers will cause the smaller account clients to consider going DIY with all or at least a portion of their investments. This could be beneficial for investors as long as IIROC does not curtail the many innovative features, guidance and tools these firms have created. A concern: With trailers banned, at what price will discount brokers sell mutual funds?

We are encouraged to see the OSC announcement of its LaunchPad program to help new tech firms develop their business models in a compliant fashion. It appears that the OSC will try to be flexible on regulations, allowing time-limited registrations or exemptions for companies to test new models. Kenmar support this initiative to support the development of online advice, robos and discount brokers. This can only benefit investors.
• *What effect will the proposal have on the cost and scope of advice provided to specific investor segments?*
This is very difficult for us to project.

We suspect a number of questionable products may be dropped. For example, BMO, the country's second-largest ETF provider, wraps its moderately priced ETFs in high-priced mutual funds before selling them at bank branches. Removal of the trailer may assist in reducing the number of such products from the market BUT they might end up in a 1.5 % SMA or fee-based account unless a Best interests standard also comes into force. This is why we keep saying that banning trailers on a stand a-lone basis will not be effective and could have adverse consequences.

It is not unreasonable to expect removal of embedded commissions will spur innovation, cost reduction, more use of automated advice and mobile platforms, especially for millennials. We fully expect Canadian industry creativity to be as creative as those in other jurisdictions. If the uptake of robos in the U.S. is any indication, it should prosper here given our higher mutual fund costs.

Advice Fees may rise but we do not see a corresponding change in the scope of advice provided for small investors. It is anticipated that any increase in fees will be more than offset by use of lower cost products but this should not be taken for granted. That is why we continue to demand a statutory BI standard be implemented.

At first there will be some consternation of the change especially since investors have been told "advice" is free. It will take some time for the system to settle down, perhaps as long as 6 -9 months or even longer. The CSA will have a role is providing investor education. Some fraction of small investors may decide they don't want or need investment advice at the prices on offer. We continue to make the point that investors with say $25,000 or less to invest may not need much in the way of investment advice. For them paying down debt, cutting household expenses, investing with an indexing firm like Tangerine or a robo may be more than an adequate solution until their investable cash increases and/or their financial situation becomes more complex. We would also expect that the Money Coaches sector would be given a boost if trailers are banned.

A comprehensive CSA communications program will be needed to support the transition period.

While we are cool to financial literacy initiatives we are excited about financial capability. It is our opinion that Canadians need as much support or more for holistic financial planning than advice on investments. In this regard **we recommend that the CSA formally partner with the FCAC to develop easy to use plain language tools, calculators, checklists related to the most common financial issues that will assist Canadians with modest savings to take control of their own financial destiny.**

16. *What types of payment arrangements are likely to result if this proposal is adopted? In particular:*
• *Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?*
We don't know but the industry is creative. We expect they will find a solution for each segment and channel. A huge concern of course is that people, especially seniors, will be herded into fee-based or other types of accounts that are not suitable for their needs. It will be up to the regulators to ensure that creativity doesn't make the situation worse than it is now. We point out that front-end load payments are in use now and will continue to be permitted according to this consultation.
17. *Do you think this proposal will lead to an advice gap? In particular:*
•*Which segments of the market are likely to be affected?*
Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.

There has long been an "advice gap" in the industry, where full-service advice is much more likely to be available for large accounts and not small accounts. That reflects the economic reality that getting lots of good quality advice is expensive and not everyone can afford to pay for much of it. There is a gap between what advice investors are actually receiving vs. what they expect (professional unbiased advice). There is a gap between what advice clients are receiving and what they really need (a simple financial plan, low cost simple products). For many, there is a gap between what they are paying for advice and the level of effort applied to their situation.

According to the J.D. Power 2016 Canadian Full Service Investor Satisfaction Study, SM despite Canada's wealth management industry promoting a goals-based approach to advice, nearly half of full service Canadian investors say their advisors fail to deliver on even the first stage of that process, which helps them set goals that reflect their risk tolerance. The study identifies three broad stages of goals-based investing: setting personal goals; implementing a strategy to achieve those goals; and monitoring progress. Only slightly more than half (54%) of investors indicate their advisor helped set goals and discussed risk. **Barely one-third (34%) say their advisor effectively delivered on all three stages.** Additionally, despite all the attention on transparency around fees with CRM2, just 27% of investors say they "completely" understand their fees, down from 30% in 2012 http://canada.jdpower.com/press-releases/jd-power-2016-canadian-full-service-investor-satisfaction-study

Respected fund industry observer Dan Hallett states in **Advice gap exists now** http://www.investmentexecutive.com/-/advice-gap-exists-now?redirect=%2Fsearch :"...Most advisors segment their client roster. This results in larger accounts getting a lot more attention than smaller ones, who are lucky to get one face-to-face meeting each year. (These assumptions are based on IE's surveys.) I know of advisors with 500 or more clients. Yet, practice and relationship-management experts suggest a maximum of 75 to 125 client relationships per advisor.As a result, clients with smaller accounts get little or no ongoing advice because the economic realities force advisors to focus on giving more service to larger accounts. So, there probably is an advice gap problem for smaller accounts already. They technically are "on the books" of an advisor. And even if we assume that they receive good advice up front, economics equate to little or no ongoing interactions and follow-up...." This situation matches our experiences. The "advice gap" is a theoretical construct developed by industry participants wanting to retain embedded commissions.

It's been suggested that in an environment without trailers, some small (say less than $50,000 in investable assets) investors may not get any service whatsoever. A case in point would be the investor who invests $50,000 (per IFIC the average MFDA account in 2014 was $44,000), in an equity mutual fund. The trailer on that would be 1% or $500, of which the salesperson might get half depending on his or her arrangement with the dealer. What kind of service is a client with a $50,000 account getting for $250? We've seen many situations where the level of service has ranged from a short meeting at RRSP season, abysmal to NIL. Recognize however we are talking very basic investment guidance like mutual fund selection, asset allocation and maybe some elementary tax suggestions. It is extremely rare to see a real financial plan in small accounts.

We expect that such small investors would be forced to utilize robos, bank branches (with proprietary mutual funds as the only choice), discount brokers (DIY) or financial priorities might shift to reducing household debt or paying down the mortgage. Clients with amounts to invest as low as $10,000 can access the markets via a direct-to-client firm like MFDA licensed dealer Steadyhand that offers its own proprietary high performance mutual funds, provides basic advice and does not pay trailers. The firm also offers fee reductions based on tenure and amount invested.

As account size grows investors can move up the advice depth ladder. They might also be seduced by a dual licensed Rep to purchase a Segregated fund and obtain the conflicted "advice" associated with that "insurance" product (Seg funds will continue to pay trailers , so "advice" of sorts will still be available to small investors after trailer prohibition in securities products).

There is an advice gap now because the advice provided is based on incorrect information. One has to question the "advice" being dispensed when the client risk profiling process rests on a foundation of Jell-O. The real advice gap is that core advice processes are not functioning. Assessing risk need, tolerance and capacity is fundamental before making investment recommendations ("advice"). Yet an independent research report by PlanPlus Current **practices for risk profiling in Canada** http://www.osc.gov.on.ca/documents/en/Investors/iap_20151112_risk-profiling-report.pdf found that while risk questionnaires are widely used in the mutual fund dealer channel, the vast majority (83.3%) of these questionnaires "are not fit for purpose." The report found that these surveys have too few questions, use poorly worded or confusing questions and involve arbitrary or poorly conceived scoring methodologies. More than half (55%) of risk questionnaires have no mechanism to identify highly risk-averse clients who should be invested solely in cash. The report identifies best practices in other jurisdictions and provides recommendations for regulators, the industry and the academic community. For example, it calls for a "clear regulatory framework that includes all aspects of risk in its definition." It recommends that regulators define the components of risk that they expect advisors to review with their clients in order to establish a client's risk profile.

- *Do you agree with our definition of an advice gap?*

If the "advice gap" is defined as the group of investors who cannot obtain the amount of [**investment**] advice they desire at the price they are willing to pay we would agree realizing however that in many cases a product-based proposition is masquerading as a trusted service- based proposition. The "advice gap" is no different than the "legal gap", or the "dental gap" in that there are individuals desiring specialized services who cannot afford them. That's life in a capitalistic society. Access to affordable investment advice, while desirable, is not a fundamental citizen right at this time.

The investment "advice" clients are receiving today from dealing representatives/ salespersons (self-identified as "advisors") is based on the low suitability standard in addition to being conflicted, thereby leading to non-optimum investor returns. Based on empirical data, a fair number of clients are receiving nothing more than a sales pitch with a recommendation to purchase, sell or borrow money to invest. As we see it, the kind of advice really needed for these small retail clients actually involves many actions that would result in using disposable cash to pay down high interest debt, secure adequate life and disability insurance, pay off the mortgage, budgeting better, spending less on frivolity, and setting up an emergency fund rather than investing in high fee products. Based on our experience, "Advisors" dependent on fundco trailers are unlikely to recommend such actions or take on such high maintenance /low margin accounts if trailers are banned (fee-only advisors would recommend actions beyond investing).

As far as tax advice goes, we do not see a big need for small accounts. Such accounts are pretty basic tax-wise. Besides , it is not clear to us that MFDA Approved persons have the qualifications necessary to provide accountable advice on tax matters .Today's widely-used interactive tax software provides more than adequate guidance on how to arrange tax affairs for small investors. Should a complex tax situation arise, we expect individuals would engage a professional accountant rather than an MFDA approved person.

Financial (other than investment advice) advice regarding debt counseling, income tax support, insurance and estate planning and will preparation would still be available from traditional sources at prevailing rates. For those requiring mortgage advice, mortgage brokers and bank branch staff can satisfy the needs. These important financial advice services will not be impacted by a ban on embedded commissions. So, where is the "advice gap"?

Notwithstanding our views and those of the CSA such an important issue deserves objective evidence .We therefore recommend that the provincial and territorial regulators, in cooperation with the MFDA/IIROC, retain an independent research firm to interview a representatively large number of investment fund investors to determine what level of service, if any, they get from their advisors in return for the trailers. This would include looking at the specific services the dealers provide their clients on an ongoing basis for the service fee/ trailer commission and relate those services to the dollar value of those charges. We expect there will be some services whose value may be difficult to quantify.

• *Should we differentiate between an advice gap for face-to -face advice and an advice gap generally?*

There is no doubt that some investors do feel more comfortable with face to face meetings. A differentiation is appropriate.

• *What types of advice or services currently provided today would be most affected by the proposal?*

• *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*

The existing advice gap would be reduced if embedded commissions and CSP 33-404 were implemented.

•How could a potential advice gap, face –to -face advice gap or financial service gap be mitigated?
• Do you think that online advice could mitigate an advice gap? If so, how?
We believe online advice will be attractive to many and will help close the postulated investment advice gap. For investors with less than $100,000, robo-advisors have already made the investment situation better. While investment solutions are still basic, low-cost diversification, coupled with automatic deposit, flexible reporting, and auto rebalancing provide an excellent starter kit for the small retail investor. Robos continue to expand their capabilities. For example WealthBar, regularly communicates through its website, emails and hosts webinar sessions to help further client confidence and build trust. They also use a wide range of investment classes to help reduce volatility for investors. Wealthsimple has full-time registered portfolio managers available for clients to talk to on the phone, over email or video chat. The company is also able to use its technology to identify and respond to investor concerns. If a nervous client is constantly logging into their account on a day when markets are tanking, Wealthsimple can contact them even if they haven't reached out to the company. Basic financial and tax planning tools are not far behind. Based on this we feel confident that small retail investors will be well served if trailers are banned.

Robo-advisors are fiduciaries so the quality of investment advice will actually be enhanced. Still, some segment of small investors want face to face interaction -it is here we believe the banks are best positioned to be able to provide investment "advice" at a competitive price. Bank-owned dealers have clients that line up to come see them at the bank branch. They have access to client's banking, mortgage, car loan and credit card information so they can operate on a high volume, low margin business model where they can keep their "advisors" on base salaries and some incentives. They have standardized advice and their costs are so far embedded and inter-twined that they don't have to show any "commissions". Bank salespersons have numerous opportunities for cross-selling, giving them a strategic competitive advantage over those firms with a more constrained service offering.

Discount broker capabilities are impressive but we remain concerned that recent IIROC proposals will reduce their benefits for the DIY investor if approved. We urge the CSA to challenge IIROC as its actions could adversely impact financial market health, decrease access, decrease competition and increase the postulated advice gap by unduly constraining discount broker capabilities.
• Do you think that the significant market share of deposit -taker owned and insurer -owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?
The Consultation Paper notes, that 55% of mass-market investors are already unadvised and those who purchase investment fund products tend to do so via integrated deposit-takers or insurers. We believe that the mass market dominance of deposit-taker (bank) and insurer-owned dealers will blunt the industry-postulated advice gap.

In a July 2016 column Vanguard Canada observed that its colleagues in the U.K. reported that the advisors who weathered the commission ban best were those who proactively decided to adjust their practices to thrive and not just survive. Many shifted to a fee-based compensation structure, as Vanguard has advocated in their advisor's alpha framework. “In Our own recent global survey of advisors found this view was shared by a majority, with 76% of Canadian advisors surveyed indicating a fee-based model was better for their clients than a commission-based model. *Is this the end of the line for trailer fees? “* https://vanguardcanada.ca/advisors/articles/research-commentary/vanguard-voices/is-this-the-end-of-the-line-for-trailer.htm The key assumption here is that regulators would take steps to ensure that fee-based accounts are suitable for clients (and that clients will have a choice as to the type of account).

18. *Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:*
• *Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?*
Some of the elaborate campaigns opposing a ban are well funded and comprehensive, comparable to a declaration of war. Given the defiant public stance of Advocis, IFIC, and others we think it is a pipedream that the MFDA channel will voluntarily transition away from embedded commissions. The infrastructure costs of such a change in business model may be prohibitive. Dual-licensed mutual fund Reps may in fact transition clients into trailer paying Segregated funds unless the CSA is able to develop an effective counter-measure.
We see these changes disproportionally affecting small-to-medium independent mutual fund dealers relative to full service *Investment Industry Regulatory Organization of Canada* (IIROC) member dealers as they rely more heavily on embedded commissions (27% of fee revenue compared to 16%).Representatives of vertically integrated deposit-takers and insurers appear to be already largely insulated from the short-term impacts of the proposed changes.

Although we see strong evidence of fund fee reductions, we do not feel there is a good chance that embedded commissions will gradually be reduced without regulatory intervention.
19. *How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:*
• *Do you see payment options and business models evolving at present?*
• *How are they likely to change over time if the CSA were to choose not to move forward with the proposal?*
We do not have the capability to make such projections.

20. *We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?*

From our limited sources we have seen a huge conversion to fee-based over the last two years in the IIROC channel. We have not yet seen a similar movement to fee-based in the MFDA channel. There may be structural/ system issues in the MFDA channel -that affects about 83,000 dealing representatives.

Potential impact on competition and market structure

21. *Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:*
• Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?
We think the dominance of banks will increase.
• What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?
• What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?
• Independent dealers?
• Independent fund manufacturers?
The CSA provides one clue:" *For active investment fund managers with little or no access to related party distribution, on average 59% of assets at these firms may experience redemption pressure over time assuming once again these managers were not able to adjust their fees or improve performance*." We have no basis for agreeing or disagreeing with this statistic.
• Integrated financial service providers?
A wonderful growth opportunity.
• Mutual fund dealers?
We see huge challenges for MFDA dealers.
• IIROC dealers?
• Online/discount brokers?
• What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?
Very hard to estimate but given the high percentage of dual-registered MFDA Reps, it would be naive to believe that the risk of arbitrage is anything less than significant.
• What would be the impact on dually-licensed mutual fund dealers and insurance agents?
Some will exploit regulatory arbitrage, others may exit the business.
• Will the proposal lead new, lower-cost entrants to the market? Why and how?
We do not see this happening. New mutual fund entrants would have to compete with the banks/ IG, outperform Fidelity and set up a distribution system for a relatively small market that faces increased regulation. Even powerhouse Vanguard entered Canada with ETF's rather than actively-managed mutual funds.

• Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?
• Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?
Yes but it may give rise to a new fee structure related to the components of advice e.g. a fee for a financial plan, a fee for specialized reports, a fee for an IPS ….
• Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?
Integrated financial service providers have a distinct competitive advantage in terms of their ability to cross-sell and cross-subsidize across business lines because they can offer convenient one stop shopping. Multiple accounts can be checked online and money transfers between accounts are simple with integrated firms. Although tied selling is prohibited, bundled cross-business pricing is not. Industry concentration will further increase in favour of the banks and insurance company –owned dealers and fundcos. Independent fundcos would be severely challenged without a dedicated distribution network. The introduction of performance fees might be one way the independent fundco might counter .Reduced competition is clearly not a positive in favour of a prohibition on embedded commissions.
• What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?
Online investment advice will be a positive. Over time, we believe many low cost services will be offered. Digital advice should drive human advisors to increase productivity, examine fees and sharpen their value proposition. The rise of AI could be a real game changer for the advice industry. *See Canada's financial services sector "moving fast" on AI* - Investment Executive
http://www.investmentexecutive.com/-/canada-s-financial-services-sector-moving-fast-on-ai

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:
• Is there any specific operational or technological impact that we should take into consideration?
We cannot comment except to note that mobile solutions are being demanded by younger investors and even some seniors.
23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.
• Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?

We are not aware of prevailing oversight or controls between the fund manager and distributors other than commission payment terms and conditions. If there really were effective controls, discount brokers would not be selling A class funds to online investors and collecting trailers for services not provided. Kenmar suggest that fund governance may also be a factor that should be reviewed as a possible reason for the high mutual fund fees in Canada. While other leading jurisdictions have a board of directors (and independent directors), Canada did not adopt that model and instead adopted the concept of the Independent Review Committee, which Kenmar does not believe provides sufficient oversight. We do not suggest that the CSA delay in implementing the recommendations herein while examining this issue, but it should be pursued.

• *To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?*

Under the lowly suitability standard, nearly anything is suitable. We fully expect all the usual well identified problems related to fee-based accounts – double dipping, aggressive asset increase initiatives, reverse churning, fee rates higher than 1% for small investors, abusive or no price breakpoints, leveraging etc. Tougher enforcement would help alleviate the abuse to an extent. A Best interests advice standard would also help alleviate the need for some of these controls and oversight.

24. *Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?*

We believe they would, say, via fee-based accounts with fees at 1 % or higher. Of course fee-based accounts can be and have been, abused, so regulators would need to be alert. The Cumming study found that an increase in trailer fees corresponds to a decrease in performance. There is negative drift in fund performance when other factors, such as trailers, influence fund sales. However, the study found a different story for mutual fund sales through fee-based purchase options. In these cases, fund sales are highly influenced by past performance and this has a positive impact on future performance suggesting that the greater transparency of fee-based accounts can potentially improve investor outcomes. We use the word "potentially" because we don't know if the fees in a fee-based account will be fair and reasonable or if it will be appropriate. If they exceed 1%, investors might be worse off.

One of the alternative payment methods is the fee-based account. In theory such an account might be an improvement over embedded commissions. In practice we have seen how the industry has exploited this account type in the double dipping scandals. Of course there are many other ways such accounts are harming investors. For example, clients nudged into such accounts might pay a 1% or more fee to hold cash, GIC's, index funds or Bond funds. This would be worse than the current level of exploitation. Another example we are seeing is that seniors (low portfolio turnover accounts) are inappropriately being nudged or forced into fee-based accounts simply to generate a steady flow of fees i.e. reverse churned .See our blogs on **Fee-based accounts** http://www.canadianfundwatch.com/2014/12/alert-trouble-with-fee-based-accounts.html and **Are you a Reverse churning victim?**

http://www.canadianfundwatch.com/2015/10/are-you-reverse-churning-victim.html Regulators need specific rules to address the many threats posed by-fee-based accounts.

As for direct pay, it would depend on the fee level and the method of payment. In principle, dealers should be able to compensate for the loss of trailers by charging a 1% annual fee (typical for equity mutual funds) or more. If it were all upfront, investor resistance would be high. Our concern is that dealers could charge more than 1% which might make the situation worse for small investors.

According to a JD Power study aimed simply to help U.S. wealth companies assess the relative attrition risk they face depending on how they change their products and pricing in response to the DOL rule the findings were illuminating: Responding to a question about their willingness to switch to fees, only 8% of commission-paying investors favour the switch, and another 33% say they probably will. Forty percent are leaning toward disagreement, while 19% are adamant in refusing. Among HNW investors, 25% said they would definitely not switch from commissions to paying 1% in fees on AUM; when the suggested fee rate rises to 2%, the objectors increase to 52%. As for commission-paying validators, 35% say they probably would not switch and 26% definitely would not. This could have implications for Canadian regulators but more research is needed***.***
Commission Clients Don't Favor Switch to Fees: *J.D. Power*
http://www.thinkadvisor.com/2017/03/16/commission-clients-dont-favor-switch-to-fees-jd-po Since the CSA is permitting commissions as direct pay, this should not be a huge issue in Canada. However, the up-front sales commission arrangement would need to be covered by a service/engagement agreement that requires the dealer to provide ongoing advice. Again, this advice should be under a Best interests standard not a suitability standard.

25. *Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?*

The Dec. 15, 2016 Canadian Securities Regulators NOTICE Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives identified a host of compensation methods that are used by dealers to skew advice https://www.securities-administrators.ca/aboutcsa.aspx?id=1540 . The survey found that firms use a wide range of practices to compensate their representatives, including direct tools such as commissions, performance reviews and sales targets, as well as indirect tools such as promotions and valuation of representatives' books of business for various purposes (for example, retirement and awards). The systems are all based primarily on sales production.

We are surprised that a consultation paper on embedded commissions/conflicts-of-interest ignores an important aspect of the management expense ratio ("MER"). Fixed rate administration fees (include but are not limited to, registrar and transfer agency costs, audit fees, legal fees and custodial fees) can effectively prevent mutual fund expenses from declining as a percentage of assets as the fund grows We are of the view that such is a rather high price to pay for the "stability and predictability" such fees provide. *We believe such fees represent a serious conflict-of-interest for a mutual fund manager as there is a clear incentive on the manager to reduce service to unitholders in order to increase its profitability. The Fixed admin fee model also disconnects fee disclosure from actual cost incurred so subsidization (or not) can take place without detection or reporting by auditors.* We see no difference between these fees and management fees and view moves to adopt such fees as a backdoor attempt at increasing management fees.

See also our response to Q14.

26. *What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:*
- *career path;*
- *attractiveness of the job;*
- *typical profile of individuals attracted to the career;*
- *recruitment; and*
- *relative attractiveness of careers in competing financial service business lines?*

We cannot respond to this question but can say that it is inevitable that proficiency and ethical standards must be raised and that could cause some Reps to depart the industry or retire early. Conversely, if the transition to a Best interests standard occurs, we could see many professional people attracted to the advice business.

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:
- *access to advice for investors,*

We think the measures are adequate. As for the issue of low financial literacy potentially hindering investors' ability to assess the value of advisory services or to negotiate fair fees for such services, the CSA plan of continuing to work on investor literacy initiatives to increase investors' awareness of investing costs and empower them to confidently engage in the negotiation of fees with their representative will need to be dramatically beefed up. This would include more explicit examples of the effects of fee de-compounding, risks and benefits of working with dual licensed persons, how to assess dealer complaint responses and selected topics like reverse churning ,using videos, simulators, plain language brochures, even games. As noted previously, we do not anticipate small investors having the leverage to negotiate fees even if they possessed the requisite negotiating skills. Right now we are seeing small investors being shunned or minimum investment amounts being increased.
- *choice of payment arrangements for all investor segments, and*
- *a level playing field amongst competing investment products?*

We feel that the measures proposed will help mitigate the main effects of a trailer ban between competing investment products.

We would not expect that POS and CRM2 reforms will dramatically improve investors' awareness and understanding of fund and dealer compensation costs in the lead up to any potential rule proposal discontinuing embedded commissions. After all, Fund Facts does not delineate the actual trailer rate (only a range is provided) and annual CRM2 reporting omits about half the cost of investing (only dealer costs are included) with product costs excluded. We would not expect this quasi disclosure to sufficiently improve investor awareness and understanding that would provide a retail investor with an initial point of reference from which to gauge the appropriateness of advisory fees under direct pay arrangements.

The proclamation: "*We would expect representatives to fully inform their clients of the types of accounts available, and the differences between those accounts, both in terms of service and cost. Our expectation is that investors would have more choice in how they may pay for advisory services further to the discontinuation of embedded commissions, not less* "should be validated.

The first sentence is rather naïve given that dealers who offer fee-based do not distinguish fee rate based on service. The only distinction is level of assets. Again, dealers are free to say we offer our services for X% and if you don't want all the services, you are still paying X% if you wish to deal with us. After all, the dealer is not obligated to take on any business; no one has a right to force the business to offer its product or service on a basis that it chooses not to. This is the essence of capitalism. In fact it is happening now to clients who are moved into fee- based accounts (or asked to move their account elsewhere).

Based on history we would have zero confidence that the CCIR will take steps to neutralize regulatory arbitrage. The power of the insurance lobby is well known. The CSA plan to continue to liaise with other regulators to discuss the risk of dealers and representatives prioritizing their compensation interests over the interests of their clients by inappropriately shifting their clients' assets to other investment products with embedded fees is inadequate investor protection. We suggest that Seg funds in particular be defined as a security and that creative rules that would help mitigate arbitrage be introduced by the CSA/IIROC/MFDA.

If the definition of advice is advice on investments (as opposed to financial advice) we feel the number of available options should be adequate. This is hard to predict precisely but we feel that the risks are low that access will be denied to those truly seeking trustworthy investment advice and willing to pay a fair price. See our WHITE Paper **Small investors will not be disenfranchised by a prohibition on trailers**
https://drive.google.com/open?id=0ByxIhlsExjE3Rk05VHBpd285VFk

We remind the CSA that the "advice" provided today is conflicted, not achieving regulatory objectives and in many cases causing investor harm. The CSA Consultation Paper on Best Interests http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm stated ***"Clients are not getting outcomes that the regulatory system is designed to give them:*** *There are a number of potential causes of this concern, including opaqueness in the* *suitability assessment, existing requirements that require more clarity to assist in effective enforcement, barriers to obtaining redress for a registrant breach, and lack of effective compliance and enforcement in certain cases."* Also *"The self-regulatory and industry organization investor complaint experience shows there is consistent and ongoing non-compliance with many of the current key regulatory requirements, with the unsuitability of investment recommendations being the primary basis for complaints to OBSI for the past five years, case assessment files for IIROC for the past three years and allegations in MFDA enforcement cases for the past three years". Source:* http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm Our comments on CP 33-404 can be found at http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160711_33-404_kenmar.pdf and are incorporated herein by reference.

We believe financial advisors should be clear with their clients about what services are provided and we believe CRM2, which require annual disclosure of the amount of trailing commissions received, in dollars, could at least in principle ,provide the means for the retail investor to evaluate whether they are getting appropriate value for the services. Kenmar believe that with a clear delineation of services, the competitive market should then address this effectively. We base this view on our belief that there are some advisors who offer many services to their clients and many advisors who offer very little.

For clients of the latter type of advisor, they can review the annual compensation report and, if they do not believe they are getting value for service, they should switch dealers/advisors. Virtually anyone who has ever transferred an account from one dealer to another is aggravated as to why the process takes so long. We would argue that it takes so long because there are no enforced regulatory requirements around maximum timeliness and basic corporate behaviour is such that a dealer is slow to transfer out client money since that directly impacts firm revenue. **To facilitate this, the MFDA, IIROC and the CSA should consider regulations regarding account transfers including maximum transfer times as integral to this consultation**.

28*. What other measures should the CSA consider to mitigate the above unintended consequences?*
We have provided numerous recommendations throughout this document to help mitigate unintended consequences. The CSA should learn from the experiences of jurisdictions that have banned commissions.
29. *Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:*
• Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's

payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.
In a non-registered account, such redemption could have adverse tax consequences and create a record keeping nightmare for investors.
• *To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?*
• *What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?*

We are unable to provide useful input in response to this question.

30. *With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,*
• *to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;*
We leave this to industry participants for response.
• *does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and*
• *what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?*

Based on previously submitted industry Comment letters, cross-subsidization allows dealers to service smaller accounts .Large investors are the source of funds that permit this to occur. If actual cost was charged, the price for advice might be too high for small investors unless the dealer decided it a sound business decision to subsidize small accounts until they grew to an economic size.

[Another form of cross-subsidization can occur across fund families .In *Favoritism in Mutual Fund Families? Evidence on Strategic Cross-Fund Subsidization* by Jose-Miguel Gaspar, Massimo Massa, Pedro P. Matos https://papers.ssrn.com/sol3/papers.cfm?abstract_id=557078 the researchers investigated whether mutual fund families strategically allocate performance across their member funds favoring those more likely to generate higher fee income or future inflows. The researchers found evidence of strategic cross-fund subsidization of 'high family value' funds (i.e. high fees or high past performers) at the expense of 'low value' funds in the order of 6 to 28 basis points of extra net-of-style performance per month, depending on the criteria. This overperformance is above the one that would exist between similar funds not part of the same fund family. The authors further document how this family strategy takes place by looking at preferential allocation of IPO deals and at the amount of opposite trades among 'high' and 'low value' funds belonging to the same fund complex (a practice that can encompass 'cross-trading'). Such subsidization practices are clearly more available to integrated firms like the deposit-taking firms (banks).]

Under certain fee structures used in Canada, all investors in a particular mutual fund (or series) pay the same management fee. However, the proportion of that fee paid out as a trailing commission may differ depending on the type of sales charge paid by each investor at the initiation of their investment (higher trailing commissions are generally paid for funds (or series) sold on a front-end basis). Thus, two investors buying the same mutual fund may face different upfront charges and different proportions of the management expense fees may be paid out in commissions to their advisors. As a result, investors with lower trailing commission ratios subsidize those with higher commission ratios through the management expense fee. This diversion of resources causes affluent (HNW) clients to pay more than they should. We would be glad to see this unfair practice end as it has no place in a contemporary advice-based system.

In our view, mitigation measures could include

- The subsidization of smaller accounts by larger ones could also be addressed through firms creating a fee schedule that entails some subsidization of smaller accounts. By taking a long term view of the relationship, and a long term business plan approach, smaller investors can continue to be served profitably under a fee-based model. Firms will benefit over time as such clients grow their assets.
- Independent fundcos may need to acquire a distribution channel to mitigate the loss of the subsidy (or abandon the market).
- Transitioning product line to actively-managed ETF's. Canada already has the highest percentage of actively- managed ETFs in the G7, with this type of fund representing 13.7 % of total ETF assets, compared with just 1 % in the U.S. market, as of Dec. 31, 2015 according to data compiled by National Bank Financial https://beta.theglobeandmail.com/globe-investor/funds-and-etfs/etfs/active-etfs-finding-fertile-ground-in-canada/article28495210/?ref=http://www.theglobeandmail.com& Per CETFA, the amount would be approximately $22.7 billion vs aggregate industry AUM of $123 billion or 18% as of end of Q1, 2017.
- Superior fund performance /effective marketing to attract clients.
- Investors should be offered lower MER fund series as would be reflected in attractive fund breakpoints and household rate packages.
- Investors could be offered loyalty discounts based on the number of years invested with the fund family
- Confident portfolio managers might be willing to implement performance fees as a means to increase revenue to offset the loss of the cross-subsidy provided to smaller investors.
- MFDA dealers could start selling ETF's in order to broaden their market coverage.

A positive by-product of a prohibition would be that the value (or not) of active management of a fund could be compared to a benchmark without the constant need to account for the embedded commission.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

We have no comment except to note that a different corporate culture is required from the leadership. They should be taking steps now to address the known consequences of a changing consumer base, fintech and regulatory environment.

32. *For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.*

We have no comment except to make the observation that it is the primary obligation of regulators to protect investors, not encapsulate costly and abusive business models.

- Are there unique costs or challenges to specific businesses?
- What transition period would be appropriate?
- Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

We believe they are part of a "deal' and so should be allowed to play out. It would be a constructive gesture if the industry voluntarily waived some early redemption penalties say for hardship cases or when evidence of mis-selling becomes apparent.

NOTE: On page 47 of the consultation we're told "Fund investors with little to invest are the most likely to be offered DSC purchase options and some firms primarily offer their clients DSC options. Also "The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and the representative's revenue requirements." **It seems to us such undifferentiated "advice" is likely mis-selling, calling out for regulatory enforcement.**

33. *Which transition option would you prefer? Why? Are there alternative transition options that we should consider?*

As investor advocates we prefer the transition with the shortest cycle time. The CSA say they understand that it will be imperative to provide sufficient time to all affected parties to ensure a successful transition. The CSA believe that a Transition Date of 36 months after the Effective Date could provide sufficient time to complete all required transition steps. If that happens, it will be 2021, 26 years after the first of the Stromberg reports on investor protection! Kenmar appreciate the disruption that a ban on embedded commissions will have but expect that at least some progressive industry participants will move faster and be rewarded by increased sales.

34. *As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?*

The industry argument is that capping commissions eliminates one of the main conflicts in the Cumming report - increased trails resulted in increased sales to that fund company with less correlation to performance. The other big conflict was that the sale of proprietary products bears no relationship to performance of those products - but the paper does not deal with that in any way - in fact it sends the modest investor to the banks. Several fundcos posit that a fee cap allows the small investor to purchase the fund at a stated price without having to explicitly pay for the "advice "- advice they may perceive that they can't afford. The affordability of course comes about by subsidizing the real costs by overcharging larger fund investors. Per the CSA, Investment fund managers could facilitate investors direct payment of dealer compensation through payments taken from the investor's investment (for example deductions from purchase amount or periodic redemptions from the investors account).

In Jan.2016, Credential Credit Union announced a fee -based payment system for mutual fund investors. According to the News Release "The OnPoint Fee-Based Account solution is best suited to investors with a minimum of $100,000 to invest who are seeking to build a strong relationship with an advisor who can provide personalized advice and long-term investment solutions. " http://www.credential.com/about-us/news/press-releases/2016/01/26/credential-financial-introduces-mfda-fee-based-account-for-credit-union-members We expect such a payment system will be expanded with lower minimum thresh-holds.

We argue that the idea of small investors negotiating fees is wishful thinking. The CSA want to prompt an explicit negotiation, but we don't think most small retail investors are equipped to negotiate because a lack of negotiating leverage, poor negotiating skills or information asymmetry. However, as investable assets increase, lower rates should apply in a competitive market.

Capping fees would not eliminate the potential for conflict created by the fund manager paying the client's agent, but it would, according to industry participants, address the financial incentive to behave badly and, in their view, largely reduce the harm created by the conflict. It is also asserted that trailers are fairly consistent within classes, so in a sense this would regularize what is already happening in practice and would eliminate the outliers in the MFDA channel. An embedded commission rate cap is of minimal value in the IIROC channel because of the large number of competing non-fund securities and SMA's available to such dealers/Reps.

The CSA's main objection seems to be that capping commissions wouldn't eliminate embedded commissions/ conflicts. But using a fee- based account also doesn't eliminate all conflicts either so there is little or no net gain by banning trailers unless a statutory Best interest advice standard is adopted.

On the other hand, investor advocates argue that maintaining trailers (even at a 1% cap) does absolutely nothing to get advisors to look at product merit as the primary determinant of what they recommend to clients. Industry participants seem to think that the only options advisors have for clients are actively-managed mutual funds .As a general rule, ETFs (and Index funds) outperform active MFs over the long term, but by "advisor" recommendation, far more money goes to MFs… simply because of the bias-inducing trailers that they pay. See **Why Indexing Works** by J.B. Heaton, Nick Polson, Jan Hendrik Witte: SSRN
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2673262

On balance, we thought the CSA arguments against a fee cap were reasonably sound so cannot think of a reason to reconsider If the CSA vision is to isolate the costs of advice, the connection between fund manufacturers and dealers/advisors must be severed but in a way that will not harm investors.

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:
• address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and
• address or not address any additional harms or issues that you have identified.

As we have explained, the prohibition of embedded commissions is complementary to the other CSA initiatives -- targeted reforms and regulatory Best interests. If these other reforms are not implemented, we believe the investor protection gains will be marginal and could significantly increase the market share of bank-owned dealers with proprietary products, which we regard as negative. If the other initiatives are introduced, then we believe the identified issues will be addressed.

When embedded trailers are banned, fund dealers will likely respond by going fee-based like the investment dealers, consolidate or disappear as control of remuneration passes from the fund companies to the dealer's hands.

What the Cumming's report does not emphasize was that dealer compensation on mutual funds is largely uniform (A 2015 report by Investor Economics found that 86 % of equity and balanced funds sold in Canada paid trailer commissions of 1 % for front-end and no load options. An additional 9 % of the funds paid fees above 1%). At dealers, fee schedules may be opaquely disclosed and may be complicated for retail investors to compare. Regulators will not be able to regulate dealer/advisor fee schedules. The CSA assumption seems to be that a competitive market will prevail. Perhaps it will. Will small retail investors really be able to negotiate fees? We doubt it, so they will be nudged into robos, bank branches, DIY investing or simple index investing like that offered by Tangerine. Not necessarily bad outcomes while they wait until their account size grows to the point where more fulsome advice can be obtained.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

The principle of separating advice from transactions is so fundamental that any other identified option is not consistent with that goal. That being said, we would listen to industry proposals.

Summation

In aggregate, the CSA estimate that 44% of actively-managed fund assets may experience redemption and reallocation pressure to competitor investment fund managers over time if embedded commissions were discontinued and these managers were unwilling or unable to adjust their fees or improve performance .For active investment fund managers with little or no access to related party distribution , on average 59% of assets at these firms may experience redemption pressure over time assuming once again these managers were not able to adjust their fees or improve performance. Assuming the CSA analysis is accurate, what does this say about the prevailing Canadian mutual fund industry and its distribution network.

Freeing the "advisor" from trailer commission constraints could be a potential Win-Win for retail investors and those who advise them. Of course there is still the risk of unsuitable investment recommendations, undue leveraging, churning, personal financial dealing, inappropriate pension commutation under foggy suitability criteria and even risky/ fraudulent Off - book transactions. Robust compliance and regulatory enforcement is key to protecting retail investors.

While we accept as fact that trailer commissions skew “advisor” recommendations and reduce fund performance, Kenmar believe many other factors are at play .We support a discontinuance of embedded commissions as a complement to the CP 33-404 regulatory reforms. [See APPENDIX I for a Summary for possible failure mechanisms related to a discontinuance of embedded commissions. See APPENDIX II for a listing of issues related to the prohibition of trailers/embedded commissions. See APPENDIX III for Referenced Documents used in the preparation of this submission.]

We hope this Comment letter proves useful to the CSA in its policy setting deliberations.

Trusted advice is a Canadian socio- economic issue well beyond the bounds of securities regulation. We had better be careful we don't squander this opportunity to protect trusting financial consumers.There will be a huge social and economic cost if we do.

We thank the CSA for the opportunity to provide these comments. We would be happy to address any questions you may have or to meet with you to discuss these and related issues in greater detail. We appreciate the time you are taking to consider our points of view. Do not hesitate to contact us if there are any questions regarding our Comment letter.

Permission is granted for public posting.

Sincerely,

Ken Kivenko P.Eng.
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APPENDIX I: Possible Failure mechanisms resulting from prohibition of trailers

We focus on three of the CSA's main concerns about conflicts of interest: that embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors; that they limit investor awareness, understanding, and control of dealer compensation costs; and that "[e]embedded commissions paid generally do not align with the services provided to investors."

Sounds pretty enticing. Our intuition was always to support prohibition. Yet as fact-based commenters we explored various scenarios to see if banning embedded commissions alone will deal with the stated concerns AND not give rise to unintended failure mechanisms.

Based on our analysis the following failure mechanisms will exist:

1. Dual licensed reps will flog Seg funds and other "investment" products not under the domain of the CSA. The life insurance industry which regulates Seg funds is lightly regulated compared to the CSA regime and Seg fund fees are higher than mutual funds. If not addressed, such regulatory arbitrage could cause harm to retail investors.

2. Integrated firms like the banks will continue to offer only proprietary products. Investors at bank branches will thus be receiving "advice" that is not only conflicted but sub- optimal. This is consistent with the findings of the Cumming report. Even that report did not consider that banks , just like insurers , also have " investment " products like PPN's and Index linked GIC's that could substitute for mutual funds . Such products are not considered to be low- cost products and contain provisions that limit the upside potential of the investment. The CSA has no mandate to regulate the sale of such products so mis-selling could increase.

3. Independent fundcos without a dedicated distribution channel could be disadvantaged by prohibition relative to the integrated firms with an internal distribution network. The end result could be reduced competition for the banks. It could be argued that the increased bank market share will ultimately work to the detriment of the retail investor.

4. Trailing commissions from the fund manufacturers will be replaced by dealer fees (incentives, inducements and non-financial rewards). These fees could very well be higher than the traditional 1% trailer on mutfunds. The Dec 15, 2016 CSA/IIROC/MFDA announcements listed a host of conflicts-of-interest that made our eyes glaze over. This revelation actually is an admission of massive regulatory failure *re enforcement of the basic requirement for registrants to act fairly, honestly and in good faith*.

If embedded commissions are banned they will simply be replaced by these advice-skewing incentives unless they are specifically banned and the rules (a new, more comprehensive version of NI81-105) vigorously enforced. Sales targets cannot co-exist with trust-based advisory relationships...they override the equations that frame the integrity of the deliverable service- trustworthy advice.
We urge the CSA act promptly to address these investor abusing conflicts-of-interest.

5. Conversion of clients to fee- based accounts is in motion now by IIROC dealers. The fees will apply to cash, bonds, bond funds, GIC's, mutual funds etc. so that it is quite possible, even likely, that overall client investing costs will rise. Such fees would not be regulated and could exceed the nominal fund industry standard of 1% for actively-managed equity funds. This could be compensated for if dealing Reps select lower cost products, but will they in the absence of a Best interests standard?

6. Reverse churning could occur (is currently occurring) that could see Buy and hold investors unduly paying more in fees. Regulatory enforcement will be even more critical as many more Canadians, especially seniors, will hold fee-based accounts. Will regulators step up to the plate?

7. The continuance of referral fees could subtract from any potential prohibition gains. Similarly, the continued use of cooperative marketing (using fund assets) could undermine the ban by continuing to allow fundcos to influence dealers. A recent OSC settlement with Sentry Securities Inc. followed a multi-year investigation into sales practices at the Toronto-based independent mutual fund company. OSC commissioner Philip Anisman, who approved the settlement, said this was the first proceeding by the OSC that addressed "prohibited payments and gifts" made by an investment fund manager and the "systemic supervisory failures" that permitted them.(the rule regarding prohibited payments came into effect in 1998 so enforcement has been rather shallow over the past 18+ years). Investment fund managers ("IFMs") are prohibited from making a payment of money or providing a non-monetary benefit to a dealing representative ("DR") in connection with the distribution of securities, except in certain permitted circumstances under Parts 3 and 5 of National Instrument 81-105 Mutual Fund Sales Practices ("NI 81-105"). All payments made to Reps from fundcos should be prohibited as they just add to problems with no benefit for clients.
http://www.osc.gov.on.ca/en/Proceedings_enr_20170405_sentry.htm

8. Small investors who desire human facing advice may be confined to bank branches (and proprietary products/funds) assuming banks develop a new fee structure. The reason the system hobbles along now is that larger investors are subsidizing smaller investors. The result is that dealers use the subsidy to deal with smaller investors. Of course it has been proven by research that the “advice” provided under the trailer regime results in conflicts- of- interest that harm investors. In some cases the "advice” can be doubly dangerous because of churning and leveraging. Regulators and investor advocates have questioned the level of advice relative to fees paid, the quality of advice provided or even if advice is provided at all. Whether small investors receive much trusted support other than fund selection. / asset allocation recommendations is an open question. More information is needed on exactly what “advice” dealing reps provide to small accounts.

9. Smaller clients may be unable or unwilling to pay directly for conflicted advice. Some may decide to become do- it- yourself investors or use robo -advisors or invest with reputable direct to client fund companies that offer guidance but not recommendations. The decision not to engage an advisor could be based on unaffordability, anger at being told in the past that advice was free or simply not feeling the advice is worth the cost. According to industry lobbyist IFIC, just 37% of mutual fund investors seek direct payment for advice. Kenmar believe a combination of convenience/simplicity, complacency, detachment, a lack of understanding of the impact of conflict-of-interest on recommendations and unbridled trust in their advisor contribute to this attitude.

10. Industry participants argue that even small accounts need personalized investment advice while some investor advocates argue that such small investors could buy a low-cost balanced fund or ETF or just pay down debt or their mortgage. Will these postulated small account advice orphans materially suffer as a result of prohibition? We believe not but it is still a risk that should be assessed.

11. Account and product cost are not currently explicit components of a “suitability” assessment. Given that fees reduce returns to investors, and numerous studies have demonstrated the negative relationship between fees and returns. Fees are an important consideration in evaluating the suitability of otherwise-similar investment funds or other investments. Cost was an element of the targeted reforms but it is far from clear that the CSA will make cost an explicit component of suitability. If it does not, investor protection will remain compromised.

12. Since the consultation is non-committal on the future of Best interests and the targeted reforms, the prevailing low suitability standard will continue, leaving a gaping hole for bad advice to continue to be dispensed with near impunity.

13. Continued lax enforcement, wrist slap penalties and a focus on individuals rather than root causes (like supervision, compliance and compensation practices) could undermine the prohibition initiative. Unless regulators apply timely and effective deterrence, rules are meaningless. The recent scandals involving double dipping

occurring over a decade is an example of massive dealer compliance and regulatory failures. Another example would be the lack of NI81-105 enforcement. Yet another would be discount brokers improperly collecting advisory fees.

An objective assessment of the cumulative impact of these failure mechanisms leads to the conclusion that the anticipated benefits of embedded commission prohibition will be less than hoped for. In the worst case, it could make the situation even worse for retail investors.

APPENDIX II: Related Issues not covered by the Questions

There are other issues we wish to draw the CSA's attention to. These include but are not limited to:

A. After embedded fees are banned, will investor's pay for investment advice?
Given the scope, nature and quality of the "advice" actually being provided, the question is -will retail investors of modest means be willing to pay for such advice when the true dealer costs are made visible via CRM2 and other means and embedded commissions banned ?

There is a range of possibilities why they would continue to pay for personalized investment advice even under the suitability standard:

- They are happy with the results obtained
- They are too busy to spend time on investing matters
- They lack confidence in their own investing abilities
- They do not have access to friends or family that are willing and able to assist them
- They feel their representative adds net value after fees
- They trust their representative even though they may not trust the financial services industry generally
- They appreciate and value advice beyond investing such as on tax matters , better saving habits , comfort during market extremes
- They are not aware of the inherent conflicts of interest and/ or how that may adversely be impacting their portfolio performance
- They believe conflicted advice is better than no advice
- They are unable to determine if the fees/ costs are unreasonable/ competitive
- They underestimate the de-compounding effect of fees on long term returns and hence are fee -insensitive

It is also quite possible they would not pay for personalized investment advice once the masking effects of embedded sales commissions are banned:

- They will discover that mutual funds are a very expensive product that does not provide superior returns over longer timelines

- They will decide the fees are too expensive or they can't afford to pay
- On tax matters. they will leverage their tax preparer (or software)
- On insurance matters, they will use an insurance broker
- They will , on principle, refuse to pay because they had previously been told advice is free
- They will discover the de-compounding impact of fees on long term performance
- They will self-educate via courses , books, investment newsletters
- They will conclude they don't need or want personalized advice
- They will be upset that they have been exploited and/or may hear about well-publicized cases of investor abuse by dealers/advisors (like the double dipping cases)
- They will conclude that they should divert cash towards paying down high interest debt instead of paying fees for investing advice
- They will discover that DIY isn't as intimidating as they thought
- They will discover other lower cost options such robo- investing, debt counsellors, investment clubs or financial coaches
- They will revert to being GIC investors and buy GIC's , Govt. Bonds , PPN's and Index linked GIC's or even Segregated funds
- They will invest in some creative version of a Life Cycle Fund

In the United Kingdom, studies seeking to understand financial consumers' decision-making behaviour conclude that they are most reluctant to pay upfront for advice [June 2006; Andrew Clare, "The Guidance Gap" (Cass Business School, January 2013) http://www.cassknowledge.com/sites/default/files/article-attachments/the-guidance-gap.pdf]

A 2010 study involving retail investors from eight European countries found that between 20 to 30 per cent of respondents were unwilling to pay upfront for advice *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/consumer_decision-making_in_retail_investment_services_-_final_report_en.pdf .
Like Canada, it is quite possible they did not realize they were always paying for "advice" via hidden fees.

In 2013, the **CFA Institute & Edelman Investor Trust Study** polled investors across the US, UK, Hong Kong, Canada and Australia. The study was based on the feedback received by 1,604 retail and 500 institutional investors. When asked what was most important when making a decision to hire an investment manager, investors ranked "trusted to act in my best interest" as most important (35%). Another 17% stated that commitment to ethical conduct mattered most to them. If you combine these two factors of trust and ethics, you will see that it is the most important thing to more than half of the respondents. The ability to achieve high returns was most important to just 17%, while, surprisingly, the least rated was the amount/structure of fees (7%). http://www.morningstar.in/posts/28966/are-investors-willing-to-pay-for-financial-advice.aspx This suggests to us that while some investors might be unwilling to pay for conflicted advice they would certainly be open to paying for professional advice they could trust.

Even amid today's strong markets, investors are happy to pay for expert advice on their investments. Those were the findings from a recent study performed between January and September 2016 by Cerulli Associates, a Boston-based research and consulting firm. Half of the approximately 5,500 participants agreed with the statement, "I am willing to pay for advice regarding my financial investments." Fully, 79 percent of households aged 30 to 39 either agreed or strongly agreed with the statement, "I am willing to pay for advice." Additionally, 73 percent of households under age 30 felt the same way. While this study applies to U.S. investors, we can find no reasons not to expect similar results in Canada.

Research by behavioural economist Dan Ariely on the "pain of paying" suggests that certain methods of payment will be more successful than others in getting the retail investor to pay directly for advice. Pain is never a good motivator to encourage consumption of a desired product or service. See *The Pain of Paying* http://danariely.com/2013/02/05/the-pain-of-paying/ and also *What is the Pain of Paying?* https://www.ezonomics.com/whatis/the_pain_of_paying/ There could be initial resistance to paying for advice especially since it was previously understood to be free.

Industry lobbyist IFIC sponsored Pollara research found that just over half (54%) would prefer to compensate their advisor through tied-advice (bundled) fees, while 37% would prefer to pay a direct fee. https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/ It is quite possible that when these mutual fund investors become aware of the true cost ,nature , robustness (or not) of the advice provided, the numbers would change significantly. It remains to be seen if CRM2 reporting will have a significant change in investor decision making.

We would expect a certain segment of Canadian investors, also might resist paying upfront fees for financial advice because they do not understand what working with a financial advisor entails and they are unable to discern the benefits, which can be intangible, delayed in time and with an uncertain outcome. They may however be willing to pay for advice if it can be demonstrated that (a) total costs will be equal or lower than prior costs (b) that billing could be spread over a year as was the case with embedded commissions and (c) the integrity of the advice can be relied upon.

The CSA will need to invest in a comprehensive public information campaign to explain the changes in order to stimulate consideration of direct pay advice (or not). Associated Govt. policy alternatives may include optional CPP, a free basic Govt. advice service (as in the UK), a tax deduction for advice fees and investor education courses/books.

B .DIY investor abuse by discount brokers
Discount brokers shouldn't be collecting trailer commissions intended to provide advice.If

we examine tables 13 and 15 of the CSA consultation document we find that only $12 Billion of the $30 billion in mutual funds are D class which means that $18 billion is invested in trailer commission paying funds. Since discount brokers cannot and do not provide investment advice, clients are being robbed of returns. Clients are not being treated fairly, honestly and in good faith as required by securities laws. We've been asking Regulators for years to enforce the law; we're still waiting for an answer. At 1% trailing commission that amounts to $180,000,000 each year that isn't going towards the nest eggs of Canadians! **The IIROC/CSA should take immediate steps to eliminate this massive violation of the requirement to deal fairly, honestly and in good faith with clients and the IIROC's claim that its rules equate to a Best interests standard.** There is no need to wait for a decision on embedded commissions.

[The consultation paper discusses this issue in a roundabout way and, to our surprise, seems to say that regulators may not have ability to tell discount brokers firms to stop collecting trailer commissions. (see Appendix B iii Require a standard class for DIY investors with no or reduced trailing commission). It says the CSA understand that "any nominal trailing commission paid would cover the costs of administrative, compliance and technological services provided by the dealer or manufacturer"." It may not be feasible or possible for the CSA to compel investment fund managers to create a new "execution only" series and/or compel dealers to distribute this type of series".] That is not the real issue. We are not talking about such a series (D?) **– we are asking that IIROC enforce the law (and it's own rules) requiring its members including discount brokers to act fairly, honestly and in good faith with clients and to provide the advice said to be provided per the Fund Facts disclosure given to clients in advance of purchase. We are also asking the CSA to examine fund governance – why is the fund making payments from investor assets to dealers to provide advice services they know will definitely not be provided?**

C. A defective KYC leads to inappropriate advice to investors
The Small Investor Protection Association www.sipa.ca has issued a Report *The Know Your Client Process Needs an Overhaul* http://sipa.ca/library/SIPAsubmissions/500%20SIPA%20REPORT%20-%20KYC%20Process%20Needs%20Overhaul%20-%20201607.pdf which provides constructive suggestions for improvement. We strongly encourage the CSA to review this report and unpublished IIROC research and take the necessary corrective actions.The discretion, the complexity of the processes and the asymmetry of knowledge and experience place the dealing representative and the firm in a position of great responsibility and the elderly investor in a vulnerable position. KYC information should formally be updated at least once per year. Unless the core KYC process is improved, merely changing the method of payment will not in itself lead to improved investor protection or better investor outcomes. The basic foundations for robust advice giving must be in place.

We further remind the CSA of the OSC Investor Advisory Panel sponsored award-winning paper on risk profiling by PlanPlus. The paper https://www.osc.gov.on.ca/documents/en/Investors/iap_20151112_risk-profiling-report.pdf The IAP's research found that most (83%) risk-profiling questionnaires are not "fit for purpose" and that many of these tools use arbitrary weightings, have poorly worded questions and aren't capable of identifying risk-averse investors. Despite these flaws, these tools are widely used in the investment industry. Almost half of the firms reported that risk questionnaires were developed in-house and another 36% said that advisors could choose their own risk profiling methodology. Only 11% of firms could confirm that their questionnaires were 'validated' in some way. What this means is that the "advice" being provided today is based on a very shaky foundation .So again, simply banning trailers will not lead to better advice. Key supporting advisory processes must be repaired or overhauled in parallel.

D. Make dealers accountable for the actions of their representatives

It's well known that regulators collect only a tiny fraction of the fines imposed on dealer Reps. whom they hold responsible for investor abuse. We therefore argue that the deterrence value is NIL. We further argue that the advisory contract is with the dealer NOT the individual Rep. Imagine if aircraft manufacturer Boeing practiced this way. An aircraft maintenance technician would be held responsible by the FAA- Boeing would be off the hook even if the plane went down. Our view is that the dealer recruits "advisors", trains them, incents them to meet sales quotas, provides the systems, policies and practices under which they operate and supervises them plus assigns a compliance officer to quality control the whole process.

The dealer gains from the active selling but when the person at the bottom of the food chain gets caught, the firm walks away. This is an attack on natural justice that ends up leaving trusting clients on their own. Dealers like it this way because they are immunized from wrongdoing and Reps like it because they know IIROC/MFDA can't collect the fines. The only loser is Main Street. Note that OBSI, with rare exceptions, rightly holds the dealer accountable for wrongdoing by "advisors" .The dealers" Trust us" marketing materials hold out the promise of integrity and fairness. It is the dealer who makes declarative statements and places marketing ads re trustworthiness and it is the dealer that should be held accountable for the actions of its representatives. In the vast majority of cases the root cause of problems lies with management and the sales culture it has created. **We therefore recommend that regulators adopt the default position that the root cause of rule breaches attribute to the dealer and that any fines levied should be to the account of the dealer.**

E. **The time for the Deferred sales charge option has past**

Kenmar have not found a good reason for investors to be sold funds on the basis of the DSC option (*The DSC sold Mutual Fund under the Microscope* http://www.canadianfundwatch.com/2015/09/the-dsc-sold-mutual-fund-under.html) . Retail investors hate to pay the DSC early redemption fee .So, rather than creating investing discipline, it keeps investors glued to their advisors with no consideration for the level of service provided.

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The CSA says that dealers promote the use of a particular purchase option, such as the deferred sales charge (DSC) option, that pays higher upfront embedded commissions, regardless of the availability of other purchase options that may better suit the investor's needs and objectives. When being sold fund investments under the DSC option (aka "back end load" option), the investor does not directly pay a sales commission to their dealer or representative at the time of purchase .While the upfront fee paid to the dealer will show up in CRM2 cost reporting, any subsequent early redemption penalties incurred by the investor will not.

We're told that data from Investor Economics, as at December 2015, 20% of Canadian fund assets totaling $234 billion were held in the DSC option. It is also typical for trailing commission rates to double at the expiration of a DSC redemption schedule (5 to 7 years) - a trailing commission rate of 0.50% for an investment held in an equity fund under the DSC option may increase to 1.00% at the expiration of the redemption schedule. Surely, the amount of "advice" needed (or supplied) does not double simply by this administrative change. The Canadian fund market is unique in its relative reliance on DSC and low load options. While making up 20% of mutual fund assets in Canada today, these options make up less than 1% of mutual fund assets in the United States and Europe which suggests to us some form of mis-selling is taking place.

In fact a MFDA compliance review completed in Dec. 2015 uncovered instances of the inappropriate use of the DSC option including clients over age 70 that were sold funds under DSC arrangements; clients who were sold funds with DSC redemption schedules that are longer than their investment time horizon; and evidence of poor disclosure of the redemption fees at certain firms and poor suitability assessment and supervision of sales under the DSC option. In a Dec. 15, 2016 MFDA Review of Compensation, Incentives and Conflicts of Interests, the MFDA identified compensation and incentive practices that increased the risk of mis-selling funds under the DSC option. It provided a couple of examples: One firm paid some representatives as little as 10% of trailer commission on client accounts. But new sales commissions on DSC funds were paid out to the rep at rates between 40% and 75%. Another example was of a firm that paid 10% commission bonuses on sales in excess of $500,000 on DSC or low-load funds, and additional production bonuses for each $1 million of sales of DSC or low-load funds.

The DSC option makes no sense to us especially in a period of near zero front-end load (FEL). The CSA notes that although DSC options have been falling in terms of market share, assets in these series continue to grow. In total, $241 billion was held in DSC options at the end of 2015, and these options grew 19% over the last five years (largely due to the growth of low load fund series assets which grew 101% over the last five years versus 3% for traditional back-end load series). While making up 20% of mutual fund assets in Canada today, these options make up less than 1% of mutual fund assets in the United States and Europe- the question is why? Based on our experience fund investors with nominal amounts to invest are the most likely to be offered DSC purchase thus disadvantaging them along several dimensions. We note that Investors Group will be abandoning the DSC option which Morningstar estimates will impact 25% of total assets held in the DSC option. At the end of March, Dynamic Funds announced that as of

June 30, 2017 the DSC purchase option will be closed to new investments. It looks like the DSC is self-extinguishing- a positive sign.

The CSA further note that "Further analysis of MFDA enforcement files show that the DSC option can attract dealers/representatives promoting unsuitable leverage strategies on their clients or churning the client accounts .Recommendations that clients borrow to invest in funds on a DSC basis enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction." **We urge the CSA to (a) prohibit referral fees and (b) constrain fees on leveraged money as ASIC has done i.e. account fees only on <u>net</u> assets.**

In our interaction with complainants we see some salespersons recommend drawing out the 10 per cent "free" funds from a particular fund. This is a potentially positive thing, in that it reduces the potential DSC fees for the client. If the advisor moves those units of the fund to the same fund but a different class (for example, XYZ Canadian Equity fund DSC switched to XYZ Canadian Equity front-end load with no commission), that is a good thing for the client. But when the fund salesperson regularly moves those 10% "free" funds into a new fund or fund company on a DSC basis, they are simply getting another 5% upfront payment and extending the time the client is trapped in their investment. This abusive practice is not being flagged by compliance. We recommend that the SRO's immediately put dealers on notice that this practice must cease.

Another tactic we have seen is that the mutual fund salesperson coincidentally decides it is time for a change in direction. They sell the fund and put the client into a new DSC fund, starting the redemption clock all over again for the investor, and receiving a new 5 per cent upfront payment from the mutual fund company. **We recommend that the SRO's immediately put dealers on notice that this practice must cease.**

DSC in RRIF's can be a killer for seniors because of minimum annual withdrawal requirement [early redemption penalties run into the tens of millions of dollars annually].Based on our experience, lucrative trailers are the motivation for the sale of DSC funds in RRIF's and RRSP's. Note that DSC penalties cannot be offset against capital gains in registered accounts. Such irrecoverable penalties impair account returns for retirees and pensioners. **We recommend that the CSA should act immediately to phase out the DSC option regardless of any decision on embedded commissions.** [the CSA expect a decline of 15-25 bps based on the pricing practices of investment funds that separate these purchase options into unique series (as DSC purchase options typically tend to be more costly to administer than front-end or no load options].

Issues also arise when there is a fundamental change in the nature of the fund. If DSC survives, we recommend that requirements be developed to provide unitholders with an opportunity to redeem securities without penalty in the case of fundamental changes to a fund.

Mutual fund sellers claim that these fees are supposed to encourage people to "buy and hold" for a longer time. However, if somebody is not getting the level of return they expect (or the quality of service they desire), this just traps people to stay with the same fund company. Investors might be interested in "buying and holding" but with a different fund; the DSC fee effectively prevents this. **Notwithstanding any changes to embedded commissions, we urge the CSA to declare that DSC sold funds are harming investors and should be wound down**. They do not meet the requirement of dealing, fairly, honestly and in good faith with clients.

F. Fair complaint handling is essential
Fair complaint handling is particularly important for all investors, particularly seniors. In our view, investment complaint handling in Canada is exploitive. Too many valid complaints are rejected by the mere issuance of a form letter claiming the dealer is not at fault. The very public attack on the Ombudsman for Banking Services and Investments (OBSI) is symptomatic of adversarial behaviour by the financial services industry. Regulators need to meaningfully enforce the requirement that complaints be handled fairly and in a timely manner. Regulatory rules need to include requirements for detecting and promptly dealing with systemic issues. What is ultimately necessary is a clear path to financial restitution which doesn't exist now except through the difficult and expensive civil litigation process See *IIROC complaint handling rule needs an update* http://www.canadianfundwatch.com/2016/01/iiroc-complaint-handling-rule-needs.html The ineffective IIROC complaint handling rule needs an overhaul without undue delay.

OBSI only provides a *recommendation* for restitution. Due to industry intransigence, OBSI has been forced to issue "Name & Shame" News Releases which appear to have had little effect on an apparently shameless dealers.] Conclusion? OBSI recommendations should be binding on dealers. See the Independent Reviewer's complete set of recommendations at https://www.obsi.ca/en/download/fm/539/filename/2016-Independent-Evaluation-Investment-Mandate-1465218315-e9fa5.pdf The OBSI Board has already recommended that OBSI be granted binding recommendation authority. Each day that passes without such authority exposes Canadians, especially vulnerable investors, to exploitation via unjust compensation denials and low ball settlements. **The CSA must grant OBSI binding recommendation authority and agree with the strategic purpose of OBSI without further delay.**

G. IIROC OEO guidance may curtail Consumer Choice
One of the issues that will arise if mutual fund trailers are prohibited is what choices will be available to the retail investor. Clearly, direct to client firms like Steadyhand noted for being investor-friendly and which have never paid trailers, might see an uptick in business as would robo-advisors. Another viable channel might be online brokers , disparagingly referred to by IIROC as Order Execution Only dealers .IIROC are currently contemplating reining in the scope of activities permitted by what we refer to as ebrokers. They intend to redefine the meaning of *recommendation* and *advice* and

thereby limit the tools and services available to the DIY investor, a category that could swell after investors confront CRM2 reports for the first time.

If IIROC institute a much more nuanced interpretation of recommendation it will reverberate back through the rules and will impact compliance at the broker level. We think this is a bigger deal than most people are making out. As the consultation is depicted as Guidance, the CSA may not need to approve the IIROC anti-competitive initiative.

Allowing Canadians to control their own financial destiny is a stated Government objective and DIY investing fits that bill very well for basic needs. It seems to us that the CSA should examine the proposed IIROC Guidance in light of all the regulatory initiatives underway, particularly this one. Clearly there is a need for services that help investor structure portfolios and it may well be that use of these services would fall under higher accountability standards. But there is nothing stopping the implementation component, the core discount brokerage, from remaining as is and separate. We see no reason for adding regulation to the transaction engine at all.

And what of course is the value and cost of allocation components and how can we get the investor to accept the risks and returns of those components. Additionally, if the discount side does develop more tools that mirror a lower cost way of getting advice as opposed to implementation, then yes, it may attract more and more investors who are not as capable of making their own investment decisions, people who do not understand the tools or what they really mean. Could this lead to investor protection issues? In our experience we have not seen any valid investor protection concerns or an influx of client complaints related to "advice" in this channel.

Canadian investors are being squeezed by the proposed OEO guidance.....required to take responsibility for advice presented as merely guidance by regulators and not allowed to take responsibility for their own decisions when deciding to do so....nowhere to run, nowhere to hide.

We expect to see pricing for structure and advice start to develop in the open, separate from products/transactions, which would be a good thing. But of course we have to be wary of the fact that many firms may well attempt to use the discount brokerage side as a way of dumping small clients in an increasing tech world (or alternatively for larger account sizes ,improperly reverse churn them in fee-based accounts). What we are really concerned about here is preventing the development of services that could compete with the current full service (conflicted and much higher cost) business model. It is unfortunate that these issues are being addressed within a significant universal constraint and that constraint is a system which does not properly regulate advice and which is product distribution focused. In an alternate universe the same consultation would be focusing positively on how we could develop the evolution and accessibility of advice for ordinary Canadians. **We urge the CSA to require IIROC to stay its plan to constrain discount brokers.**

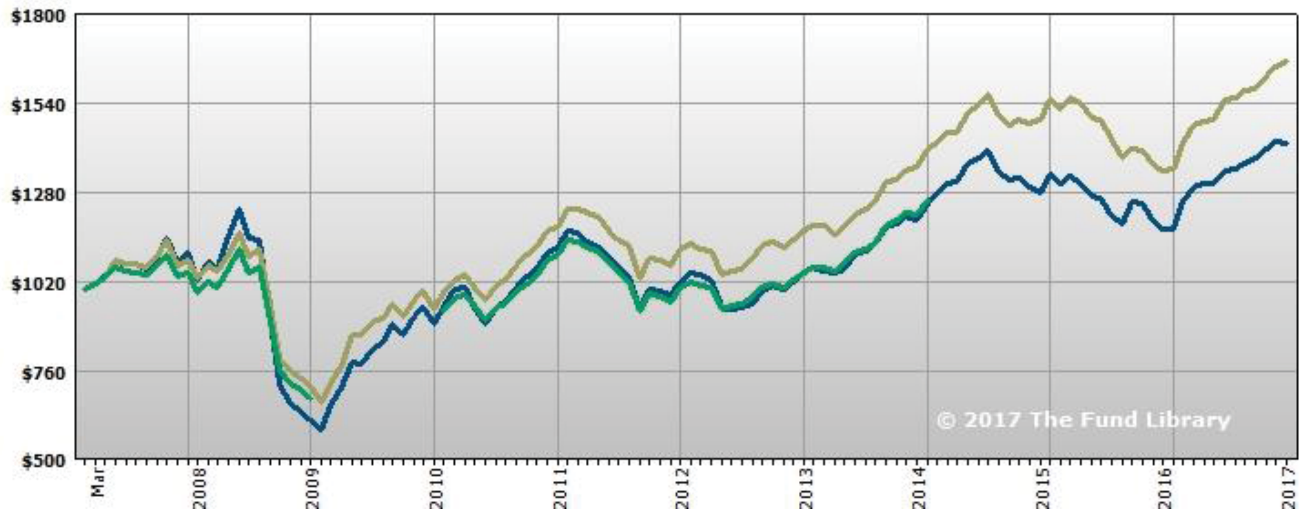
H. Canadian fund risk-adjusted performance re impact of trailers
The CSA postulate that fund managers may be aware their funds will continue to have new inflows of cash when there are relatively high trailer commissions so may have less motivation to perform well / take risks to ensure clients remain invested. The CSA state that the research that they have gathered and reviewed suggests that this inherent conflict-of-interest diminishes the investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns. There is no doubt that an embedded commission creates a conflict-of-interest.

Portfolio managers are supposed to be fiduciaries so we expect that fund governance protocols do not permit this conflict-of-interest to exist. If it does, the CSA should commence enforcement actions. For example, paying full trailers to discount brokers does It is clear that extracting fund assets to compensate distributors impairs fund returns.

The fact that dealers promote higher margin products seems to play out in that direct-to -client fundcos with solid performance have difficulty attracting clients and index products are rarely sold despite their positive advantages for the small investor. The latest SPIVA report demonstrates that the majority of Canadian actively-managed mutual funds do not beat their passive benchmark over longer time periods. The comparison is not totally valid however because the index is costless and frictionless and does not include the cost of distribution (aka “advice”). **We would need to see a deeper analysis to conclude that competitive market forces (based on after -fee performance) are insufficient to overcome the implied conflict-of-interest created by distribution channel access achieved by trailers.** There may be other forces at work.

A G&M article *Canadian mutual funds are the world leader in closet indexing* http://www.vandermeerwealth.com/pdf/Canadian_mutual_funds_are_the_world_leader_in_closet-indexers.pdf suggests that sub-par performance may be deliberate, not necessarily due to the influence of trailer commissions. In their paper, **Indexing and Active Fund Management: International Evidence,**” four professors of finance – Martijn Cremers of Notre Dame, Miguel Ferreira of the Nova School of Business and Economics, Pedro Matos of the University of Virginia and Laura Starks of the University of Texas at Austin – estimate that about 37 per cent of the assets in equity mutual funds sold in Canada are in closet indexers. The implication here is that Canadians are paying for active management but are not receiving it. Depending on the magnitude of the shortfall, the impact on returns could be more significant than the effect of trailers.

See for example TD Canadian Equity A (MER=2.18 %, Assets $ 4.9 billion



Blue: TD Canadian Equity Fund - A
Gold: S&P/TSX Composite Index TR Benchmark
Green: Fund Library Canadian Focused Equity Average

Showing chart for past 10 yr(s).

Chart period: 10 Years GO

We eagerly await the results of the CSA investigation into closet indexing.

The Cumming report results can also at least be partially explained by forces in addition to trailer commissions. For instance, it can be argued that the bank branch network is so convenient for most time- pressed Canadians that investable cash does not necessarily flow to top performing funds but rather to "OK" proprietary funds readily available at bank branches. At the end of 2015, 69 % of assets in the MFDA channel were held at dealers that focussed primarily on proprietary funds. This may be why independent fundcos like Fidelity and Invesco have to have superior returns to attract assets from a smaller segment of the investing population that actually pay attention to fees, performance, risks and taxes.

In our view, it is the structure of the Canadian fund distribution channels that is the dominant factor in influencing fund flows even after considering the not insignificant impact of trailers. Eliminating trailers without implementing other reforms may have the unintended effect of concentrating fund assets even further with bank and insurance owned dealers [Deposit –taker and insurer owned fund dealers dominate fund distribution in Canada. At the end of 2012, of the 37% of households that owned investment funds, 87% purchased their funds through a deposit-taker/insurer owned distributor while only 18% purchased their funds through an Independent/other fund distributor; according to Morningstar data, the banks' combined share rose from 39% at the end of 2011 to 48% by September 2016.] .This growing dominance may not be unacceptable to regulators but at least it should be a factor in restructuring / redesigning the “advice” (“wealth management") business in Canada.

I. Rules without Enforcement are just words

According to the 2013 CFA Institute Global Market Sentiment Survey, financial firms have themselves to blame for the lack of public trust in the industry. The survey found that over half of the respondents outside of Canada (56%) believed that the lack of an ethical culture within financial firms was the biggest factor contributing to the current distrust of the financial industry. In Canada that number was slightly higher at 58%.According to the survey participants, one way to regain the public's trust is through the improved enforcement of existing laws and regulations. Globally, 24% of CFA members agreed with this approach. Of the CFA members surveyed in Canada, 27% felt this was one of the best ways to improve investor trust and market integrity. Source: http://www.cfainstitute.org/about/research/surveys/Pages/global_market_sentiment_survey_2013.aspx We have been advocating this since 2005.

As we have pointed out many times before, that without robust enforcement, the rules don't matter much. We have for years illustrated how few investor complaints are actually investigated by SRO's and Commissions. When we review Hearing Panel decisions we find the bulk of actions are against individuals rather than the root cause of most issues, the dealers. When the dealers are investigated we find that mitigating factors overwhelm aggravating factors, sanctions are modest and root causes are not resolved. More recently, we have seen how the regulators have handled the so-called double dipping scandals. A major aspect of the scandals revolved around fee-based accounts and A class mutual funds paying trailers commissions. In effect, the dealers were collecting fees twice over long periods of time.

Steadyhand president Tom Bradley summed up investor displeasure at the regulatory settlements in these words". *“Then there were four. Four banks have now disclosed to the Ontario Securities Commission that they were overcharging their wealth management clients. BMO is the latest to self-report that they were double charging their clients (following in TD, Scotia and CIBC’s footsteps). In a no-contest settlement last week, the bank agreed to compensate 60,000 clients to the tune of $50 million. The BMO case is interesting because the overbilling was not just isolated to BMO Nesbitt Burns, the brokerage arm. It was endemic, with clients also being overcharged in BMO Private Investment Counsel, BMO Investments (bank branches) and BMO InvestorLine (discount broker). .. In my view, these four institutions are getting off way too easy, as are the advisors and branch managers involved. Fee-based accounts, which caused most of the problems here, are not complicated, so the overcharging can’t be blamed on a systems error. I can assure you that in investment firms, inputs or factors that impact compensation are never overlooked (30 years of managing investment professionals allows me to say that). The banks' systems may be inadequate, but they are not the reason for this betrayal of client trust. They also got off easy because all four announcements were reported one day and forgotten the next. And the fines paid to the OSC were token. The big amounts (i.e. $50 million for BMO and $73 million for CIBC) simply involved returning the clients’ own money to them (with 5% interest).”* 50 million more reasons for CRM2 - Episode 4 - by Tom Bradley https://www.steadyhand.com/industry/2016/12/21/fifty_million_more_reasons_for_crm2/

Investment Fee Overcharging Summary: PIAC

Institution	Reimbursement to Clients	Number of Accounts Affected	Duration of overcharging	Contribution to Investor Protection Initiatives	Date of Settlement
BOM	$49.9 Million	60,393	2008-2016	$2.1 Million	December 2016
CIBC	$73.2 Million	81,575	2002	$3 Million	October 2016
Bank of Nova Scotia	$20 Million	45,703	2008 to 2015	$800,000	July 2016
TD	$13.5 Million	10,480*	2000 to 2014	$600,000	November 2014
Quadrus Investment Services Ltd.	$8 Million	3,329	2011	$250,000	November 2015
CI Investments Inc.	$156.1 Million	360,000	2009 to 2015	$8 Million	February 2016
Totals	**$320.7 Million**	**515,777**		**$14.75 Million**	

*This was one category of violation where the number of affected accounts was not listed.

Another example of lax enforcement:
This is a very puzzling comment from the CSA Footnote 62, page 41

Advisor class units that are offered by some ETF providers are designed for advised investors and are meant to be purchased through an advisor. The only difference between this class of units and the common class units is the trailing commission component (or alternatively denoted the "service fee" component) embedded in the management fee of the Advisor class. We do not know if these holdings of Advisor class units in the online/discount brokerage channel are a consequence of previously advised assets transferring in or are due to investor error. However, we note that some discount brokerages do make Advisor class units available for trade on their platforms.

Given this knowledge, how can the CSA / IIROC possibly justify non-intervention? The mere offering of Advisor Class in these instances is wrong, contrary to the duty to act fairly, honestly and in good faith and basic morality. This is nothing more than a money grab. When the CSA makes findings like this, they have to publicize and name names. Should the public not know which discount brokers do this? It provides a signal as to ethics. In CP 33-404, the CSA makes a big deal out of information asymmetry yet when it is in a position to even out the information imbalance it appears quite reluctant to do so. **Kenmar are of the firm conviction that this lack of meaningful and timely enforcement of existing rules is a major cause for so many negative retail investor outcomes.**

APPENDIX III: Research Reports and materials we considered

The documents listed below paint a clear picture. The takeaway message is that the mutual fund industry has evolved into a sales and marketing culture. Sales incentives like trailers support this culture .Any financial advice provided is incidental, undefined and ad hoc and unregulated. Fund industry lobbyists have been successful in blunting reforms in the $1.3 trillion Canadian mutual fund industry. This has however resulted in needed investor reforms being delayed or derailed.

There have been periodic attempts to break the embedded commission model and give DIY discount investors what they want: the stock-picking prowess of portfolio managers but without advice. In 2004, E-Trade Canada announced it would sell the F class funds of Invesco Trimark Investments and Elliott & Page. Self-directed investors cheered but both firms soon reversed themselves after the rest of the industry made known its deep displeasure. Today Questrade Inc. has its Mutual Fund Maximizer program, which rebates trailers on most big broker-sold funds. A few fund companies offer F series, so Maximizer broadens the range of funds from which to choose. But some discount brokers that offer trailer rebates have been told to stop the practice for their funds. In 2013, a major bank-owned discount broker cut top performing Steadyhand funds out of its lineup because it does not pay trailers. It varies from dealer to dealer, and it changes from time to time. Some don't charge anything - Qtrade, iTrade and BMO Investorline. The others mostly charge a fee for either the purchase or sale, but not both- fees vary considerably.

We are informed that at least one bank-owned dealer has removed Steadyhand, Mawer and Leith Wheeler from their platform because they don't pay a trailer. If trailers are banned, we'll probably see more pricing uniformity. Our preference would be that DIY investors get charged the same commission they get on ETF trades - i.e. $9.95 or less. [Industry talks about investor choice but discount brokers are distorting the market by keeping these low cost funds away from DIY investors See *Purchasing Steadyhand through Discount Brokers - Clearing the Air - Steadyhand Investment Funds* (2013) https://www.steadyhand.com/industry/2013/03/27/purchasing_steadyhand_through_discount_brokers_clearing_the_air/]

If the industry was client-focused , fund manufacturers would reduce price breakpoints, introduce more D Series funds and eliminate DSC money market funds .It seems odd that investor advocates, bloggers and personal finance journalists promote TD's low cost eFunds more than TD does. TD distributes moderately priced index options to its online brokerage customers but none through bank branches. This is an industry that treats dealers/"advisors" better than customers. That's why **we would recommend the CSA to introduce competition and investor choice via access to U.S. Mutual funds as is already the case for ETF's.**

The commission-based system corrupts dealer and "advisers" Back in 2005, the MFDA said it was aware that a number of MFDA members had entered into referral arrangements with Portus, a controversial and troubled fund, regarding managed accounts involving BancNote Trust Series investments. It said "MFDA members in the affected jurisdictions must immediately cease referring clients to Portus during the period covered by the temporary order and any subsequent orders," the MFDA says. The regulator also directed dealer to "take appropriate steps" to determine if any of their Reps have entered into referral arrangements directly with Portus and if so, to cease such activity immediately. It reminded dealers and Reps that securities-related referrals cannot be entered into by Reps either directly or indirectly through another entity, such as an insurance agency or a personal service corporation, these sorts of referrals can only be made through an MFDA member. Over 20 % of Portus assets were acquired by referral arrangements that paid outsized sales commissions. A key fact about which there is clarity is that Portus paid exorbitant fees to advisors who referred their clients to Portus and provided them with sales incentives that would be banned if the investments their clients were making were in conventional mutual funds. It is also clear that the dealers/advisors who referred their clients to Portus did not look beyond the dollar signs and sales incentives in determining the suitability of the Portus investments for their clients. Nor did they seem to understand or appreciate the need for due diligence inquiries respecting the nature, structure and governance of these investments, or the nature and validity of the principal-protection arrangements. The arguments that the dealers/advisors were relying on Portus to do this points out serious weaknesses in the securities regulatory system.

Canadian Fund Industry Overview

Recently CSA sponsored research (2016) on mutual fund commissions' influence on fund flows led by Douglas Cumming, finance professor at the Schulich School of Business at York University in Toronto - and the related Frequently Asked Questions document - has triggered passionate responses. The research found that commissions and "related dealers" (those affiliated with fund manufacturers) result in higher fund flows regardless of portfolio performance. The fund industry - and financial advice providers - downplayed the report, urging regulators to do more analysis before making any policy changes. The industry's automatic "no" response to virtually every investor-friendly proposal risked bringing on the very commission ban the industry now faces. Each time such an idea surfaces, the industry seemingly puts up roadblocks rather than making constructive suggestions to move proposals forward.

How to Lose Market Share [a warning message to the complacent Canadian mutual fund industry]
http://www.investmentexecutive.com/-/comment-how-to-lose-market-share?redirect=%2Fsearch

Change and opportunity ahead for Canada's financial advice industry: Vanguard Global AdvisorTrends report
"Financial advisors play a fundamental role in providing Canadians with valuable financial advice. But their business model is changing with many advisors shifting towards fee-based business models driven in part by the implementation of Client Relationship Model reforms," said Jason McIntyre, head of distribution for Vanguard Investments Canada Inc. "Advisors see this as a positive development that can lead to greater client trust, fee transparency and an opportunity to communicate value."
https://www.vanguardcanada.ca/advisors/articles/vanguard-news/news-from-vanguard/gat-press-release.htm

CSA reveals damning evidence of impact of embedded commissions
http://www.moneysense.ca/save/investing/embedded-commissions-hurt-investors/

Mind the Gap: Active Versus Passive Edition Morningstar
Key Take-Aways
1) The biggest costs investors tend to incur don't show up on a fact sheet but are a product of their own bad behavior.
2) Investors in passive funds have tended to pay smaller bills for their conduct over time.
3) Index fund investors' reasonable expectations, or as Bogle has referred to it, index funds' "relative predictability," go some way toward explaining their exemplary behavior.
4) Channel-specific considerations have also played a part. 401(k) plans are a pipeline for legions of disciplined investors.
http://ibd.morningstar.com/article/article.asp?id=755644&CN=brf295,http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtId=12,%20brf295

Two ways mutual fund investors get burned; First they get scorched by fees, then behavioural silliness compounds the problem: They chase funds with strong track records
The typical Canadian ETF beats its actively managed counterpart by almost 2 per cent a year, after fees. If Canadian investors behave as poorly as those in the United States, those in actively managed funds would give up a further 1 per cent a year by chasing past returns. On the flipside (as mentioned above), Morningstar says index-fund investors outperformed their funds by 0.58 per cent annually during the same time period ended Dec. 31, 2015.If that were true in Canada, those who invest in index funds might beat those who invest in actively-managed funds by more than 3.4 per cent a year. You can make a lot more money if you can avoid getting burned.
http://www.globeinvestor.com/servlet/ArticleNews/story/GAM/20170203/RBGISTRATLABHALLAM

The Market for Conflicted Advice by Briana Chang, Martin Szydlowski: SSRN
Abstract: We study decentralized markets in which advisers have conflicts of interest and compete for customers via information provision. We show that competition partially disciplines conflicted advisers. The equilibrium features information dispersion and sorting of heterogeneous customers and advisers: advisers with expertise in more information sensitive assets attract less informed customers, provide worse information, and earn higher profits. We further apply our framework to the market for financial advice and establish new insights: it is the underlying distribution of financial literacy that determines the consumers' welfare. When advisers are scarce, the fee structure of advisers is irrelevant for the welfare of consumers.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843050

Banks misleading clients on mutual funds - Canada - CBC News
http://www.cbc.ca/news/canada/banks-misleading-clients-on-mutual-funds-1.1415027
Research: Top 10 Issues Facing the Canadian Asset Management Industry
http://www.pwc.com/ca/en/investment-management/publications/top-10-issues-facing-canadian-industry-2010-09-en.pdf Mutual fund companies today face the challenge of differentiating themselves in the industry. As a result, fund companies are increasingly looking to their business models to acquire and retain assets. To succeed, fund managers will not only need to develop a robust distribution model, but focus on delivering knowledgeable, quality advice. Indeed, the advice channel in Canada is gaining importance amongst investors, which could be attributed to the complexity of funds, especially given the myriad of offerings and providers that investors can choose from and the positive experiences when using an advisor. In addition to mutual funds, investors are faced with numerous investment choices like exchange-traded funds (ETFs), wrap accounts, principal-protected notes, segregated and hedge funds. To better understand these products and how they fit in their portfolio, investors are looking for trusted professional advisors.

Regulators point out anomalies in fund sales and accounting practices | Steven G. Kelman | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=655104&culture=en-CA

Financial Advisor or Investment Salesperson? Consumers Federation
http://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf

Reshaping retail fund distribution: PWC June 2015
https://www.pwc.lu/en/asset-management/docs/pwc-am-reshaping-retail-fund-distribution.pdf

Morningstar Manager Research Observer Jan. 2017 http://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_input

Margin of error: Why advisors shouldn't be off-book loan distributors - Investment Executive
"Interestingly, B2B Bank doesn't consider its clients to be the people who borrow from it. In its own corporate profile, B2B says its "client communities" are advisors and dealers. It sees itself as a lender "that serves a network of 27,000 financial professionals." It reassures them that "we don't compete with our clients by offering products directly to the public." No, indeed. Under this business model the manufacturer doesn't sell its products (investment loans) directly to consumers. Instead, the manufacturer's clients (advisors and dealers) are utilized, in effect, as product distributors. They're the sales force for these loans..."
http://www.investmentexecutive.com/-/margin-of-error-why-advisors-shouldn-t-be-off-book-loan-distributors?redirect=%2Fsearch

Stromberg report on mutual funds (1998)
http://www.sipa.ca/library/SIPAdocs/Stromberg_InvFunds-Oct1998.pdf

The Fund Library: Columns: **New fund risk-ratings regime a blessing in disguise?**
"...Now this does not mean that all managers will immediately lower the risk rating for these funds, because they do have the discretion to keep the ratings higher. However, understanding that lower risk ratings can increase the pool of potential investors and thus increase sales, it is logical to think that if some companies begin to lower their risk ratings, other will soon follow. It will also be interesting to see what happens in 2017 when the volatility we saw during the financial crisis in 2007 and 2008 begins to drop out of the 10-year SD calculation. If we do not experience a spike in market volatility within the next year, the volatility numbers will begin to fall and inevitably, so will risk ratings. So what at first what looked like an attempt by the regulators to increase the risk ratings in the fund industry could potentially give managers the ammunition they need in order to lower the ratings on many of their funds. Stay tuned...."
http://www.fundlibrary.com/features/columns/page.asp?id=16061 Kenmar continue to believe the CSA has created a risk disclosure system that will mislead investors and cause them harm. It is by far the world's worst fund risk disclosure system.

The lowdown on paying for referrals | Advisor.ca
http://www.advisor.ca/my-practice/paying-for-referrals-13121

Indexing and Active Fund Management: International Evidence January 5, 2015
Abstract: We examine the relation between indexing and active management in the mutual fund industry worldwide. Explicit indexing and closet indexing by active funds are associated with countries' regulatory and financial market environments. We find that actively-managed funds are more active and charge lower fees when they face more competitive pressure from low-cost explicitly indexed funds. A quasi-natural experiment using the exogenous variation in indexed funds generated by the passage of pension

laws supports a causal interpretation of the results. Moreover, the average alpha generated by active management is higher in countries with more explicit indexing and lower in countries with more closet indexing. Overall, our evidence suggests that explicit indexing improves competition in the mutual fund industry.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1830207

90% SALES 10% ADVICE :A SNAPSHOT OF THE FINANCIAL PLANNING INDUSTRY
http://www.industrysupernetwork.com/wp-content/uploads/2011/10/A-snapshot-of-the-financialplanning-industry-110930-1010version.pdf "The facts set forth in the report support the position long held by ISN that ongoing commissions and asset-based fees for advice enable planners and dealer groups to earn 'passive' income at the expense of consumers and should be banned, along with all other forms of conflicted remuneration. If ongoing asset-based fees are permitted to continue, credible reform requires that these fees be subject to a regular 'opt-in' mechanism. The ASIC [Australian Securities Commission] report has pulled back the curtain to reveal the extent to which the structure of the financial planning industry impedes planners from being able to act in the best interests of their client. The Future of Financial Advice reforms are essential to restructure this industry to serve the interests of clients, who are relying on advisers to help them save for retirement, build wealth, and otherwise manage their financial lives. However, the financial planning industry has stridently opposed the key aspects of reform legislation that would clean up their industry. The ASIC report makes this opposition easy to understand: this is an industry built around conflicted remuneration and passive income charged to millions of unwary clients (often from their compulsory super) who receive no ongoing services. "

Banning Investment Commissions – moving beyond "if" towards "how" | Chalten Fee-Only Advisors Ltd. | Blog
We continue to emphasize that the root cause of the Caveat Emptor advice environment is management, not the front line dealer Reps. A large minority are merely trying to survive in a toxic environment and do what they can to protect their clients. The low recruitment criteria, attractive sales inducements and weak compliance systems created by Bay Street management are the cancer that permeates the so-called Wealth Management industry today. Prohibiting trailers may be necessary but it is not sufficient to bring about a trusted advisory marketplace.
http://www.chaltenadvisors.com/blog/banning-investment-commissions-moving-beyond-if-towards-how/

PMAC Supports the CSA's Consultation on Option of Discontinuing Embedded Commissions - PMAC
PMAC see the future of personalized advice in Canada as avoiding conflicts of interest
http://www.portfoliomanagement.org/pmac-supports-csas-consultation-option-discontinuing-embedded-commissions/

Mid 2016 SPIVA Canada Scorecard

Not a single manager investing in U.S. equity was able to deliver higher returns than the benchmark, the S&P 500, over a five-year horizon.
http://ca.spindices.com/documents/spiva/spiva-canada-scorecard-mid-year-2016.pdf

Investing industry is a drag on returns- by design
http://www.theglobeandmail.com/globe-investor/investment-ideas/strategy-lab/growth-investing/why-mutual-funds-hurt-your-returns/article4619712/ "..One simple example of that drag is the fees charged by actively- managed mutual funds. Those levies take a big bite out of your returns. Andrew Hallam, the millionaire teacher and a fellow Strategy Lab contributor, has written compelling articles demonstrating that actively-managed funds underperform a broad stock market index. He's right." G&M Oct 18, 2012. , Pg B16

Conflict -of- interest part of DNA In "Conflicts of Interest and Competition in the Mutual Fund Industry," Ajay Khorana (Georgia Institute of Technology) and Henri Servaes (London Business School) examine how conflicts-of - interest in the U.S. mutual-fund industry affect competition and investor behaviour (their database covered the period 1979-1998). Overall, their paper "highlights a number of conflicts between fund families and investors," say the authors. For example, they found "no evidence that investors derive any benefit" from annual fees for marketing and distribution (12b-1 fees in the U.S). Furthermore, "fund families generally want to maximize assets under management … and the resulting management fees," an objective at odds with investors' "desire for high risk-adjusted performance at low cost."

Should Canada's financial advisors be held to a fiduciary standard?
http://dtpr.lib.athabascau.ca/action/download.php?filename=mba-15/open/punkon-aprj-final.pdf

The Cost of Active Investing Tuck School of Business at Dartmouth; National Bureau of Economic Research (NBER) April 9, 2008
Abstract: I compare the fees, expenses, and trading costs society pays to invest in the U.S. stock market with an estimate of what would be paid if everyone invested passively. Averaging over 1980 to 2006, I find investors spend 0.67% of the aggregate value of the market each year searching for superior returns. Society's capitalized cost of price discovery is at least 10% of the current market cap. Under reasonable assumptions, the typical investor would increase his average annual return by 67 basis points over the 1980 to 2006 period if he switched to a passive market portfolio.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105775

A Dissection of Mutual Fund Fees, Flows, and Performance by Douglas J. Cumming, Sofia Johan, Yelin Zhang: SSRN
Abstract: This paper provides a dissection of both mutual fund fees and flows into several categories, and presents evidence that relates specific components of fees to flows, and fees and flows to performance. For stand-alone funds that cannot be purchased directly from fund managers, fees that compensate fund advisors when investors maintain their portfolio positions, and fees that penalize investors for early withdrawal, have a much

flatter flow-performance relationship ("flow-performance slope"), and higher flows regardless of past performance ("flow-performance intercept"). Further, the data indicate that flow-performance intercept and slope are significantly negatively and positively, respectively, related to future risk-adjusted performance, which is consistent with the view that flow-performance provides a strong incentive to generate future returns. These findings are quite stable over time, and robust to numerous sensitivity checks. We find some consistency in the evidence but less robust statistical significance amongst the subsamples of direct purchased funds, and among fund-of-funds.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2678260

The Genesis of DSC Mutual Funds | WhereDoesAllMyMoneyGo.com
http://wheredoesallmymoneygo.com/the-genesis-of-dsc-mutual-funds/ Shows how the trailer was born.

Leave deferred sales charges for mutual funds to the dinosaurs - Globe and Mail
http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/leave-deferred-sales-charges-for-mutual-funds-to-the-dinosaurs/article28088507/

Talk versus action on embedded commissions ban | Advisor.ca
http://www.advisor.ca/news/industry-news/talk-versus-action-on-embedded-commissions-ban-223245

Favoritism in Mutual Fund Families? Evidence on Strategic Cross-Fund Subsidization by Jose-Miguel Gaspar, Massimo Massa, Pedro P. Matos: SSRN
Abstract: We investigate whether mutual fund families strategically allocate performance across their member funds favoring those more likely to generate higher fee income or future inflows. We find evidence of strategic cross-fund subsidization of 'high family value' funds (i.e. high fees or high past performers) at the expense of 'low value' funds in the order of 6 to 28 basis points of extra net-of-style performance per month, depending on the criteria. This overperformance is above the one that would exist between similar funds not part of the same fund family. We further document how this family strategy takes place by looking at preferential allocation of IPO deals and at the amount of opposite trades among 'high' and 'low value' funds belonging to the same fund complex (a practice that can encompass 'cross-trading'). Our findings complement the existing literature on distortions in delegated asset management by highlighting the role played by family affiliation. They are also relevant to the regulatory debate concerning 'cross-trading' between funds under common management.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=557078

Impact of Fees on Investor Returns

Numbers and percentages Most economists protect the returns for the decade ahead. This could have a major effect on the impact of product fees on your retirement security. In the past, if the benchmark return was 10 per cent and you under performed by 2%

then you left 20% of this potential return on the table. Going forward if the benchmark return is 6% and you still underperform by 2%, now you're still taking all the risk but you've left one third of the potential return on the table. Pay attention to product cost and account fees- they are more important than ever before. Be sure to scrutinize the new personalized cost reports that dealers will be issuing to you shortly.

Research: The $25 billion annual mutual fund rip-off
http://cupe.ca/pensions/The_25_billion_annua
A comprehensive study by Canadian pension fund expert Keith Ambachsheer has found that defined benefit pension plans in Canada achieved annual average returns at least 3.8% higher than mutual funds with comparable investments. Defined Benefit pension funds outperformed the market by 1.23% per year, while mutual funds had average returns that were 2.6% below the market during the 1996 to 2004 period. Returns for most mutual investors were even less than this, as a result of sales fees and consistently poor selection of mutual funds by misinformed investors: buying high and selling low. This means that those with savings in mutual funds lost a total of about $25 billion a year from the higher management fees and lower returns compared to workplace pension funds. Higher management fees are responsible for about $15 billion of this.

How much do investors lose from conflicted advice? « The Mathematical Investor
http://www.financial-math.org/blog/2015/02/how-much-do-investors-lose-from-conflicted-advice/

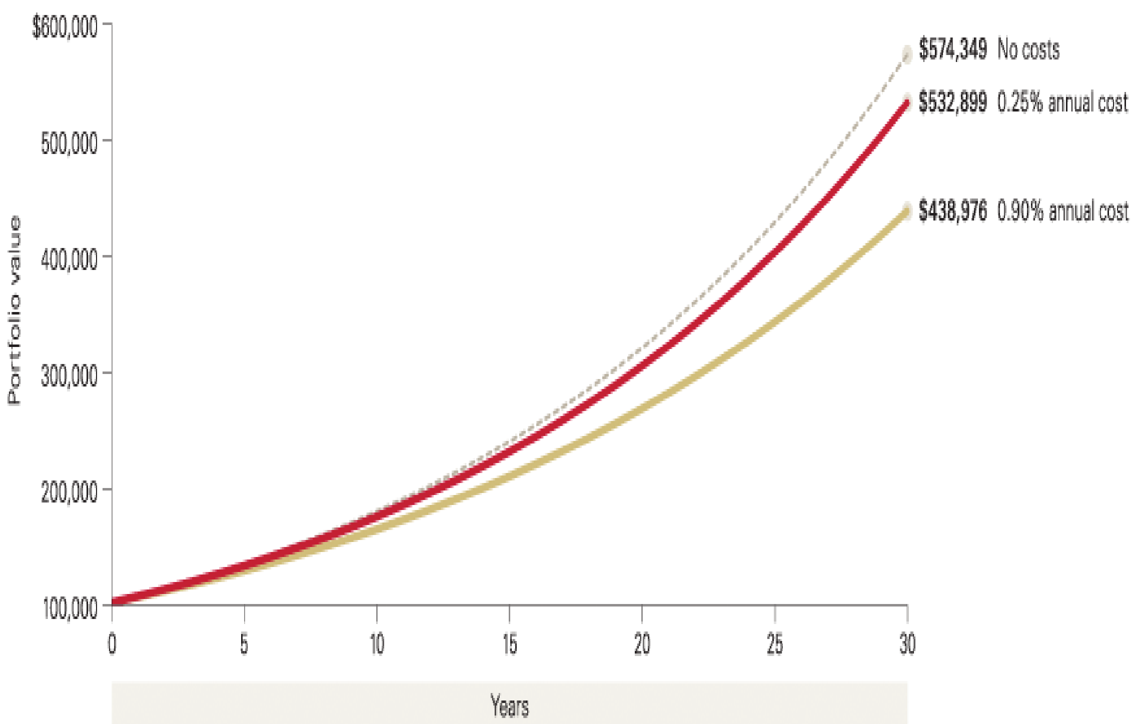
A Dissection of Mutual Fund Fees, Flows, and Performance by Douglas J. Cumming, Sofia Johan, Yelin Zhang: SSRN
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2678260

Invesco comment letter on mutual fund fees
http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130412_81-407_adelsone.pdf

Wrap accounts add costs but yield questionable benefits .The CSA confirms our experience with wraps. Over the last several years, wrap accounts (fund-of-fund products) have grown in popularity, now accounting for approximately 47% of long-term mutual fund assets under management, up from 37% in 2006 .Wrap .accounts hold substantial appeal for Reps since they are per-packaged mutual fund investment portfolios which eliminate having to do any fund selection and asset allocation . In the case of a wrap, the advisor need only assess the suitability of the top level fund rather than assess the suitability of every fund in the portfolio. Notwithstanding the dramatic workload decreases that wraps provide for dealer Reps, the trailing commissions payable on wraps are the same or higher than on stand-alone equity mutual funds. We have found no evidence clients obtain more face time with Reps; instead we are told, the time freed up is used for prospecting for even more buyers. Fund manufacturers also gain by sales [AUM] of their own proprietary funds rather than using Best-in-Class funds. The client ends up with a package of expensive funds whose asset allocation is not tailored to their individual needs, personal situation and objectives.

A fund-by-fund break down of the hidden advice fees Canadians are paying - The Globe and Mail
http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/table-trailer-fees/article29792039/

Investment fees cost Canadians hundreds of thousands
Next to buying a home, fees paid on investments can be the single biggest lifetime expense many Canadian households will have to deal with. Over the course of an investor's life, mutual fund fees can end up costing the average Canadian household $323,654.40, according to Nest Wealth, a Toronto-based digital wealth manager (www.nestwealth.com). "Put in context, the average Canadian household will spend $80,000 more on investment fees than they'll spend to raise their child to the age of 18," says Randy Cass, founder and CEO of Nest Wealth. "It's not surprising that Canadians feel like no matter how much they try to save, they keep falling further behind their goals."
http://www.newswire.ca/news-releases/next-to-buying-a-home-investment-fees-can-be-the-average-canadian-households-largest-single-expense-587432951.html



Note: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final account balances do not reflect any taxes or penalties that might be due upon

distribution. Source: Vanguard.
https://personal.vanguard.com/us/insights/investingtruths/investing-truth-about-cost

The Tyranny of Compounding Fees: Are Mutual Funds Bleeding Retirement Accounts Dry?
https://www.onefpa.org/journal/Pages/The%20Tyranny%20of%20Compounding%20Fees%20Are%20Mutual%20Funds%20Bleeding%20Retirement%20Accounts%20Dry.aspx

Lessons from proprietary mutual fund returns - Yahoo! Finance Canada
http://ca.finance.yahoo.com/news/lessons-proprietary-mutual-fund-returns-195227448.html

The costs and benefits to fund shareholders of 12b-1 plans
In Canada there is a trend to set a fixed administration rate (%) so that any gains in assets are not passed on as savings to fund unit holders.
https://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf

How Fund Fees are the Best Predictor of Returns | Morningstar
http://www.morningstar.co.uk/uk/news/149421/how-fund-fees-are-the-best-predictor-of-returns.aspx

Wrap mutual fund disappointment
http://www.fa-mag.com/news/wrap-mutual-fund-disappointment-12154.html

Wrap Account Ripoff (Forbes.com): "In 2007 Josephine DesParte, an 88-year-old Chicago widow, had $8 million tucked into an account at William Blair & Co. One-quarter of it was in municipal bond funds and cash and the rest in three stocks dear to her heart: Together the securities were generating more than $100,000 in annual dividend and interest income. DesParte's coupon-clipping strategy made good sense for the widow, but she claims the inactivity made the commission-based account a dud for William Blair. In October 2007 brokers Brian L. Kasal and William H. Ross persuaded DesParte to begin selling her stocks and many of her bonds and to diversify into a number of blue chips. They also moved her into a wrap account, which, DesParte would later claim, gave William Blair the advantage of shaving off 1.5% of her assets a year, or $120,000, in annual fees. The brokers' moves further saddled her with a $322,000 capital gains tax bill for 2007, DesParte claimed. DesParte filed a $2 million claim with the Financial Industry Regulatory Authority seeking compensation for wrongful investment losses and taxes. She was awarded $1.1 million in November 2009.
http://www.forbes.com/forbes/2010/0412/investing-brokerage-commission-retirement-finra-ripping-you-off.html?boxes=Homepagetmagazines " Needless to say, wrap accounts and managed accounts are on the upswing in Canada and wreaking havoc with portfolio performance.

Research: Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds

http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2872995 ABSTRACT : We conduct an experiment to evaluate why individuals invest in high-fee index funds. In our experiments, subjects allocate $10,000 across four S&P 500 index funds and are rewarded for their portfolio's subsequent return. Subjects overwhelmingly fail to minimize fees. We can reject the hypothesis that subjects buy high-fee index funds because of bundled non-portfolio services. Search costs for fees matter, but even when we eliminate these costs, fees are not minimized. Instead, subjects place high weight on annualized returns since inception. Fees paid decrease with financial literacy. Interestingly, subjects who choose high-fee funds sense they are making a mistake.[The composition of their subject pool , college staff/MBA students made it more likely that they would find support for rational theories; given the dismal results it is thus no surprise that ordinary Canadians have trouble figuring out fund fees]

The behaviour of individual investors
https://www.umass.edu/preferen/You%20Must%20Read%20This/Barber-Odean%202011.pdf

OSC Investor Advisory Panel Report Conflicted compensation can undermine the trust that is an integral part of the advisor client relationship. The Panel's 2013 Survey Findings on Adviser/Investor Relationship http://www.osc.gov.on.ca/en/Investors_nr_20130318_iap-adviser-investor-relationship.htm found that only 20% of investors strongly agree that they trust their financial advisor's advice while 64% overall believe that how a financial advisor is paid impacts the recommendations they receive. Furthermore, a majority (58%) rely on their financial advisor as their main source of information and yet more than 4 in 10 don't know how their advisor is being paid. The Panel also saw strong support for a statutory best interest duty – 93% agree that it is needed.

Global Fund Investor Experience Study: Morningstar June 2015
https://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf Canadian mutual fund fees are among the highest fees in the world as supported by numerous independent research studies [portfolio transaction expenses add to investor costs but are not included in the MER]. Needless to say, this severely impairs the retirement income security of Canadians.

High Fees Destroy Bond Fund Performance | Morningstar
http://www.morningstar.co.uk/uk/news/95449/high-fees-destroy-bond-fund-performance.aspx

The arithmetic of all- in investment expenses: J. Bogle
A very interesting paper. Results may be different in Canada due to higher Mutfund MER's and trading expenses. Even worse for Segregated funds. Vulnerable investors, such as seniors, may be disproportionately disadvantaged according to other research. All regulators report that complaints from seniors are disproportionately high, mostly due to unsuitable investments.

http://johncbogle.com/wordpress/wp-content/uploads/2010/04/FAJ-All-In-Investment-Expenses-Jan-Feb-2014.pdf

Banning Trailer Commissions Could Give Canadian Investors a Wealth of Lower-Cost Products | The Motley Fool Canada
http://www.fool.ca/2017/01/13/banning-trailer-commissions-could-give-canadian-investors-a-wealth-of-lower-cost-products/

Uncovering the hidden fees: Questrade
http://media.questrade.com/downloads/manuals/crm2_free_guide.pdf

Trailer commissions are BIG $$'s http://www.thestar.com/business/article/846861--daw-industry-defends-mutual-fund-trailer-fees According to a August 12th 2010 article by the Toronto Star's James Daw , *Industry defends mutual fund trailer fees* , a lot of money is at stake. He quotes Carlos Cardone, senior consultant with research house Investor Economics who says about $2 billion was deducted from Canadians' mutual fund assets in 2009 to pay advisers what are called trailer commissions. That compares with about $9.5 billion in the U.S., with ten times the population. The Canadian figure excludes what banks embed in their funds to pay sales and advisory staff. Bank funds hold roughly 30 % of total mutual fund assets in Canada. According to the CSA Consultation "A significant portion of the management fees earned by most Canadian mutual fund manufacturers on the mutual funds they manage is used to pay an ongoing commission to dealer firms. This payment was originally intended to compensate dealer firms for the ongoing services their advisors provide to investors after the mutual fund purchase, including investment advice. This is generally referred to as the "trailer fee" or "trailing commission"...Trailing commissions are usually paid by mutual fund manufacturers to dealer firms quarterly for as long as their clients hold investments in the manufacturers' mutual funds. Each dealer firm then pays out a portion of those trailing commissions to its representatives according to the firm's own compensation grid. Generally, under this compensation grid, the more commission or fee revenue the advisor generates for the firm, the greater the portion of that revenue the advisor gets to keep." There is ZERO connection to the amount or quality of advice provided or any measures of client satisfaction.

How much do actively-managed mutual funds cost investors?
http://independentinvestor.info/content/view/961/236/1/0/ "When you add up the numbers for MER, taxes and load fees you come up with the following (what is sometimes called the croupier's take; see Davis 2009 Reveal the true cost of the croupier's take doc.1825).In the US -the MER, impact and load costs add up to 3.87% of fund investments. In Canada - the comparable number is 5.13%. Therefore, the typical US and Canadian equity funds needs to outperform their index benchmarks by almost 4% and by more than 5%, respectively, in the two countries before its investors do better than the market as a whole. This is a major challenge, and the odds of any active fund manager overcoming these types of numbers are very poor. And remember these numbers do not take into account expense categories 2 (non-MER MER expenses), 3

(non-traditional management fees), 4 (mutual fund shenanigans) and 7 (risk premium) in our list because we have not been able to quantify them but which are nevertheless very real expenses."

Influence of "Advisors"

Research: *What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?* http://www.nber.org/programs/ag/rrc/NB10-05%20Chalmers,%20Reuter%20FINAL-revised.pdf

What Do Financial Advisors Do? | Investopedia
Does your "advisor" perform these tasks?
http://www.investopedia.com/articles/personal-finance/050815/what-do-financial-advisers-do.asp

Financial Advisors: A Case of Babysitters? by Andreas Hackethal, Michael Haliassos, Tullio Jappelli: SSRN
Abstract: We use two data sets, one from a large brokerage and another from a major bank, to ask: (i) whether financial advisors are more likely to be matched with poorer, uninformed investors or with richer and experienced investors; (ii) how advised accounts actually perform relative to self-managed accounts; (iii) whether the contribution of independent and bank advisors is similar. We find that advised accounts offer on average lower net returns and inferior risk-return trade-offs (Sharpe ratios). Trading costs contribute to outcomes, as advised accounts feature higher turnover, consistent with commissions being the main source of advisor income. Results are robust to controlling for investor and local area characteristics. The results apply with stronger force to bank advisors than to independent financial advisors, consistent with greater limitations on bank advisory services. http://www.csef.it/WP/wp219.pdf

The value of advice- an investor viewpoint
http://www.investingforme.com/pdfs/reports-studies/Advice-An-Investor-View.pdf

Why Don't Most Financial Planners Plan Finances?
A recent article http://www.milliondollarjourney.com/why-don%E2%80%99t-most-financial-planners-plan-finances.htm on financial planning stated:" While many financial planners claim to do financial planning and provide holistic advice, very few actually provide comprehensive planning with written financial plans, as taught in the CFP courses.The issue is best highlighted by Alan Goldhar, Professor of Financial Planning at York University and Manager for the Ontario Public Trustee. The Public Trustee takes over the finances for people that are mentally unable to make financial decisions. They have taken over more than $500 million in investments for 10,000 clients, most of which had a financial planner, broker or bank advisor. They interview the client and the family and then send in a team to obtain all financial documents. The shocking fact is that, of the 10,000 clients they took over, none had a financial plan! Not one!". For seniors, such a state of affairs is more than troubling.

Advisor Risk
https://docs.google.com/viewer?a=v&pid=forums&srcid=MDQyNjM4MzIyMTkzMjczODgyNDABMTQxNTYxNzExMTMwMjcyMzE2NzEBV2lUMEYtb1ZrejBKATQBAXYy Trailer commissions are embedded in the management fee rather than shown separately. Many retail investors mistakenly believe there is no cost to buying or owning a mutual fund. They don't grasp the long-term significance of distribution costs on account performance. Dealer Representatives aren't required to disclose all forms of their compensation that they earn from clients' fund investments. If mutual fund costs and compensation practices aren't mentioned to clients, they don't become a factor in a client's decision-making. This creates a risk for unsuspecting clients.[Costs deter only one of six investors from buying, according to an Investor Education Fund survey which is a major financial competency problem in itself.]

The value of advice: An investor viewpoint Kenmar Associates
http://www.investingforme.com/pdfs/reports-studies/Advice-An-Investor-View.pdf

Financial Abuse - (this insightful exposition was written several years ago before the IDA morphed into IIROC). Author Andrew Teasdale is an expert on suitability, KYC and portfolio construction)
http://moneymanagedproperly.com/new_folder/rights%20and%20abuse/financial%20abuse.htm **" "...Trailer fees:** Trailer fees are annual fees paid by a mutual fund company to an investment advisor for recommending the mutual fund. The investor does not need to be told about this even though the money is paid from the investor's own funds. Likewise the advisor has no obligation to do anything for the client to earn these fees. Trailer fees and other referral type fees are an abuse of the client -advisor relationship and, unless these fees are disclosed and used to offset valid and identifiable services performed by the advisor, they increase costs and are detrimental to an individual's financial position. The greed of the industry has seriously affected the ability of mutual funds to meet the objectives and needs of the individual. Indeed, the benefits of one of the most efficient investment vehicles ever invented have been submerged under the self- interests and costs of an industry that has lost sight of its reason for being...." [The fact that trailer commissions as a percentage of "adviser" income has risen since 1996 was not known to retail investors .The lack of disclosure added to investor risks and may explain the apparent increase of leveraging and the rapid rise of wrap accounts]

Research: Legal liabilities of Financial Advisors in Canada
http://www.canadianfundwatch.com/2012/10/legal-liabilities-of-financial-advisors.html

Financial Advisors Encourage Bad Behavior
http://www.forbes.com/sites/rickferri/2012/03/30/financial-advisors-encourage-bad-behavior/

The Market for Financial Advice: An Audit Study This working paper by Sendhil Mullainathan (Harvard), Markus Noeth (University of Hamburg), and Antoinette Schoar (MIT), was recently published by the National Bureau of Economic Research (NBER), a private, non-profit, non-partisan research organization. Most individual investors consult a financial advisor before purchasing investments. Given the central role of advisors in the investment process, Mullainathan, Noeth and Schoar tested whether financial advice serves to de-bias individual investors and thus correct mistakes they might make without these inputs, or whether advisors encourage the same bad behavior. The study defines 'good advice' as recommendations that move investors toward a low-cost, diversified index fund approach, which textbook analyses on mutual fund investing suggests. Overall, their findings suggest that the market for financial advice does not alter individual investor biases, and if anything may exaggerate existing biases. They also found that advisor self-interest plays an important role in generating recommendations that are not in the best interest of the clients. They are unwilling to lean against these biases even when they know they exist because not doing so helps them further their own economic interest.

Research on Fund fees: Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows
http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/Out%20of%20Signt.pdf The more opaque the fees, the easier it is to bamboozle retail clients. The paper by Brad Barber, Terrance Odean and Lu Zheng concluded that: "..*We report evidence that mutual fund marketing does work. On average, any negative effect of expense fees on fund flows is more than offset when that money is spent on marketing; non-marketing expenses, however, reduce fund flows. Though [front load] load fees are also spent on marketing, the positive effect of marketing on flows does not appear to be sufficient to offset investors growing awareness of and aversion to loads…" While operating expenses (including embedded trailers) constitute a steady drain on a fund's performance, the effect of that drain is masked by the considerable volatility in the returns on mutual funds…"* [We've always found it curious that the fund manufacturer marketing materials and advertisements do not refer to the advice component of the mutual fund value proposition. It is strange because IFIC gives advice such emphasis in their lobbying literature.]

Macro Considerations

Have active Canadian fund managers earned their keep?: Morningstar
http://www.morningstar.ca/industry/articles/Active_Passive_White_Paper.pdf

CFA Institute Integrity List: 50 Ways to Restore Trust in the Investment Industry
http://www.cfainstitute.org/about/vision/serve/Pages/integrity_list.aspx #3 **Place the client's interests before your own ;** #8 **Strive for a conflict-free business model**

Barriers to financial advice for non- affluent consumers
https://www.soa.org/researchbarriers/

Risks to Customers from Financial Incentives: FSA
http://www.fsa.gov.uk/static/pubs/guidance/gc12-11.pdf [UK FSA] This is an excellent document demonstrating how incentives distort advice. After extensive research the FSA found that:
• Most firms did not properly identify how their incentive schemes might encourage staff to mis-sell. This suggests they had not sufficiently thought about the risks to their customers or had turned a blind eye to them.
• Many firms did not understand their own incentive schemes because they were so complex, making it harder to control them.
• Firms did not have enough information about their incentive schemes to understand and manage the risks.
• Most firms relied too much on routine monitoring, rather than risk-based monitoring, such as performing more checks on staff with high sales volumes.
• Some firms had sales managers with a clear conflict- of- interest that was not properly managed.
• Many firms had links to sales quality1 built into their incentive schemes that were ineffective.
• Some firms had not done enough to control the risk of potential mis-selling in face-to-face situations.
Such results have caused the FSA to essentially ban commissions

Why hasn't indexing taken root in Canada? | Christopher Davis | Fund Investing | Morningstar
"..That's not a problem for Canada's six largest banks, which have successfully used their built-in distribution network of bank branches to sell in-house funds. The banks control an increasingly large slice of long-term mutual fund assets. According to Morningstar data, the banks' combined share rose from 39% at the end of 2011 to 48% by September 2016. (Investors Group, which controls 7% of long-term fund assets, uses a distribution model similar to the banks, selling only funds with its house label through its giant national network of advisors.)..."
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=781441

Horizons abandons advisor-class ETFs
Horizons says it will halt sales of its advisor-class units by Jan. 31, and expects to fully eliminate these units by the end of April by converting them into common units of the same ETFs. The Horizons announcement on Dec. 29 comes less than two weeks before the scheduled Jan. 10 release of a consultation paper by the Canadian Securities Administrators, which is expected to propose a ban on embedded commissions paid by mutual funds and ETFs.
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=787238

Study shows trust for advisors in Canada down

Entitled *From Trust to Loyalty: A Global Survey of What Investors Want*, the survey also showed that in Canada, strong ethics was the most important factor for clients. "Overall, trust globally is up from 50% to 61% so that's the good news," she says. "In Canada, we are still above the global average with 64 per cent, but that is down from the 2013 survey when we were at 76%. Globally the financial markets have done better in that timeframe, while the reverse is true for Canada, so I think that might be the rationale for the change in sentiment." http://www.wealthprofessional.ca/news/study-shows-trust-for-advisors-in-canada-down-208737.aspx and https://www.cfainstitute.org/about/press/release/Pages/02172016_128524.aspx

Fund Fact sheets littered with weaknesses
http://www.theglobeandmail.com/globe-investor/investment-ideas/fund-fact-sheets-littered-with-weaknesses/article625822/ In this piece respected fund analyst Dan Hallett discusses FF deficiencies re risk disclosure . We agree with Dan's observations and also add that we have for the past 4 years been pleading with regulators to spell out Rep/dealer conflicts-of-interest and locate fund fees disclosure ahead of performance on the Fund Facts form. Relocating cost information would give costs more prominence.

Managing conflicts of interest in the financial services industry: ASIC
The paper seems to suggest that extraordinary effort is required to "manage" conflicts but in the end ASIC concludes that if the efforts are expended, ASIC will consider the conflicts "managed" re investor protection. Corporate culture, policies, employee training, oversight and regular audit are required. Maybe better to avoid conflicts of interests altogether.
http://download.asic.gov.au/media/1327370/Conflicts_discussion_paper_April_2006.pdf

Guidance on conflicts of interest for investment advisors: Research
It appears that under a fiduciary or BI advice standard, the "management" of conflicts of interest is extremely difficult. Avoidance may be the only way since disclosure has been shown to be ineffective even detrimental in the retail investor case. We wonder if there is any research that demonstrates conflicts can be satisfactorily managed at the retail investor level.
http://www.foxrothschild.com/content/uploads/2015/05/Horn-Guidance-on-Conflicts-of-Interests-for-Investment-Advisers-February-2015.pdf

Seniors/ Retirement

The Feeling's Not Mutual | Canadian Centre for Policy Alternatives
The High Costs of Canada's Mutual Fund Based Retirement System
David Macdonald **FEBRUARY 25, 2015** Download
Abstract: This study compares the management fees charged by mutual funds and pension plans, and finds that high management fees will cause Canadians relying on mutual funds for their retirement income to work longer or retire with less, compared to those with pension plans. The study recommends an expansion of inexpensive workplace

pension plans or public pension plans, like the CPP; and as a stopgap measure, trailers fees—the portion of mutual fund fees that go back to the advisor—could be capped or banned entirely.https://www.policyalternatives.ca/publications/reports/feeling's-not-mutual

OSC IAP Seniors Roundtable: Facilitator's Report
http://www.osc.gov.on.ca/documents/en/Investors/iap_20141212_facilitators-report-seniors-roundtable.pdf

University of Toronto Research Report: Fraudsters Take Aim at the Baby Boomers (May, 2007)
http://www.utoronto.ca/difa/PDF/Research_Projects/DIFA2007

PROTECTING SENIOR INVESTORS: REPORT OF EXAMINATIONS OF SECURITIES FIRMS PROVIDING "FREE LUNCH" SALES SEMINARS – U.S. Securities and Exchange Commission
https://www.sec.gov/spotlight/seniors/freelunchreport.pdf

Seniors, Suitability and Ethics
http://fpawi.org/downloads/Symposium_2011/2._2011_symposium___ethics___seniors_suitability_handout.pdf

Fact Sheet: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings | whitehouse.gov
https://www.whitehouse.gov/the-press-office/2016/04/06/fact-sheet-middle-class-economics-strengthening-retirement-security

Retirement Security - theZoomer: Television For Boomers With Zip!
Great feature story on advisors and retirement security Lawyer Harold Geller, Alan Goldhar, Keith Ambachtsheer, John DeGoey, Cary List and investor Peter Whitehouse explain the sorry situation. A strong argument for Best interests is made.
http://www.thezoomertv.com/videos/retirement-security/

Purse Strings Attached: Towards a Financial Planning Regulatory Framework
.The report reveals that the pace of reform has been slow for an industry entrusted with the retirement security of Canadian consumers. "It's time all employees of the financial planning industry in Canada face the reality-they need to employ a uniform standard of care for investors, complete with a full disclosure of how they're being compensated," notes Jonathan Bishop, co-author of the report. The research reveals Canadian consumers are potentially leaving thousands of their retirement dollars in someone else's hands by conflicts of-interest .The report concluded that the time remains ripe for provincial consumer and finance ministries to work towards a regulatory framework for financial advisors. http://www.piac.ca/wp-content/uploads/2014/11/pursestrings_attached_final_for_oca.pdf

According to a Broadbent Institute study **An Analysis of the Economic Circumstances of Canadian seniors** https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659 a large percentage of older, working Canadians are heading to retirement without adequate savings. Unbiased advice would help reduce the percentage.

A recent study **Old Age and the Decline in Financial Literacy** http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1948627 shows the ability of the elderly to manage their money may decrease after they reach retirement age, but confidence in their ability to make good financial decisions stays the same. The study, found financial literacy declines at a consistent rate after retirement. The ability to answer basic financial questions decreases as respondents age, and this rate of decline almost exactly matches the gradual erosion of memory and problem-solving abilities later in life. This is worrisome because households aged 60 years and older control about half of the wealth in Canada. Since fewer employers provide pensions than ever before, more people are dependent entirely on their retirement savings and that in turn is dependent on trustworthy investment advice.

Protecting Seniors and Their Life Savings: Policies and Practices of Missouri's Investment Firms
A specific policy that ensures account information for senior clients is maintained, regularly reviewed, and updated is a solid approach to avoiding unsuitable recommendations. This information is vital because as investors age, their investment time horizons, and objectives, risk tolerance, family's needs and tax status may change. Liquidity becomes a higher priority, and products that were once a sound investment may no longer be suitable if money is locked up in complicated products where liquidation is possible only after a substantial penalty is paid. These changes in investment needs and goals can be recognized in a timely manner through regular account maintenance and updating.
http://www.sos.mo.gov/securities/MIPC/SecuritiesReport_ProtectingSeniorsLifeSavings.pdf

PROTECTING SENIOR INVESTORS –Compliance, Supervisory and Other Practices When Serving Senior Investors
http://iiac.ca/wp-content/uploads/Canadas-Investment-Industry-Protecting-Senior-Investors_March-18-2014.pdf

MFDA sets out regulatory priorities - investmentexecutive.com
" ....In terms of leveraging, it stresses that firms should have policies in place to ensure they meet their leveraging suitability obligations, including criteria for assessing the suitability of a client's use of leverage and describing appropriate circumstances for recommending the use of leverage.
The bulletin also stresses that protecting senior investors is "an area of focus and a strategic initiative" for the MFDA. It says firms should consider certain senior-specific

issues in their supervisory work, including: reviewing new account and KYC paperwork, suitability reviews, marketing and advertising, and the use of business titles specifically directed towards senior investors (to ensure they don't mislead clients). It suggests that firms should consider developing specific procedures to supervise activity with senior investors. Additionally, it notes that dealers are responsible for maintaining policies and procedures to ensure the fair and prompt handling of client complaints, and it sets out what those policies should include. This may be a particular issue for seniors, it suggests, as they may have physical limitations that would make it difficult to submit a formal written complaint; so, it suggests that dealers should be prepared to assist senior clients in documenting their verbal complaints..."
http://www.investmentexecutive.com/-/mfda-sets-out-regulatory-priorities

Attitudes Toward the Importance of Unbiased Financial Advice
AARP conducted a nationally representative survey of adults ages 25 and older who currently have—or who have had—a retirement savings account.
http://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2016/attitudes-unbiased-fin-advice-rpt-res-econ.pdf

The Best Interest Standards and the Elderly - Canadian MoneySaver
https://www.canadianmoneysaver.ca/the-best-interest-standards-and-the-elderly/

The Best interests Advice Standard
https://www.canadianmoneysaver.ca/the-best-interests-advice-standard/
The Changing State of Retirement in Canada – Fidelity (Oct., 2007)
http://m.twmg.net/state_of_retirement_cda.pdf A survey of more than 2200 households shows that Canadians are on track to replace only 50% of their pre-retirement income. To maintain a comfortable lifestyle they may need as much as 80% of pre-retirement income. That's one reason that investing fees and expenses are so important.

Retirement brings new financial challenge
https://secure.globeadvisor.com/servlet/ArticleNews/story/gam/20121127/SRWEALTHMGMTQAMPAATL The investor de-accumulation phase will have a major impact on the advice industry.Drawing down assets in retirement encompasses more than simply ensuring that clients have enough money to cover living expenses and such lifestyle choices as vacations and golf fees each year, but also that clients are not pulling so much out of retirement nest eggs that they are bumping into higher and higher tax brackets. Retirement income planning, covers just how much income people should draw from various sources: tax-deferred, tax-exempt and taxable income accounts. This is true financial planning and is significantly different from transaction based selling of mutual funds. The Regulatory and fund industry implication are self -evident. We're surprised there is so little debate about opening up a supplemental tranche of CPP as an obvious and elegant solution to most retirement concerns being discussed. Securities regulators are not qualified and ill suited to develop retirement incomes policies in Canada. Canadians at large are not willing allocators of capital. It's something they are forced into

doing in the absence of alternatives. Many cost and behavioural finance concerns would be resolved with the CPP option. Flaherty came close to going this route at the PEI first ministers conference but caved to the insurance lobby and we got the stillborn PRPP instead. We stand with Keith Ambachtsheer and Malcolm Hamilton in support of an expanded CPP.

CPP 'economies of scale' make it a cheaper alternative to PRPPs
http://business.financialpost.com/2012/11/27/cpp-economies-of-scale-make-it-a-low-cost-alternative-to-prpps/ "In the final report of the Ontario Expert Commission on Pensions, Professor Harry Authors notes: "I feel obliged to report that a significant number of submissions raised the possibility [of] an expanded or two-tier CPP. I was particularly struck by the fact that this idea was raised in different ways in briefs from stakeholders as disparate as the Canadian Federation of Independent Business and the Canadian Labour Congress.""

General interest

White Paper: The "advice gap"? Kenmar Associates
http://www.canadianfundwatch.com/2015/11/white-paper-advice-gap.html

What Investors Want: CFA Institute
https://blogs.cfainstitute.org/investor/2016/02/18/what-investors-want-2/

Investment risk and financial advice: Vanguard
Excellent summary on risk profiling issues and shortcomings. Applies to robos as well as advisors. Demonstrates the serious shortcomings of FF risk disclosure. If there is an advice gap, the lack of robust risk profiling processes must certainly be a part of the problem. Note the OSC IAP supported report (PlanPlus) on risk profiling reported serious risk assessment issues in Canada suggesting that advice based on faulty risk assessment leads to faulty advice regardless of the impact of trailers.
https://www.vanguard.co.uk/documents/adv/literature/investor-risk-profiling.pdf

Regulating remuneration systems: distribution of financial products - Oxera
http://www.oxera.com/getmedia/c28539cd-c6dc-42e4-9940-a624b0ff47ea/Remuneration-systems_Final-report_Jan2015.pdf.aspx?ext=.pdf

Are Investors Willing To Pay Up-Front For Advice? - Financial Freedom
Certainly appears to support banning of trailer commissions - however Canadians are so used to being told advice is free , it is not obvious what reaction would be . It will be interesting to see investor reaction when the first CRM2 reports are received.
http://boomerandecho.com/are-investors-willing-to-pay-up-front-for-advice/

DIY Investing Is the Only Way to Avoid Conflicts of Interest
http://www.doughroller.net/investing/conflicts-of-interest-diy-investing/

Many Canadians on shaky financial ground
http://m.wealthprofessional.ca/news/many-canadians-on-shaky-financial-ground-217634.aspx

Research: Mutual Fund Investors: Sharp Enough?
Who are mutual fund investors? The answer is critical to regulatory policy. The mutual fund industry portrays fund investors as diligent, fairly sophisticated, and guided by professional financial advisors. The SEC paints a more cautious portrait of fund investors, though touts improved disclosure by the fund industry as a sufficient antidote. However, an extensive academic literature finds that fund investors are unaware of the basics of their funds, pay insufficient attention to fund costs, and chase past performance despite little evidence that high past fund returns predict future returns. These findings suggest that policymakers should rethink current regulatory policy. Disclosure may not be enough. http://ideas.repec.org/a/ris/jofitr/0948.html

Research**: Investor behaviour and beliefs: Advisor relationships and investor decision-making study** OSC Investor Education Fund
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf ".In summary, advisors are the key influence in investor decision-making. Investors rely upon their advisor for planning and asset mix advice, as well as advice on what specific investments to buy. Other sources of information are secondary to the advisor's opinion. Investors trust their advisor to provide advice that benefits the client first. This trust is underpinned by a belief that their advisor has a legal responsibility to 'put the client's best interest first'. With this as a foundation of investor belief, investors find little reason to be concerned about fees, and perhaps as a result, fewer than half of advisors disclose what they are paid..". Another troublesome finding is that disclosure of trailing commissions declines as the age of the investor increases. Some 40% of 20-39 year olds agree that trailing commissions were disclosed versus 24% for age 40-59 and just 18% for those age 60+. This suggests to us that a seniors vulnerability issue has developed.

Can financial education improve financial literacy and retirement planning?
http://irpp.org/assets/research/faces-of-aging/can-financial-education-improve-financial-literacy-and-retirement-planning/IRPP-Study-no12.pdf ".."Danger lurks, however, when financial education is viewed as a *substitute* for, rather than a *complement* to, these other policies. Willis argues that "[a] society that believes that financial...education will solve consumer financial problems has an all-too-convenient excuse not to engage in the difficult task of finding better...public policies" (2008, 272).This is not to say that developing financial capability is unimportant — innovative efforts to help Canadians understand the need for retirement planning, to avoid the many perils of the financial services market and to take an active part in policy debates should be encouraged. Such efforts are necessary but far from sufficient... "

Pollara Poll IFIC 2016

According to the 2016 Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry, confidence in financial advisors is strong, with 95 per cent of mutual fund investors indicating they can trust their advisor to provide them with sound advice and 88 per cent saying that they get better returns as a result of the advice they receive. Eighty-two per cent credit their advisor with helping them achieve better savings and investment habits, and 91per cent say they get value for the money they pay to their advisor. One-half of investors say retirement funding is their primary motivation for investing in mutual funds and an additional 14% say their mutual funds are intended to augment their income at retirement or later in life. The current market gives consumers choices about how they access and pay for savings products and advice. The Pollara research found that mutual fund investors prefer to have choice when it comes to payment options. Just over half (54%) would prefer to compensate their advisor through bundled fees, while 37% would prefer to pay a direct fee. https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/

Investor Awareness Booklet
Enhancing the Client-Financial Advisor Relationship (Presented by Onus Consulting Group) *Evaluating Your Financial Advice While Gaining a Better Understanding of Canada's Retail Investment Industry*
http://www.onusconsultinggroup.com/uploaded_files/InvestorAwarenessBooklet.pdf

Is this the end of the line for trailer fees? Aka commissions**: Vanguard**
" Given how common trailer fees are in the mutual fund industry, any hint that commissions may be limited (or even banned as in the United Kingdom and Australia) naturally raises alarm bells from advisors worried about the impact of any restriction on compensation. Our Vanguard colleagues in the U.K. have reported that the advisors who weathered the commission ban best were those who proactively decided to adjust their practices to thrive and not just survive. Many shifted to a fee-based compensation structure, as Vanguard has advocated in our advisor's alpha framework. Our own recent global survey of advisors found this view was shared by a majority, with 83% of Canadian advisors surveyed indicating a fee-based model was better for their practices than a commission-based model, as the illustration shows."
https://www.vanguardcanada.ca/advisors/articles/research-commentary/vanguard-voices/is-this-the-end-of-the-line-for-trailer.htm?lang=en Report at https://www.vanguardcanada.ca/documents/global-advisor-trends-en.pdf

Miscellaneous

G20 HIGH-LEVEL PRINCIPLES ON FINANCIAL CONSUMER PROTECTION
See section 6 conflicts of interest
https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf

TR14/4 – Risks to customers from financial incentives – an update - Financial Conduct Authority https://www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives

The motivations, needs and drivers of non-advised clients: FCA
https://www.fca.org.uk/publication/research/non-advised-investors-research-paper.pdf
Rethinking Mutual Fund Pricing, Entirely: Morningstar
http://news.morningstar.com/articlenet/article.aspx?id=788545

Supervising retail investor advice: inducements -FCA
https://www.fca.org.uk/publication/finalised-guidance/fg14-01.pdf

Impacts of conflicts of interest in the financial services industry: U.D DOL
https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/conflictsofinterestreport4.pdf

Funds overpriced? Various studies, including Standard & Poor's well-known SPIVA reports, have shown that most funds fail to outperform their relative benchmark index fund. In some cases, the fund underperformance can be attributed to the fund's higher incremental costs relative to the benchmark's fees. In fact, a recent study concluded that a large percentage of actively managed mutual funds are priced to fail, as their fees and other costs sometimes negate their actual outperformance of their benchmarks based purely on returns...." https://iainsight.wordpress.com/2017/01/08/the-gotcha-that-wont-go-away/

If he's not rich, don't listen to him – letters to the ROB editor - The Globe and Mail
http://www.theglobeandmail.com/report-on-business/rob-commentary/rob-letters/july-23-if-hes-not-rich-dont-listen-to-him-letters-to-the-rob-editor/article31082809/

Opinion News: Opinion: **Why the time to eliminate trailers has come**
".., The mutual fund industry has no moral authority left when it comes to retaining embedded compensation. The Cummings report has shown that embedded compensation causes conflict and, as such, the people who are pro client choice are effectively pro conflicted advice..."- John DeGoey http://www.wealthprofessional.ca/opinion/opinion-why-the-time-to-eliminate-trailers-has-come-207554.aspx

FCA cracking down on inducements Report at
https://www.fca.org.uk/news/inducements-conflicts-interest-thematic-review-keyfindings
Trailer commissions not the only way advice is skewed.

UK FCA suggests reforms that would make financial advice and guidance work better for smaller investors http://www.fca.org.uk/news/reforms-will-make-financial-advice-and-guidance-workbetter-for-consumers Some of the ideas would work well in Canada too and should be considered by the CSA/Government.

Why it's hard to hope for mutual fund fee reform
http://www.globeinvestor.com/servlet/ArticleNews/story/GAM/20170203/RBGISTRATLABHALLAM

It's time to ban embedded fees - Investment Executive
"...One of the biggest beneficiaries of such a move is likely to be independent advisors. For too long, advice has been devalued by embedded compensation, which distorts the market for advice and undermines advisors' value to clients. Trailer fees work well for the investment fund companies and for dealers because trailers serve as a powerful incentive to accumulate assets - but these fees don't reward superior advice to clients and don't allow high-quality advisors to distinguish themselves. That's why advisors should embrace the CSA proposal to eliminate embedded compensation as a once-in-a-lifetime opportunity to shed a system that devalues their service, deters them from developing into genuine professionals and often compels them to be simply salespeople..."
http://www.investmentexecutive.com/-/it-s-time-to-ban-embedded-fees?redirect=%2Fsearch

Canadian Fund Watch**: Kenmar review of "A Major Setback for Retirement Savings: Changing how Financial Advisers are Compensated could Hurt Less-Than-Wealthy Investors Most "**
http://www.canadianfundwatch.com/2016/04/kenmar-review-of-major-setback-for.html

Self-assessment tool to manage conflicts of interest: IIAC
http://iiac.ca/wp-content/uploads/Conflicts-of-Interest-Self-Assessment-and-Materiality-Weighting-Considerations-June-1-2012.pdf

Is Conflicted Investment Advice Better than No Advice?: NBER
http://www.nber.org/papers/w18158

Supervising retail investor advice: inducements and conflicts-of-interest -FCA
https://www.fca.org.uk/publication/finalised-guidance/fg14-01.pdf

The Market for Conflicted Advice by Briana Chang, Martin Szydlowski: SSRN
Abstract: We study decentralized markets in which advisers have conflicts of interest and compete for customers via information provision. We show that competition partially disciplines conflicted advisers. The equilibrium features information dispersion and sorting of heterogeneous customers and advisers: advisers with expertise in more information sensitive assets attract less informed customers, provide worse information, and earn higher profits. We further apply our framework to the market for financial advice and establish new insights: it is the underlying distribution of financial literacy that determines the consumers' welfare. When advisers are scarce, the fee structure of advisers is irrelevant for the welfare of consumers.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843050

Collapsing Arguments for Conflicted Advice | Huffington Post
http://www.huffingtonpost.com/dan-solin/collapsing-arguments-for_b_8311552.html

Fund Stewardship Matters: Morningstar Research Shows Link Between Good Stewardship and Strong Performance
Morningstar evaluated the 27 Canadian fund providers to which Morningstar analysts had assigned a 2010 Stewardship Grade. The group includes both large and smaller providers, and represents approximately 75 percent of the industry's assets and 1,500 distinct funds. Among this group, Morningstar analysts assigned five firms a Stewardship Grade of "A," six firms received a "B," 15 firms received a "C," and one firm received a "D." Overall, Morningstar found that fund companies with higher Stewardship Grades had better-performing funds during the study period, as measured by their Morningstar Success Ratios.http://www.prnewswire.com/news-releases/fund-stewardship-matters-morningstar-research-shows-link-between-good-stewardship-and-strong-performance-for-canadian-fund-companies-277431651.html

Financial Illiteracy meets conflicted advice: John Turner
http://www.actuaries.org/stjohns2016/presentations/Tue_Plenary_Turner.pdf

Opinion: Conflicted advisors – when weekly sales targets take priority over client care
http://m.wealthprofessional.ca/opinion/opinion-conflicted-advisors--when-weekly-sales-targets-take-priority-over-client-care-207865.aspx

Carl Richards: **Six Things the Investment Industry Can Do to Change the World |** CFA Institute Annual The “behavior gap,” he said, comes from measuring time-weighted versus dollar-weighted rates of return. “Most of the money in a mutual fund is advised; it gets there because an adviser put it there. So if there is a big difference between the time-weighted and dollar-weighted rate of return on mutual funds, and most of the money is advised, we are part of the problem,” he said. “We are constantly creating new products. It is easy to sell to clients what they want, but it takes a bit more to have them purchase what they need, and often we are facilitating this mess we have created. Our industry has to be one of the most opaque industries in the world. Nobody really knows what they pay. It’s really hard to even figure it out.”
https://annual.cfainstitute.org/2014/05/06/carl-richards-six-things-the-investment-industry-can-do-to-change-the-world/

FAIR Canada **» Reforming Mutual Fund Fee Structure Critical For Canadians**
http://faircanada.ca/whats-new/reforming-mutual-fund-fee-structure-critical-for-canadians/

FAIR Canada » **Report to CSA Indicates Trailing Commissions Impact Fund Sales to the Detriment of Investors**
http://faircanada.ca/whats-new/report-to-csa-indicates-trailing-commissions-impact-fund-sales-to-the-detriment-of-investors/

Trailers paid to on-line brokers

We do not understand why IIROC permit trailer commissions to be received by online brokers transacting class A mutual funds. Regardless of the outcome of this consultation, IIROC should use its enforcement powers to prevent online brokers from receiving cash for advice that they do not and cannot provide. There is no way this can be considered as dealing fairly, honestly and in good faith with clients.

Bloomberg TV Canada. **Video on embedded commissions**
It's time we **Do Something' About Mutual Fund Fees in Canada:** OSC Chair Jensen
http://bloombergtv.ca/2016-09-07/news/its-time-we-do-something-about-mutual-fund-fees-in-canada-osc-chair/

Conflicted advice and second opinions: Lowenstein
http://www.cmu.edu/dietrich/sds/docs/loewenstein/ConflictedAdvice2ndOpinions.pdf

Ambachtsheer and Waitzer comment letter to CSA re Best interests
http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160909_33-404_waitzere-ambachtsheerk.pdf

Kenmar Comment letter to CSA Best Interests
http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160711_33-404_kenmar.pdf

It’s Time to Ban Advisor Commissions | Canadian Couch Potato on Advocis position
With an investment advisor, the situation is completely different. Selecting appropriate funds for the client is (or should be) a fraction of the overall service. An advisor’s time is spent primarily on goal planning, risk assessment, tax planning, portfolio maintenance, behaviour management and a host of other ongoing services. None of that has anything to do with financial products. So why should a professional advisor be compensated primarily by mutual fund commissions?
http://canadiancouchpotato.com/2013/06/13/its-time-to-ban-advisor-commissions/

Anxiety, Advice, and the Ability to Discern: Feeling Anxious Motivates Individuals to Seek and Use Advice
Across 8 experiments, the influence of anxiety on advice seeking and advice taking is described. Anxious individuals are found to be more likely to seek and rely on advice than are those in a neutral emotional state (Experiment 1), but this pattern of results does not generalize to other negatively valenced emotions (Experiment 2). The relationships between anxiety and advice seeking and anxiety and advice taking are mediated by self-confidence; anxiety lowers self-confidence, which increases advice seeking and reliance upon advice (Experiment 3). Although anxiety also impairs information processing, impaired information processing does not mediate the relationship between anxiety and advice taking (Experiment 4). Finally, anxious individuals are found to fail to discriminate between good and bad advice (Experiments 5a–5c), and between advice from advisors with and without a conflict of interest (Experiment 6).

http://www.hbs.edu/faculty/Publication%20Files/gino_brooks_schweitzer_jpsp_2012_fd79893e-9f44-4a69-9460-848527d2d598.pdf

The Gamma Factor and the Value of Financial Advice: CIRANO
This study, based on a new Canadian survey and adjusting for the causality issue, reconfirms the positive value of having financial advice. As in our earlier paper, the discipline imposed by a financial advisor on households' financial behaviour and increased savings of advised households are key to improving asset values of households relative to comparable households without an advisor. Benefitting from a subset of participants in both surveys, dropping an advisor between 2010 and 2014 was costly: those households lost a significant percentage of their asset values while the households who kept their advisor have gained in asset values.
https://www.cirano.qc.ca/en/summaries/2016s-35

How Financial Advisors Can Help Close the Behavior Gap
https://blogs.cfainstitute.org/investor/2015/07/27/how-financial-advisers-can-help-close-the-behavior-gap/

The costs and benefits to fund shareholders of 12(b)-1 plans: SEC
Some history of US embedded commissions in mutual funds.
https://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf

Why U.S. equity funds in Canada are so lousy | Christopher Davis | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=761077&culture=en-CA

Most US equity funds are priced to fail — Morningstar
http://www.evidenceinvestor.co.uk/most-us-equity-funds-are-priced-to-fail/

Fund Fees Predict Future Success or Failure: Morningstar
http://news.morningstar.com/articlenet/article.aspx?id=752485

Blowing smoke on trailer fees - MoneySense Cummings
http://www.moneysense.ca/save/investing/blowing-smoke-on-trailer-fees/

Younger investors most willing to pay for financial advice: Cerulli
http://www.investmentnews.com/article/20170104/FREE/170109984/younger-investors-most-willing-to-pay-for-financial-advice-cerulli?ito=583

Financial Advice: Does it Make a Difference? by Michael S. Finke:: SSRN
Abstract: The financial advice profession provides a potentially valuable service to consumers within an increasingly complex financial marketplace. Financial advice professionals can substitute for costly investment in financial knowledge by households. This paper provides evidence that financial advisers improve financial outcomes when the

interests of the advisor and household are aligned. However, professional advice can harm consumers if conflicts of interest create high agency costs. Understanding how differences in compensation methods and regulatory frameworks affect incentives is essential to improving the breadth and quality of professional advice.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2051382

OSC Annual Report-Dealers / Advisors A recent OSC report airs concerns over advice to seniors. The Report states:
"Through recent compliance reviews or investor complaints, CRR and the Investor Office, have detected concerns related to the provision of investment advisory services or sales of products to vulnerable investors; in particular, senior investors, but also investors with other vulnerabilities (e.g. a diminished cognitive capacity, a severe or long term illness, a physical disability, mental health problems, a language barrier). Senior investors, especially those who may have diminished capacity, are vulnerable to investment advice that is unsuitable, investment fraud and financial abuse. OSC staff is concerned with issues related to senior investors because: ☐ they are growing as a demographic, both in terms of population and also in terms of household investable assets, ☐ they are relying on investments to fund retirement costs, and in some instances agreeing to invest in high-risk products to generate a desired level of income, and they may have a reduced investment time horizon to recover from financial losses, ☐ they may not understand the risks and investment features of the product they have invested in. We are prepared to take serious regulatory action when we find unsuitable investments."
http://www.wealthprofessional.ca/news/osc-report-airs-concerns-over-advice-to-seniors-other-regulatory-red-flags-211059.aspx Report at
http://www.osc.gov.on.ca/documents/en/Securities-Category3/20160721_sn_33-747_annual-rpt-dealers-advisers.pdf

Canadians deserve real price competition in mutual funds - Inside Track - Investment Executive
http://www.investmentexecutive.com/-/canadians-deserve-real-price-competition-in-mutual-funds

Regulatory Guide 246 Conflicted Remuneration: ASIC
http://download.asic.gov.au/media/1247141/rg246.pdf

Some alternative viewpoints

A Major Setback for Retirement Savings: Changing how Financial Advisers are Compensated could Hurt Less-Than-Wealthy Investors Most: P. Lortie
http://policyschool.ucalgary.ca/sites/default/files/research/financial-advice-lortie.pdf

Four reasons to pay dreaded trailer investing fees
An alternative view of trailing commissions often referred to as fees. Conflict of interest not covered in this article

http://www.globeadvisor.com/AdvisorContext/Articles/20150331_001/Invesco-story-commission.html

In Defense Of Mutual Fund DSC Fees For Smaller Investors
http://www.moneysmartsblog.com/defense-mutual-fund-dsc-fees-investors/

Commission-based clients may not want to switch A new JD Power report on US investors' reaction to the conflict-of-interest rule advanced by the Department of Labor (DOL) has found that investors currently paying commissions do not want to switch to fee-based payment in their retirement accounts, according to Financial Advisor IQ. Under the DOL's fiduciary rule, financial advisors have to always act in their clients' best interests when servicing retirement accounts. The rule also requires for retirement account-holders to be charged fees on a percentage of assets under management instead of on a per-trade or commission basis. While fee-based compensation can motivate advisors to grow their clients' assets, fees can be more expensive than commissions. Responding to a question about their willingness to switch to fees, only 8% of commission-paying investors favour the switch, and another 33% say they probably will. Forty percent are leaning toward disagreement, while 19% are adamant in refusing. http://www.wealthprofessional.ca/news/commissionbased-clients-may-not-want-to-switch-222906.aspx and https://financialadvisoriq.com/c/1590253/182213

Invesco Canada responds to the CSA report on mutual fund fees 2015
http://image.e.invescocanada.com/lib/fe961372756c047c72/m/1/Invesco+Response+to+CSA+report.pdf

Embedded Commissions Article - An Important Read | Advocis Calgary
At the crux of the compensation debate in Canada is the desire to see the consumer properly advised and properly protected. If consumer protection is the real issue for regulators, why not start with increasing advisor professionalism? Consumers would benefit tremendously from a requirement that their advisor meet ongoing proficiency standards, satisfy continuing education requirements, and adhere to a code of professional and ethical conduct that ensures the client's interest is always put first. With this approach, consumers are better protected by knowing their advisor is held to a higher standard — not by having their freedom to choose how they pay for advice taken from them. http://www.advociscalgary.ca/embedded-commissions

Investor Economics report on fund flow factors
https://www.ific.ca/wp-content/uploads/2015/12/Investor-Economics-Analysis-of-Factors-Influencing-Fund-Flows-September-2015.pdf/12353/ [Cumming publicly commented on the IFIC sponsored report by Investor Economics in a few places, perhaps most notable here: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf See, e.g., page 16 ;The last para on page 16 succinctly points out the flaws.

Don't ban trailer fees without all the facts | Steven G. Kelman | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=721159&culture=en-CA

Embedded Fee Model Under Current Regulatory Structure Serves Canadians Well | IFIC.ca
https://www.ific.ca/en/news/april-16-2013-embedded-fee-model-under-current-regulatory-structure-serves-canadians-well/

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April 28, 2017

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Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission
New Brunswick Superintendent of Securities
Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
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Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Conflicted Compensation

Harold Geller and MBC Law Professional Corporation are pleased to comment on the Canadian Securities Administrators ("CSA") consultation paper 81-408 – Consultation on the Option of Discontinuing Conflicted Compensation ("Reform Proposal"). Consultation paper 81-408 is an important part of the overall CSA review of the conflicts of interests which harm Canadian investors and impair market efficiency.

The Reform Proposal, on its own, is an essential effort to resolve the overall problem whereby investors' interests are in conflict with the self-interest of advisers and their dealers (hereinafter collectively referred to as "Salespeople"). This conflict of interest is not one that is resolvable through disclosure, or in the case of CRM2, partial disclosure of the conflicts. The CSA Reform Proposal is a welcome and overdue step towards providing protection to investors from unfair, improper and abusive practices which harm investors and undermine the integrity of Canadian capital markets.

The following comments are limited to those issues of interest to the individual retail investor only. In summary, it is our opinion that:

1. The overriding issue is the conflicts of interest inherent in the current conflicted compensation model used for the sale of investment products. These inherent conflicts of interest routinely result in the interests of the investor being subordinated to the interests of those selling the investment products. Salespeople have far greater knowledge of capital markets than do their retail clients. This creates significant reliance by the investor on Salespeople, which reliance leads to vulnerability in many cases. Salespeople have the opportunity to exploit this vulnerability when acting in a conflict of interest.

2. This conflict is long-standing.

3. The industry has failed to resolve this issue on its own.

4. Regulatory steps are required to align the interests of Salespeople with that of investors.

We agree with the presentation of the issues as described in Part 1 – these conflicts are well known and the issues are appropriately summarized.

The industry has failed to remedy the conflicts arising from conflicted compensation either by requiring greater proficiency or managing the conflicts by avoiding biased compensation models. Examples include the spreads on fees paid for sales which incent salesperson to sell of particular products or, in particular, proprietary, inferior performing, and higher risk products. Given this failure, action is needed.

Will investors pay for advice?

Salespeople and manufacturers allege that investors will not pay for advice. There is no empirical evidence presented to support this contention. This paternalistic argument (that Salespeople know what is best for the investor) comes from the industry, a conflicted interest group. Further, this argument undermines the counterproposal, rejected in the Reform Proposal, that disclosure by itself will remedy the conflict.

Salespeople claim on one hand that the investor is capable of appreciating the nuance of the complex disclosure post-CRM2, yet deny that the investor will continue to invest if clearer disclosure of true costs and market-distorting incentives is required. "Mass-market" and "mid-market" clients (i.e. smaller accounts) are less likely to have the sophistication necessary to appreciate the significance of the disclosures. As the Reform Proposal makes clear,[1] 88% of all households that owned investment funds in 2012 were in these two categories.

At the same time, there is no empirical evidence of which we are aware that investors will not pay for advice. Indeed, this argument is self-defeating. Investors have always paid for advice one way or another. Salespeople argue that clients should pay without knowing, because if they knew they would act differently (see the Direct Pay discussion below). The Reform Proposal merely requires that investors know what they pay for advice.

There is no social scientific study to show what clients will do if conflicted compensation is banned. As the Reform Proposal states,[2] the Canadian experience is unique. Salespeople, their lobby groups and manufacturers, often refer to sales surveys as evidence that no change is necessary or, alternatively, change is harmful. Survey results conducted by industry players require careful examination of their construction and implementation. Consider the analogy of the rigorous oversight by regulators of drug trials conducted by pharmaceutical companies.

Studies referenced by the CSA reveal that investors who receive conflicted advice have worse outcomes than those with non-conflicted advice. This is true regardless of how the regulators move towards transparent disclosure of the costs of advice. This motivated Salespeople to resist the introduction of CRM2's mandatory disclosure of costs. Essentially, the industry does not want to be accountable for the services it renders to its clients.

There appears to be no relationship between advice and fees charged. As noted in the Reform Proposal, DIY investors get no advice from discount brokers, yet often pay the same fees as other investors.[3]

Impact of the Reform Proposal

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[1] At pages 26 et seq. Table 2.
[2] At page 6.
[3] At page 51, at page 51.

Once informed of the true cost of their investments, investors may choose to cease relationships with product-driven Salespeople. This is predicted by the Reform Proposal.[4] Indeed, one impact may be that investors switch to holistic planners in place of product Salespeople. To distinguish themselves from others with a similar shelf of products, Salespeople often promote their holistic planning services ("We provide peace of mind." "We act in your best interest.") In other words, they sell planning advice. None advertise that they sell better products. ("Our stocks are better than theirs.") Even proprietary products often closely resemble products sold by competitors (at a lower price). In any event, there is no downside risk to investors being better informed of the true cost of advice or in the elimination of the temptations posed by a conflicting compensation model.

What compensation should be covered

The Reform Proposal suggests elimination of all payments to Salespeople to incent sales of specific products. As the proposal suggests, the issue is the distortion of advice as a result of conflicted incentives. All compensation should be captured. For example, underwriting compensation, referral fees and other sales incentive sweeteners have long been known to result directly in increased sales and more favourable recommendations by Salespeople. The retail investing public is entitled to bias-free advice. Most retail investors cannot appreciate the bias created by the conflicts and what that means for the advice. Disclosure cannot overcome this deficit. Consider the "best interests" debate, where a product is "suitable" for a client, but rewards the Salesperson more than a better (for the client) product available. Salespeople will usually sell the inferior product if incentives reward this.

Exempt products

There is no policy-based fairness principle to exclude exempt products from the Reform Proposal, whether they be structured notes or insurance products (segregated funds). Regulatory arbitrage is a bane of the present system. Our office has seen many cases in which insurances licensees sell exempt products with high compensation to them that are easily replicated at far lower cost by non-exempt investment funds. This arbitrage opportunity rewards conflicted sales recommendations.

Integrated Salespeople

The Reform Proposal observes that integrated dealers make up more than 80% of the investment fund market for retail investors.[5] This is more significant for more vulnerable investors (mass-market and mid-market), who rely on their bank branches to recommend proprietary products from a very restricted shelf. The Reform Proposal must capture internal transfer payments or the integrated dealers will circumvent the Reform Proposal, at risk to the most vulnerable clients. The recent furore raised by the CBC's investigation into bank practices,

[4] In the "Impact" analysis at pages 62 *et seq.*
[5] At page 30 *et seq.*, Tables 5-8

highlights the urgency felt by the public.[6] This must be a broadly based ban to avoid workarounds in Salesperson distribution and compensation models.

Payment options – automatic pay

Any limited permission for payment by the investor from assets held with the Salespeople, requires considerable study. Notionally, this facilitates the investor paying for advice. In reality, there is great risk of this being a backdoor equivalent of conflicted compensation. Many investors, especially in mass-market and mid-market households, lack the financial experience to read and appreciate their periodic statements. They routinely sign forms presented by trusted advisers without reading them – as do we all.
While this mechanism may have merit, the CSA should consider carefully how to permit this option without risking the very harm that the Reform Proposal targets. The Reform Proposal discusses "reverse churning", where a "buy and hold" investor is charged a percentage fee.[7] With automatic pay, there is no bill to pay, no "aha" moment in which the client asks whether the advice is worth the cost and then comparison shops.

Payment options - direct pay

The Reform Proposal also refers to the "direct pay model" where the client writes a cheque for the advice. The industry argues that this raises a major risk. They contend that retail clients who do not pay for advice will not get advice, to their detriment. Direct pay raises the risk that clients will not value the advice as much as its cost. Automatic pay raises the risk that clients will not appreciate that they are paying for the advice, as is often the case with investment fund trailer fees. Which is better? Full, mandatory disclosure or the risk of no disclosure? CRM2 answered this question. Direct pay merely reinforces the CRM2 policy.

There is some evidence that the only benefit to investors of working with a Salesperson is the encouragement to save for retirement. This evidence focuses on the value of planning advice as opposed to product sales. In fact, few investors who invest with self-described financial planners receive financial planning. Most of those who do receive any financial planning, receive template plans which are better described as sales pitches.

Financial planning vs. Product sales

In the conflicted compensation model, the value of advice is disconnected from the sale of a product. The two most important components of financial planning are: pay down debt, and save money. Neither is part of a product sales strategy. Indeed, conflicted compensation encourages asset-gathering strategies through deferral of debt repayment, leverage loans/margin investing and commutation of pensions. These are the antithesis of financial planning, yet are strategies commonly promoted by self-described financial planners. Financial planning and the sale of products can be irreconcilable objectives.

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[6] http://www.cbc.ca/news/business/bank-s-deceptive-titles-put-investments-at-risk-1.4044702
[7] At page 65, and footnote 127.

The Reform Proposal should encourage Salespeople to offer and provide conflict-free, financial planning in the best interest of their clients. Direct pay supports this.

The advice gap

The Reform Proposal defines the "advice gap" as being "investors who cannot obtain the amount of advice they desire at the price they are willing to pay", an access to service issue.[8] We agree that this is an issue, but we submit that there is a far greater issue facing retail investors in all the markets identified by the CSA, from mass-market to affluent. This is the mismatch between what clients think they are buying (financial planning) and what they receive (sales promotion).

The Reform Proposal should alleviate the real advice gap.

1. The advice gap is not, as salespeople claim, related to the lack of advisors, but the lack of proficiency among advisors. Investors suffer when conflicted advisors provide conflicted planning advice which is, at its heart, sales recommendations.

2. As the UK experience has shown, many non-proficient and conflicted advisors will not continue to offer services when a fair playing field is offered to the investor. This is a positive outcome that narrows the advice gap. The advice gap is inherent in a product sales compensation model. Planning advice is the key to successful investor outcomes, not product sales.

3. Incenting the advisory relationship and de-incenting the sales relationship will directly lessen the advice gap. Consider that advisors usually promote return on investment as the key metric. Clients want to accumulate savings. Returns are only one component of a successful client experience. Returns should not be earned at risk to the client's outcome, unless there is full disclosure in plain language without bias.

4. The value of advice will become clearer when the full cost of advice is transparent. This is a major problem with CRM2 which requires opaque disclosure of the payments to the advisor without clear disclosure of the other conflicted compensation. Thus, this failure of CRM2 will be addressed with the removal of conflicted compensation.

As noted in the conflicted compensation, Salespeople and manufacturers of lesser quality products have little incentive to act in the best interest of investors. Disclosure of compensation removes this anti-market efficiency behaviour.

[8] Page 62 *et seq.*

Predicting the impact of the Reform Proposal

The Reform Proposal makes predictions.[9] These appear to be reasonable. A freer market should respond with new and improved models. Disruption will occur and creative models will emerge. A great hope in this regard is Canadian versions of Fintech. Regardless of fear mongering, the industry will prosper.
The removal of conflicted compensation is good for compensation of professional financial planners. Instead of a front-end payment for sale, clients should pay for planning and advice as services are rendered. Thus, good client behaviour (spend less, save more, pay debt) will replace poor client behaviour (maintain and even increase debt and purchasing high fee products) driven by variable, disproportionately upfront sales compensation. This different model aligns the work of good advisors with their compensation.

Further, the best outcome for clients is the professionalization of Salespeople. Proficiency and professionalism should replace sales. This is good for those advisors who provide advice of good and excellent quality. It will push out those that are merely interested in sales (churning), and support those who put the best interests of clients first.

Conclusion

The Reform Proposals are a necessary and important step towards aligning the interest of Salespeople with that of their investor clients. This alignment will address the present advice gap. This alignment will remove incentives that harm both investors and market efficiency. The CSA proposal is timely and necessary.

Yours very truly,

Harold Geller

[9] At page 62 *et seq.*

Via email

April 30, 2017

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf

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Manitoba Securities Commission
Ontario Securities Commission
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Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

I thank you for taking the time to read this submission regarding embedded commissions.

I feel that it is far beneath the services of a profession to be discussing whether or not fees, costs or commissions should be revealed, hidden or any other clever deviation or variation.

It is becoming increasingly common knowledge among Canadians, that there is a massive amount of commission (or fee hungry) salespersons, who do a very good job of concealing the essential elements of the relationship to the people they claim to serve.

This makes an industry which should be based upon trust, appear tainted and predatory, and it will eventually make the regulators appear to be 'helpful' in the predation.

Nothing but self-serving, unprofessional behaviour contrary to the public interest, would result from letting firms continue to play the game of hide and seek on how they are paid.

"The ability to hide or conceal charges in a financial industry is needed only as a selfish and shady method by which to “place obstacles before the blind”, or hide information and truths from the vulnerable clients that this industry purports to serve.”

We now know better than this, and when we know better, it then becomes incumbent that we do better.

Larry Elford

Alberta

« Sous toutes réserves »
Purolator

Brossard, ce 1er mai 2017.

Me Anne-Marie Beaudoin
Secrétaire générale de l'Autorité des Marchés Financiers
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Objet : **La position du Conseil des représentants du Réseau SFL, concernant le projet d'abolition des commissions intégrées au Canada.**

Nota Bene
Dans le présent document, le genre masculin est utilisé à titre épicène dans le but d'alléger le texte. Également, les termes représentants, conseillers, planificateurs sont synonymes. Il existe plusieurs réseaux de distribution au Canada, similaires au Réseau SFL.

Maître,

La présente est pour vous transmettre l'opinion des conseillers du Réseau SFL, reconnus comme **des entrepreneurs autonomes ou constitués en cabinet.**

Nous avons pris connaissance du contenu des trente-six questions soumises à titre de guide d'intervention pour présenter notre opinion. Nous avons fait le choix de ne pas y répondre telles que suggérées puisque plusieurs d'entre elles nous semblent tout à fait inappropriées et risqueraient plutôt de nous mener ailleurs que ce que nous désirons vous partager aujourd'hui.

Quelques faits

Depuis plus de 25 ans, l'industrie des fonds communs de placement a connu une croissance fulgurante, contribuant grandement à l'enrichissement des épargnants canadiens.

La consultation générale initiée par les ACVM, qui a mené à la production du document 33-404, a identifié quelques problématiques quant aux sources potentielles de conflits d'intérêt, s'il en est. À cet effet, une grande banque canadienne a tout récemment été mise en vedette dans tous les médias suite à des allégations provenant d'anciens employés. À ce jour, aucune accusation n'a été portée.

Cependant, les commentaires d'une centaine d'employés alimentent grandement les doutes auprès des consommateurs en général. D'ailleurs, lors d'émissions spécialisées à la télé, il a déjà été mentionné que des grandes banques semblaient exercer une certaine pression sur leurs employés afin qu'ils effectuent le plus possible de ventes croisées, tout en favorisant l'offre répétée de produits "maison" auprès de leurs clients. Ces démarches sont-elles initiées dans le meilleur intérêt de leurs clients? On peut se poser la question.

Malgré les risques liés à ce genre de pratique, les ACVM ont plutôt décidé de s'attaquer aux commissions intégrées (81-408) en voulant les éliminer et par conséquent, de menacer l'existence même du conseiller indépendant. Est-ce la meilleure façon de reconnaître la valeur ajoutée de celui-ci? Permettez-nous d'en douter!

SFL et ses conseillers «entrepreneurs»

Cette bannière de distribution en services financiers est présente et en pleine croissance partout au Canada. SFL est reconnu comme un important courtier qui n'offre aucun produit maison en épargne collective.

Les conseillers indépendants, dont ceux du Réseau SFL, sont des entrepreneurs au sens réel du mot. Ils ne reçoivent aucun salaire mais plutôt une rémunération sous forme de commissions ou d'honoraires. De plus, ils sont reconnus comme ayant largement contribué à l'essor de cette industrie et ainsi d'avoir permis à des milliers de canadiens, de petits et grands investisseurs, d'atteindre leurs objectifs d'épargne.

À cet effet, une étude récente le démontre clairement :

> ***« La discipline imposée par un conseiller sur les habitudes financières de ménages et leur taux d'épargne supérieur sont les clés qui mènent à l'amélioration de la valeur de ces ménages lorsque comparés aux ménages sans conseiller »***[1]

Les conseillers SFL offrent à leurs clientèles une gamme complète de produits et de services professionnels.

[1] *Centre interuniversitaire de recherche en analyse des organisations (https://www.cirano.qc.ca/files/publications/2016s-35.pdf)*

Au fils des ans, leur offre de services s'est raffinée afin de mieux répondre aux besoins de leurs clients. La qualité de leurs conseils et leur accompagnement auprès de leur clientèle deviennent une valeur ajoutée qui augmentera le taux de réalisation des objectifs financiers de leurs clients.

Le conseiller SFL n'a aucune obligation quant au choix de ses fournisseurs. Il n'a aucune contrainte quant aux choix des produits qu'il offre. Et sa plus grande préoccupation sera de respecter les cibles de réussite et l'intérêt de son client. Évidemment, il ne subit aucune pression de vendre tel ou tel produit puisqu'il a le choix entre une gamme de produits non restrictifs. Il est important de rappeler que le conseiller SFL est un entrepreneur indépendant et n'offre pas de produits maison en épargne collective.

Son seul actif est sa clientèle. C'est avec la qualité de ses conseils, de son service et des produits offerts qu'il réussira à **construire, à satisfaire et à conserver** sa clientèle.

Tel que mentionné, tous les conseillers indépendants sont des entrepreneurs. Ils prennent des risques d'affaires et doivent aussi débourser d'importants frais dans l'élaboration et le maintien de leurs affaires.

Voici quelques exemples des frais déboursés sous leur responsabilité :

- Frais de déplacement
- Permis
- Perfectionnement
- Assurance responsabilité
- Comptable et autres frais professionnels inhérents
- Équipement de bureau
- Formation continue
- Loyer
- Personnel administratif
- Prospection
- Représentation, promotion, marketing

Il est raisonnable d'affirmer que les dépenses engendrées par un conseiller indépendant pour le maintien de sa profession se situent entre 25% et 35% de ses revenus. L'acquisition de clientèle peut également faire augmenter ces coûts considérablement.

On comprendra que la situation est totalement différente dans une institution de type bancaire qui assume tous les frais cléricaux et qui rémunère ses employés à salaire.

De plus, les conseillers indépendants procurent de nombreux emplois, directs et indirects, partout au Canada.

Le conseiller peut, tout comme celui du Réseau SFL, faire l'objet de vérifications de la part des autorités réglementaires. Ses activités sont encadrées par la Chambre de la Sécurité Financière.

Depuis plusieurs années, les conseillers indépendants ont des obligations de plus en plus importantes en matière de conformité, de formation et de professionnalisme. Nous convenons tous du bien-fondé de la rigueur que ces dernières apporteront à notre profession, au bénéfice de nos clients.

Ces obligations assurent une qualité accrue en ce qui a trait à la valeur des conseils donnés. Il est largement démontré et prouvé que les clients qui bénéficient de conseils de leurs conseillers réussissent mieux que ceux qui n'en ont pas.[2]

Le mode de rémunération actuel est composé de quatre éléments : de commissions provenant de ventes avec frais différés, avec frais réduits ou sans frais, ou encore d'honoraires. En tout temps, le conseiller peut être rémunéré en fonction des objectifs et de l'horizon temporel de son client.

De ce fait, le conseiller s'assurera que son client possède tous les éléments en main pour atteindre sa sécurité financière sans payer de frais additionnels.

Les enjeux

Nous savons tous que les ACVM ont entrepris une vaste consultation sur l'option d'abandonner les commissions intégrées.

Les conseillers SFL, comme tous les autres conseillers indépendants, s'interrogent sur les objectifs qui motivent et guident les ACVM au pays. Aux dires même des représentants de l'AMF au Québec, il semble que toute cette démarche émane de seulement quelques groupes de pressions dont «Fair Canada». Qui est Fair Canada? Qui finance ces organismes? Quels sont les intérêts recherchés par ceux qui financent?

Les conseillers vous confirmeront qu'en aucun temps les clients informés se plaignent de la rémunération de leur conseiller. Ils savent reconnaître la qualité du service et la valeur du conseil.

Trois enjeux (ou plutôt affirmations) sont soulevés dans le document de consultation 81-408 en prétextant que les buts recherchés dans cette démarche sont d'abord la protection des investisseurs et ensuite, l'efficience des marchés.

Ces enjeux sont :

1. Les commissions intégrées pourraient donner lieu à des conflits d'intérêts;
2. La compréhension des coûts réels pourrait être difficile pour les investisseurs;
3. Les commissions intégrées pourraient ne pas convenir aux services fournis par le représentant;

[2] Voir https://www.ific.ca/fr/policy_topics/value-of-advice/

Même si le document de consultation 81-408 explique clairement qu'aucune décision ne semble prise, la lecture de ses 182 pages nous laisse manifestement croire qu'au contraire, la décision d'abolir les commissions intégrées semble apparaître comme l'unique piste de solution pour les ACVM.

Nous nous expliquons mal les raisons qui motivent les ACVM à orienter voire même diriger les discussions sur cette voie. Nous sommes d'avis que l'orientation actuelle de la réflexion adoptée par les AVCM pour améliorer le sort des investisseurs n'est vraiment pas l'avenue à privilégier.

Voyons ces trois enjeux plus en détail, savoir :

1. **Les commissions intégrées pourraient donner lieu à des conflits d'intérêt;**

Au niveau des fonds mutuels, il y a lieu de rappeler que les commissions sont très similaires d'un manufacturier à l'autre, voir identiques dans bien des cas.

Les clients voient la valeur ajoutée qu'ils obtiennent et comprennent la réalité économique du conseiller entrepreneur.

À l'inverse, ils comprennent aussi que cette réalité ne s'applique pas au domaine bancaire. L'offre de service est différente, tout comme les produits offerts et l'indépendance des conseils.

En définitive, différentes options sont offertes aux clients et ces derniers peuvent facilement choisir ce qui leur convient le mieux.

Pour nous, le vrai conflit d'intérêt se révèle lorsqu'un ¨conseiller-salarié¨ a l'obligation de vendre le produit que son institution-employeur lui oblige de présenter à la clientèle qui lui a été confiée en contrepartie du salaire reçu comme employé. Par ailleurs, on pourra convenir que vendre un produit qui pourrait répondre au profil d'investisseur d'un client est une chose, mais recommander le meilleur produit parmi les quelques 6 000 options possibles en est une autre.

Décidément, un fait semble très clair pour nos clients:
<u>l'indépendance de leur conseiller leur procure assurément la meilleure garantie contre les conflits d'intérêts potentiels</u>.

Compte tenu de la réalité entrepreneuriale du conseiller indépendant, il est impossible de penser qu'un mode de rémunération unique à honoraires pourrait s'avérer ¨rentable¨ dans tous les cas. Ce faisant, un nombre important de clients pourrait devenir privés de recevoir des conseils judicieux et indépendants, et pouvoir se procurer de bons produits.

En coûte-t-il vraiment moins cher pour le client d'avoir un compte à honoraires plutôt qu'un compte à frais réduits? Un compte sans frais ou un compte à frais différés? À titre de professionnel dans la distribution des services financiers, nous croyons et affirmons que NON.

Lors d'une récente rencontre de monsieur Mathieu Simard de l'AMF (le 21 février 2017) à nos bureaux, il lui fut démontré qu'en remplaçant la rémunération actuelle d'un conseiller indépendant par une rémunération à honoraires, un très fort pourcentage de clients (évidemment les plus petits) seraient abandonnés par le conseiller, faute de pouvoir être rémunéré décemment pour continuer à les servir de façon professionnelle.

2. La compréhension des coûts réels pourrait être difficile pour les investisseurs;

Il est peut-être vrai qu'avant le MRCC2, le ratio de frais de gestion (RFG) et, par le fait même, les commissions intégrées pouvaient ne pas être facilement compréhensibles par le client. Cela étant dit, il est maintenant obligatoire d'en discuter et le fait que les frais et commissions soient divulgués sur les relevés annuels nous semble la meilleure garantie pour le client que le conseiller expliquera la ventilation des frais.

Cependant, nous croyons qu'il est beaucoup trop tôt pour évaluer les résultats de l'implantation du MRCC2. Il serait avisé et sage de patienter quelques années pour en mesurer les effets réels.

Contrairement aux nuances subjectives exprimées dans le document 91-408, la rémunération versée aux conseillers n'a jamais nuit à l'enrichissement des clients.

L'expérience vécue dans d'autres pays a clairement démontré, hors de tout doute, qu'une proportion importante de clients subissent les effets négatifs conséquemment à des décisions semblables à celles que semblent vouloir prendre les ACVM au Canada.

Pour nous, il y a deux façons de voir les choses :

- On peut penser faire mieux qu'ailleurs!
- On peut aussi éviter les erreurs commises ailleurs!

On sait maintenant que certains pays, dont le Royaume-Uni, qui ont aboli les commissions intégrées sont à rechercher présentement des moyens pour relancer l'industrie et à s'assurer que les épargnants ¨qui ont été mis de côté¨ puissent obtenir ¨à nouveau¨ des conseils judicieux et des services professionnels.

3. Les commissions intégrées pourraient ne pas convenir aux services fournis par le représentant;

Sur ce point, il y a probablement des éléments qui méritent discussion. Il faut se rappeler que les courtiers recommandent à leurs conseillers de respecter les règles de la conformité édictée par l'AMF. Par conséquent, les conseillers revoient périodiquement leurs clients et se doivent de compléter ce qu'on appelle un CVC (Connaitre Votre Client), et ainsi mettre à jour les objectifs et les informations propres à chaque client.

Alors, sans être parfaite, on peut tout de même affirmer que cette pratique d'affaire assure un suivi certain après de toute la clientèle par les conseillers et pour les courtiers, que des conseils ont effectivement été prodigués.

Cependant, nous sommes toutefois d'avis que les clients sont assez avisés pour juger de la qualité du niveau des services reçus versus ce qu'ils désirent recevoir, et que la rémunération touchée par le conseiller soit à la hauteur de leur degré de satisfaction. Les clients ont donc toujours le choix d'exprimer leur satisfaction ou leur insatisfaction en conservant ou en changeant de conseiller.

Conclusion

Le Conseil des représentants du Réseau SFL est d'avis que tout changement au mode de rémunération présentement offert aux conseillers indépendants, mettra sérieusement en péril la pérennité de l'industrie. Ne pouvant pas obtenir ou trop peu de rémunération en échange de leurs conseils auprès des clients à plus faible volume d'actifs**,** plusieurs conseillers auront le réflexe de se désengager de la profession et ce, sans compter les risques que le recrutement de nouveaux conseillers devienne à plat. C'est pourquoi, **plusieurs investisseurs** (les plus petits qui ne comprendront pas la nécessité de verser des honoraires pour obtenir des conseils) **risqueront donc de se retrouver sans conseillers pour bien les guider.**

Par conséquent, toute cette approche risque grandement de compromettre la valeur ajoutée de tout le travail accompli dans l'industrie depuis plusieurs décennies. **Nous répétons notre conviction qu'il n'y aurait plus moyen d'assurer une relève chez les conseillers indépendants.**

Dans le document de 182 pages de 81-408, on fait allusion aux FNB. Pourquoi? Les gens sont libres d'en acheter ou de choisir les conseils d'un conseiller. Ces produits peuvent être très volatils en période de baisse. Par ailleurs, il a été démontré clairement que de bons fonds mutuels procurent des alphas supérieurs aux indices mais surtout, ceux-ci donnent accès aux conseils.

En fait, il existe une foule de produits sur le marché. Certains paient des commissions ou des honoraires et d'autres, pas du tout. Les clients peuvent aussi gérer eux-mêmes leurs actifs, ou faire affaires avec de grandes institutions ou encore travailler avec des conseillers indépendants.

Donc, les clients «s'appartiennent». Alors, de grâce, ¨**LAISSONS-LEUR LE CHOIX**!¨

Nous pouvons convenir que c'est le privilège du client de pouvoir choisir avec qui il veut travailler pour planifier adéquatement son avenir financier; il a aussi le même privilège de pouvoir souscrire le produit qui pourra lui convenir pour atteindre ses objectifs.

La situation au Canada, depuis les vingt-cinq dernières années, ressemble davantage à un succès qu'à un échec. Elle a permis l'enrichissement de millions de baby-boomers. À consulter le presse d'affaires, cela ne semble pas le cas au Royaume-Uni présentement!

Nous espérons que, tout comme nous, vous prendrez très sérieusement en considération la présente et que vous verrez à améliorer et à faire avancer la profession… plutôt qu'à l'éliminer à court et moyen terme. Nous sommes d'avis que le dialogue s'impose

Au nom du conseil des représentants du réseau SFL pour le Québec, veuillez agréer, Maître, l'expression de nos salutations distinguées.

[redacted]

Daniel Binette, Services Financiers Daniel Binette Inc
Secrétaire du Conseil des représentants SFL

[redacted]

Gilles Garon, Services Financiers Garon et associés Inc.
Maître, Conseil des représentants SFL

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CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

The Secretary
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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorite des marches financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, North West Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

I am a retired senior who has felt the bitter sting of conflicted sales advice of mutual funds. It was a life altering experience I would not wish on anyone.

Anyone presenting themselves as an advisor should not be collecting hidden sales commissions from the company recommended. It would be like a doctor getting paid under the table to prescribe a certain drug that was more expensive than others available or worse, wasn't needed at all.

These so-called embedded commissions can also lead to other bad advice like borrowing to invest. The more in embedded commissions a salesperson makes in trailers while at the same time putting the investor at greater risk. The situation is even worse when the salesperson gets a commission for referring a trusting client to a lending institution. These referral arrangements should be outright banned.

I highly recommend that the CSA ban embedded commissions and at the same time require that "advisors" put the client's interests above their own commercial interest, otherwise it is a conflict of interest.

Canadians depend on "trusted" advice to manage their nest eggs for retirement but the current system is Caveat Emptor.

At the same time I urge the CSA to give the Ombudsman for Investments binding authority for its recommendations of the national ombudsman.

I sincerely hope this feedback is useful to the CSA.

It is fine to post my comments publicly as I would like others to be aware of the dangers of the current system of conflicted advice.

Sincerely,

Mildred Jagdeo

May 8, 2017

Dear Sirs: if this e-mail is delivered to the wrong department, please forward it onto the appropriate regulatory commission.

I have been in the life insurance business for over 48 years. During my career I have helped many small business owners and clients build up their retirement plans. To do so I have had to be extremely persistent in calling on and visiting with these clients. I could only do so if I was being compensated by commission. I have spent thousands of hours driving to client's offices and homes to encourage them to save for retirement and 50% of the time I am not compensated or rewarded for my efforts. These clients don't just walk into my office...they are busy conducting their lives and running their businesses, and are too distracted to initiate investing their funds or purchasing life and disability income insurance. It is only the adviser who is compensated by commission who is motivated enough to call on them without being compensated immediately or at all. The commission system has worked wonders across Canada with trillions of dollars of savings and insurance being put into force by commissioned advisers. Billions of dollars of life insurance claims have been paid because of these diligent agents/advisers...benefits to widows and orphans and retirees that otherwise would not happened. Saving for retirement or purchasing life insurance isn't like buying house or car insurance where there are deadlines. Retirement saving and life insurance and disability insurance don't have deadlines and are not provided to millions of people through their employment....why would you want to take this wonder workforce of advisers away from independent business owners and employees not covered by Employee Benefit Packages....like you yourself probably enjoy?

As I mentioned I have been instrumental in helping many clients build up large retirement nest eggs and I have personally delivered millions of dollars of life insurance claim cheques to widows....none of these benefits would have accrued if I just sat in my office and waited for clients to call.

Finally, after 48 years in the business I have never had a formal complaint lodged against me and my clients have never received a fee billing from me. It amazes me that none of my clients have asked me to switch to a fee for service format and yet the Bureaucrats continue to push this agenda. No doubt there are complaints across Canada but please don't ignore the gigantic amount of good that has arisen from Commissioned Advisers.

Kindest Regards,

Rick Reynolds, CLU CHFC

Via email

Julia Lipovetsky, small investor
lipovetskyj@gmail.com

May 8, 2017

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

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Also addressing:

Alberta Securities Commission

British Columbia Securities Commission

Manitoba Securities Commission

Financial and Consumer Services Commission, New Brunswick

Securities Commission of Newfoundland and Labrador

Superintendent of Securities, Northwest Territories

Nova Scotia Securities Commission
Superintendent of Securities, Nunavut

Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Financial and Consumer Affairs Authority of Saskatchewan

Superintendent of Securities, Yukon

I am a small investor who has in the past believed that mutual fund advice I received from employees at the Big Five Canadian banks (pillars and institutions of the Canadian financial system) and their brokerage arms, was a courtesy in both meanings of the word, that it was sound, that our goals were aligned. Several years ago, my family had experienced the exact opposite dealing with a "financial advisor"* at a "boutique firm" (boiler room-type operation but with IIROC's and OSC's stamps of approval), so sticking again with the banks and with mutual funds felt like an even safer haven by comparison than it did before we ventured 'outside'.

But as it turns out, buying mutual funds through your bank is no guarantee of objective, honest advice. And the new disclosure rules in CRM2 do little to illuminate for the small investor the *magnitude* of the impact "embedded" (hidden) commission fees have on our savings (next paragraph). This stale, outdated incentive model hijacks an "advisor's"* (really salesperson) efforts away from where they should be, from focusing on the individual needs of their client, and instead to steering, and often pushing, clients toward those investments that will yield for the "advisor"* the highest commissions, to varying degrees of detriment to the investor, in most cases significant and in some even tragic. EFTs and index funds are rarely actively promoted, because there is little or no commission and so little or no incentive to recommend to the client what may actually be best for them. But even when exposed (CRM2, media coverage), this conflict of interest is so ubiquitous and so seemingly inevitable, that most people don't even bother caring, and after all, it's only 1% or so.

* *I use quotation marks because to this day no such regulated designation ("Financial Advisor") actually exists in Canada (despite much ado over many years), a painful shock to us at the time, and an outrage still.*

That "1% or so" translates into ***hundreds of thousands of dollars*** in eroded returns over an average Canadian's lifetime, having added absolutely no value. No wonder retirement age **in the 21st century**, in the "age of tomorrow", is not budging, is actually regularly threatening to go *up*, in the era *following* the scientific revolution, industrialization and mass production, computing, the splitting of the atom, deep space exploration, instant global connectivity and access to all information, and the mapping of the genome! Might it be, still, after a too long and painfully bumpy history of finance free-reigning over the land, decimating retirement savings and family legacies, stunting generations and collapsing nations, the same old, circa 19th century, horse and buggy, simple cash flow problems? As in, simply, 'cash' flowing, unimpeded and virtually unchecked, from the average working stiff to the average, evolving backward, obsessed with growth and rabid with greed financial institution, slowly, quietly, surely (well, maybe not so quietly anymore).

For Canadian banks, sadly, transparency and voluntary, meaningful reforms are still a long way away, as is genuine responsibility and accountability to their retail investment clients. Kicking serious, legitimate complaints of advisor misconduct, including of conflicted and inappropriate advice, to the bank's internal ombudsman is worse even than ignoring them, it feeds false hopes and adds gross insult to the serious injury of being oh so politely duped into parting with the more timely, secure and comfortable version of one's retirement. While "provincial securities regulator" carries the respectable and reassuring patina of government, "*internal* ombudsman" at least hints at a conflict of interest (and shouts it at those who have experienced it first-hand), a blatant conflict of which both have made an art and a science (next paragraph). In the case of a bank's ombudsman, whether polite, concerned and caring in tone or delivered in cold, blunt legal-speak, their poorly veiled agenda is to deny (deny, deny, deny) responsibility and avoid exposure, to stall, for months and even years, until the customer finally gives up, their dignity thoroughly trampled, or in the case of an elderly customer, gives up the ghost (even better).

And so you, regulators, you, *public servants*, with all the years and decades-long discussions and debates, costly research, consultations and amassed voluminous technicalized reports to ascertain the obvious (and then *still* ignore it), year after year after year feigning interest in what we the public have to say, how are you different than a bank's own ombudsman?! What are you actually *doing* other than stalling *real change*, who are you *actually* protecting – those you claim to protect, or those you claim to keep in check? And if the increasingly aware public is mistaken on this account, then PROVE IT! ACTUALLY, *"… protect Canadian investors from unfair, improper, or fraudulent practices and foster fair and efficient capital markets"* – don't just busy yourselves with proclaiming it in self-congratulatory marketing sound bites, with endless consultations, with picking off individual bad apples here and there and other low-hanging fruit. ACT! Do the *real*, the *tough* work, *remake* the industry to remake Canada, NOW! Deciding to put an end to the systematic shafting of the Canadian public should not be "an option", should it?!

With an admittedly oversized degree of optimism, I nevertheless hope that the continuous collective input of small investors (*the public*) reaches the *public* organizations addressed in this letter. It is of the *utmost urgency* that the embedded mutual fund fees, that in their effect constitute negative value and significantly and dangerously erode the country's largest pool of savings - private savings - are eliminated, and that institutional and individual fiduciary duty *finally* becomes the cornerstone of the Canadian financial industry in the 21st, the global century, which we are well into. The Canadian public *is* entitled! Entitled to trust its banks and its government, no expert consultations required.

I value this opportunity to provide my input and I grant permission for publication of this letter.

Sincerely,

Julia Lipovetsky,
small investor

Harvey S. Naglie LLM

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

May 9, 2017

The Secretary
Ontario Securities Commission
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Thank you for this opportunity to comment on CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions. While I strongly support the elimination of embedded commissions, I did not intend to participate in this consultation. Familiar with both the large body of work already developed by regulators on this topic and the many articles and op-eds dealing with this issue, I did not think that I could add anything new, different or worthwhile. However, after reading some of the initial comment letters submitted, I became intrigued and a bit concerned by the recurring references to the UK 'advice gap' in several submissions advocating for the retention of embedded commissions. Many of these commenters asserted unequivocally that the UK's decision to eliminate commissions was directly responsible for producing an 'advice gap', i.e. individuals unable or unwilling to pay for financial advice; and they proceeded to warn that Canada would suffer a similar fate if a decision were made to outlaw embedded commissions. Troubled by this worrisome prospect, I decided to learn more about the UK experience and particularly about the cause and nature of the advice gap. This comment letter offers me the opportunity to share what I learned.

The Retail Distribution Review (RDR) came into effect in the UK on December 31, 2012 and applied to every adviser across the retail investment market, including independent financial advisers. The most visible change for many clients was the introduction of explicit fees for financial advice. Historically, advisers relied on commission from product providers to pay at least some of the costs for advice. Regulators took the view that this could give rise to conflicts of interest and prohibited product providers from paying commissions directly to advisers.

Speculation in the UK about the potential emergence of an advice gap began prior to the introduction of RDR and intensified after its launch. Estimates of the size of the potential gap varied widely. In 2012, Deloitte calculated an advice gap of up to 5.5 million consumers, but only two years later Towers Watson estimated no advice gap at all. This confusion was amplified by data showing a decline in the number of financial advisers offering professional advice - from around 26,000 in 2011 to 24,000 in 2014; and an increase in the proportion of retail investment products sold without advice from about 40% in 2011 to 2012 to about two thirds in 2014 to 2015. Many observers blamed the fall in advice usage on RDR's elimination of commissions. They claimed that RDR had made advice less accessible by driving up its cost and reducing the number of advisers. However, many challenged this explanation of the UK advice gap as too simplistic.

Confronted with these conflicting views and inconclusive data, the UK government launched the Financial Advice Market Review (FAMR) in August 2015. FAMR began its work with a public consultation process that asked for evidence on "the extent and causes of the advice gap for those people who do not have significant wealth or income". This request generated a wide range of responses. One of the most emphatic assessments was offered by the Financial Services Consumer Panel (FSCP), the independent statutory body set up to represent the interests of consumers in the development of policy for the regulation of financial services (like the OSC's Investor Advisory Panel). The FSCP asserted that there was no evidence of a glut of savers looking for advice that it could not get. According to the FSCP "consumers do not always seek professional advice, even when they could benefit from it: some are not aware of what is available; they do not want to pay for advice because they do not understand the price or value of it; they cannot afford it; or they prefer to take decisions themselves." In a similar vein, Which?, a UK consumer group that promotes informed consumer choice in the purchase of goods and services, sampled 1,000 UK adults with between £10,000 and £50,000 available to invest and discovered that the demand for advice was not as high as some had thought. Their research found 67% of respondents had never considered using an adviser for advice on a specific investment.

The FAMR consultation also elicited the view that efforts to tackle the advice gap would be misplaced and that public policy should more appropriately focus on addressing the more serious problem, a savings gap. Others suggested that the advice gap would be more aptly described as a 'sales gap' that did widen when banks left the 'advice' market because their staff were generally poorly qualified and did not have a transparent charging structure. Furthermore, they were confident that individuals who need and value advice, rather than product sales, could find it; while any product sales gap left by the departure of the banks was being filled by online discount brokers. Still others suggested that there was enough adviser capacity to satisfy the current demand and the advice gap should be treated as a case of inadequate demand rather than supply. They claimed that the public had been dissuaded from advice in an environment where it was easier to borrow than save, and amid a constant barrage of scandals and fines. This group clearly believed that there was a needs gap, and a habit of longer-term saving had to be restored.

Admittedly, several respondents to the FAMR request, did attempt to provide evidence of an advice gap. They pointed to people who were being turned away by financial advisors that in the past would have served them. They believed that a lot of advisers were setting the bar for new clients much higher than before. However, the FAMR was not convinced by these arguments. In its final report released in March 2016, there was no suggestion that commissions should be reinstated. Instead, the FAMR recommended that regulators and government focus their efforts on supporting the development of new and more cost-effective ways of delivering advice and guidance to consumers through more effective use of technology. The FAMR also noted that absent a more trusting consumer engagement with financial services, it would not be possible to achieve a long-term, sustainable solution to making financial advice more valued by and accessible to consumers.

The FAMR made specific recommendations in three areas:

1. Affordability – Several recommendations were intended to allow firms to develop more streamlined services and engage with customers in a more effective way. These included a proposal to help firms develop mass-market automated advice models to bring them to market more quickly.

2. Accessibility – Several measures were designed to help consumers engage more effectively with advice. These included making their own information more easily available to them and those that advise them and the development of nudges to encourage customers to seek advice at key life stages.

3. Liabilities and consumer redress – Several recommendations dealt with increasing clarity and transparency about the way in which the Financial Ombudsman Service deals with consumer complaints and consumer redress.

These recommendations make clear that the FAMR did not regard the elimination of commissions as the root cause of the UK advice gap. Therefore, while the UK experience does highlight the issue of advice accessibility, it provides no succor for those commenters in the current CSA consultation championing the retention of embedded commissions. The UK review clearly rejected the notion that accessibility could be addressed by reinstating commissions and instead recommended several other initiatives, many of which Canadian regulator would do well to consider adopting.

I thank you once again for the opportunity to provide you with my comments.

Sincerely,

Harvey S. Naglie

Harvey S. Naglie LLM
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May, 9, 2017

OSC
20 Queen Street West
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(Deliveries on the 22nd floor)

Dear Sirs:

As I read all the articles regarding the matter of removing commissions for advisors I cannot help to look at how often my dealer has decreased my commission grid and increased my costs to do business over the last 3 years.

It has been brought to my attention that dealers and branch managers can manage there advisor grid as they see fit. Well I can tell you my dealer and branch mangers take a lot of monies from me but I have never seen either of them come out to help me with my business growth.

I am a smaller mutual producer so my grid is lower however, if you are looking at making things fair for everyone why would you not consider leveling out this commission grid for all advisor regardless of volume, that is only fair.

Secondly, many branch managers are also advisors so where the fairness is when they can double dip and get paid from our work and well as their own. Is this fair as we are paying them to assist us from the overrides plus the commissions they earn from selling is this fair to clients as well advisors?

I think these two points are matters that must be considered in your overall commission and compensation discussions as I can tell you many advisors fall under this situation and are not happy with the favoritisms and lack of support they are getting from their dealers and Branch managers because they have a smaller block of business. Again is this fair for advisor to have to deal with this and them also losing our commission's small as they may be.

Thanks for your time and trust you will address these concerns in your discussions

A Starving Advisor.

I am a retired senior. I support the discontinuance of embedded commissions in mutual funds. The majority of seniors cannot comprehend complex mutual fund classes with embedded commissions that currently exist. We require plain language in order to assess our investments without the complications of financial jargon and embedded commissions.

Mutual funds sold on a deferred sales basis are particularly harmful to seniors. I want to know the cost of the fund I am buying separate from the cost of the advice. This would allow for a more transparent process and the interests of the client being addressed first and foremost without any incentivized conflict.

Life savings should not be compromised due to hidden commissions. The government is constantly warning citizens to save for their retirement. The quality of one's senior years is dependent on income derived from investments. Often health issues require additional funds that must be used from savings. Embedded commissions are stripping the retirement savings and potential savings of investors. Many, if not most investors are unaware of the hidden cost of embedded commissions. It is very worrisome that Canadians pay some of the highest mutual fund fees in the world. It is time to remove embedded commissions and the negative consequences of these commissions to the financial, social and emotional health of trusting investors. Canadian seniors want transparency, fairness and a "best interest standard" implemented.

The CSA has been wrestling with this issue for over 20 years. There has been ample time for studies, monitoring and consultations. Please act now and protect investors .

M. Boom

London, Ontario.

Permission is granted for public posting of this letter.

Bonjour,

Notre bureau offre des services de planification financière depuis 19 ans, nous avons donc une bonne expérience avec les besoins et objectifs des clients. Voici nos commentaires :

Avantages d’avoir un conseiller indépendant

1) En tant que conseiller indépendant, on recherche le meilleur produit pour notre client au frais le plus bas. Que le produit soit offert par RBC, Fidelity, CI, on va prendre le meilleur gestionnaire.
    a. Il est prouvé qu’un client avec un conseiller indépendant accumule plus d’actifs pour sa retraite. Alors pourquoi mettre plein d’obstacles pour restreindre l’accès au conseil. Les petits investisseurs qui veulent faire croître leur capital ont besoin de conseils éclairés.
    b. La moyenne des actifs de nos clients est beaucoup plus élevée que la population du Québec. Une preuve que le conseil permet aux gens d’accroître grandement leur capital.
    c. Nous sommes rémunérés sur l’actif que l’on gère pour le client. On a donc le même intérêt que le client, faire croître son capital à long terme. Est-ce la même situation dans les institutions bancaires?
2) Un récent rapport des autorités réglementaires (décembre 2016) a mentionné que les problèmes de distributions se situent dans les réseaux à produits captifs, pas dans les indépendants.
    a. Est-ce qu’une institution financière qui offre juste ses produits maison travaille vraiment dans l’intérêt de ses clients? Poser la question est y répondre. Surtout si les produits sont chers en frais et peu performants.
3) Pourquoi les autorités réglementaires tiennent absolument à évaluer la possibilité d’abolir les commissions payées aux conseillers qui améliorent la situation financière de leurs clients alors qu’on laisse de côté tous les produits financiers vendus ici et là sans que le « conseiller » ou le « vendeur » ne détienne de permis approprié ou qu’il ait l’obligation de se former?
    a. Combien ça coute :
        - Un fonds FTQ ou Fondaction (CSN)?
        - Un dépôt à terme émis par une banque?
        - Un billet à capital protégé?
        - Un fonds distinct assorti d’une garantie de à 75% ou 100%?
        - L’achat d’une obligation?
        - Un compte à intérêt quotidien?
    b. La distribution de certains de ces produits n’est pas accompagnée d’une planification de retraite en bonne et due forme, qui viendrait améliorer la condition financière générale du client.

Divulguer le frais total des fonds (RFG)

1) Il faut déclarer au client le frais total (gestionnaire + conseil), pas juste la portion qui est versée au courtier.
    - Le client aura ainsi une meilleure connaissance et compréhension des coûts.
    - Si j'achète un divan, est-ce qu'on me donne juste le prix du cuir ou le prix du divan au complet.
    - En dévoilant le frais complet des fonds, les conseillers travaillant dans les caisses ne pourront plus dire aux clients « Faîtes affaires avec nous car on n'a pas de frais ni commissions, les conseillers indépendants ont des frais et des commissions ».
    - On rencontre souvent des clients qui détiennent des fonds distincts avec des frais de gestion totaux de 4% par an et qui n'en étaient pas du tout conscients.
    - Même si le client sait ce que lui coute le conseil, il doit savoir ce que le gestionnaire lui coute. Il y a d'ailleurs des poursuites aux États-Unis contre des gestionnaires de fonds qui n'ont pas refilé aux investisseurs les économies d'échelle. Plusieurs firmes canadiennes pourraient être poursuivies : Source CFA Newsbrief December 28 2016. Mutual fund trustees are being challenged by investors' lawsuits claiming the trustees have failed to act diligently in the interest of shareholders. Investors accuse trustees of a variety of shortcomings in their conduct, including failing to pass along savings from economies of scale to shareholders as their funds grew and not adequately scrutinizing fees.

2) Les nouveaux rapports (inclus dans le relevé du 31/12/2016) de dévoilement des frais payés par le client sont trop complexes, trop de données. Les clients n'y comprennent rien et referment le papier avant de se rendre à la page 16! C'était évident à prévoir.

Impacts de changer le mode de rémunération à honoraire

1) Nous travaillons en partie avec des comptes à honoraires depuis plus de 10 ans. Ça amène plus d'administration et de suivis à faire. Peu de conseillers vont vouloir s'occuper des clients avec peu d'actifs.
    a. Nous avons effectué des pressions sur les gestionnaires de fonds pour réduire le Frais de gestion et amener des séries à frais plus bas. L'industrie s'est améliorée et doit encore s'améliorer.
2) La rémunération à honoraires va amener les clients à payer plus cher pour avoir les services des conseillers. Voici pourquoi :

a. Présentement, on complète un questionnaire de répartition d'actif avec un nouveau client et on établit une politique de placement. De là le % en actions et en obligations dans le portefeuille.
b. La majorité des fonds paient les commissions de suivi suivantes :
    i. Actions : 1%
    ii. Obligations : 0.5%
    iii. Équilibré : 1%
    iv. Si on veut être logique, les fonds équilibrés devraient verser 0.8% de commission de suivi et baisser le frais de gestion total du fonds de 0.2% + taxes.
    v. Ces % devraient être le maximum qu'un fonds peut verser au conseiller. On enlève ainsi une partie des conflits d'intérêts possibles.
c. On ne voit pas d'incitatif à investir un client plus en actions si la rémunération reliée aux actions est de 1%, comparativement à 0.5% pour les obligations. Il est clair qu'un plafonnement/standardisation de la rémunération règle une partie du problème.
d. Voici ce qu'il va arriver si tous les comptes doivent devenir 100% à honoraires :
    i. Les conseillers n'auront plus de commissions à frais de vente reportées
    ii. Beaucoup de conseillers vont charger 1% ou 1,25% d'honoraire sur l'ensemble du portefeuille
    iii. Ça va donc couter plus cher au client en bout de ligne
    iv. Qui va vouloir servir un client qui a 10 000$ à investir? À 1%, ça donne 100$ de revenu par an. En tenant compte de tous nos frais, le coût moyen par client est de 300$, avant que je sois rémunéré pour mon temps…
    v. Les conseillers qui offrent peu de services vont vouloir maintenir leur rémunération et vont facturer 1% d'honoraire aux clients.
e. Les courtiers de plein exercice des banques ne se gênent pas pour charger 1.25% ou 1.5% d'honoraires aux clients afin d'atteindre leurs objectifs de production et conserver un % de rémunération élevé. Ça coute parfois plus cher qu'un fonds mutuel standard. Est-ce qu'on appelle ça mettre l'intérêt du client en premier?

Nos recommandations

Si on veut simplifier pour les investisseurs (afin qu'ils comprennent, c'est le but primaire) et les conseillers, voici ce qu'il faudrait faire :

- Simplifier l'information fournie aux clients
    - Les rendements sur une page, les frais sur une autre page. Maximum.
    - Les relevés de portefeuilles doivent tenir sur 2-3 pages, oublions le superflu.
    - Déclarer le frais total (RFG) par fonds, en % et en $. Une fois par année et pour le total du compte, pas par plan. KISS (Keep It Simple and Stupid).
    - Les CVC doivent être établis par objectifs. Si l'objectif du client est la retraite, pour son REER, REER de conjoint, CÉLI et compte non enregistré, ils doivent donc avoir un plan global. 1 seul CVC pour tous ces plans. Mon client qui sait que son portefeuille contient 60% en actions et 40% en revenu fixe, il connaît son niveau de risque global. Pourquoi le mêler en indiquant le % de risque par compte quand dans la majorité des cas, l'épargne est pour la retraite? Si un client a un Régime d'épargne études, on fait un CVC séparé pour ce compte dont l'objectif est différent.
    - Éliminer les frais DSC et LSC et garder juste les codes de fonds FEL. Il resterait juste les codes FEL et les Séries F, I, O. Mais en faisant ça, ça va être difficile pour les jeunes conseillers. N'oublions pas qu'un fonds équilibré ou d'actions en série F avec un honoraire de 1% ajouté revient au même coût qu'un fonds mutuel standard dans la majorité des cas.

- Encadrer de plus près les réseaux de distribution où sont les conflits d'intérêts.
    - Interdire les concours et voyages payés aux conseillers et autres concours basés sur les volumes. Dans le domaine des assurances aussi. On est encore surpris que ça existe encore en 2017
    - Plafonner le taux des commissions versées sur les fonds de revenu, équilibrés et d'actions.
- Réduire le fardeau administratif des conseillers. Si on a plus de gestion à faire avec les comptes à honoraires, on pourra servir moins de clients. Et c'est les plus petits comptes qui vont être pénalisés.

Jean-François G. Labbé, MBA, CFA Planificateur financier

Alexandre Brassard, BAA, Planificateur financier

Response to CSA Consultation Paper 81-408

1. Given that mutual fund managers' compensation is based on performance, and considering the fact (taken from Appendix A of the CSA Consultation Paper) that funds that outperform receive more sales and those that underperform receive less, then it is a contradictory argument to suggest that fund managers will underperform to increase cash flows into their funds.

2. The assertion that funds that pay commissions underperform those that do not was certainly not true during the market recession starting in 2007 and ending in March, 2009. All of the equity funds that I was using performed better than the corresponding ETFs or F series Index Funds.

3. Implied throughout this consultation paper is that investors should be investing in the best performing funds. The problem with this is that in my over 30 years in this industry, I have never seen a study, or seen any evidence, that there is a significant correlation between past and future performance. In fact, in an article appearing in February, 2017 in the AdvisorAnalyst.com entitled “Smart Beta Returns (Hint: History is Worse than Useless”), it shows a negative correlation. This was graphically illustrated by Nick Murray, an American who has been in this industry for over 40 years, at one of the last Mackenzie Universities that I attended. He gave the example of the best performing fund over I believe the previous 10 years. This fund had out performed its nearest rival by 4-5% a year. He then asked what we thought the average return was for the people who had invested in that fund during that time period. The correct answer was either -11% or -13%, I can't remember which. The reason for this was that most of the money was invested into this fund at or near its peaks.

Added to the problem of not being able to predict how an individual fund is going to perform is the fact that the relative performance of various sectors of the capital markets varies significantly (Please see attached Fidelity Performance Chart). Then you have Fund Managers having different management styles that perform differently depending on where we are in the business cycle.

So, unless you want to, at best, underperform, or at worst, lose money, you should not be concentrating your investments in the currently best performing funds. When my clients experience significant gains in some of their funds I suggest they take profits, moving those profits to either funds that are currently underperforming but with good growth potential or to fixed income funds until we experience a market correction.

4. One of the things in the CSA Consultation Paper that disturbs me the most is the assertion that we financial advisors sell the funds that compensate us the most. This shows a complete lack of knowledge as to what we do and how we do it.

Whenever we meet with a prospective new client or an existing client with changed circumstances, we initially do a complete financial review to determine the client or client’s current situation. Then we discuss their goals and aspirations. After this analysis we discuss what they should and can be doing in order to meet their needs and achieve their goals. For a portion of the new prospects we have to say that we cannot help them because either they are not in a position to be helped or they are already on track to achieve their goals. Since most advisors hold licences that allow them to provide insurance, bank and investment products, we are able to provide the means by which our clients can achieve their goals.

After it has been determined that the client can and should be putting away money into investments either by doing a periodic investment or a lump sum, or both, and after having an extensive discussion and/or having them do a risk profile questionnaire, we look at providing the investments that will best achieve the investors goals. Especially for investors investing moderate to large lump sums of money, we look at recommending a diversified portfolio to protect them from having too much in the funds or sectors that might go down in value but still having some exposure to the sectors and funds that will perform the best during a given time frame.

For the mutual funds that I am recommending, I do not know exactly what the MERs are until we get to the actual discussion of these when discussing the client's costs. In other words, they play no part in my determining which funds the client should be using. When discussing how I get paid, I say that I get a portion of the MER. Because the MER is a percentage of the money invested, when they do well, I do well, and when they suffer, I suffer. So it is in both of our interests for them to do as well as possible.

One way that regulators could do more to protect the interests of the investor is to require that all persons entering this industry receive the training and education to use such a process.

5. In all scenarios that I have seen showing what investors would have to pay if we switched to fee for service, the vast majority of my clients would be paying more than they are now. For a significant number of my newest and smallest clients, they couldn't afford me and I probably couldn't afford to keep them. How can this be in the best interest of these investors? And for the investors who could benefit from fee for service, under the current system that option is open to them and their advisors.

You may ask why I should care about people with smaller amounts of money to invest; because they probably need the help as much or more than the affluent. Also, I get as much or more pleasure helping people with modest means to become and remain financially independent than I do making the wealthy wealthier.

6. The suggestion that funds invested under the DSC option may deter investors from redeeming even in the face of consistently poor performance ignores the fact that all fund companies have a wide range of funds that the investor could move the money into without incurring a sales charge or restarting the DSC clock. Also I would suggest that if there is a fund with consistently poor performance the fund company is going to give it special attention to get it to perform better. It has been my observation that it seems to be easier to make a poor performing fund perform better than it is to keep a top performing fund on top. In making investment recommendations, I often suggest investing a little higher percentage in funds and sectors that are currently underperforming, especially when I know the fund company and fund manager.

Although I seldom use the DSC option anymore, it can be an effective way for newer advisors to earn some up front income while allowing smaller investors an inexpensive way of getting financial advice.

7. As all of the previous points suggest, I do not believe that there is evidence that the imbedded commission structure creates a conflict of interest. Furthermore, I do not believe that transitioning to direct pay arrangements will stop unethical advisors from doing things that benefit them more than the investor. Many of us who have been in this industry for a considerable time know of

instances where investors have had significant assets churned away by brokers who were paid for every transaction. In the time before trailer fees were introduced, where an advisor was seeing a client with no new services that he/she could provide, he or she might be tempted to change investments to generate income for themselves. I would suggest this could become a significant problem again if trailer fees were eliminated.

To summarize, I believe that the current system serves all investors very well, allowing not just the affluent to get financial advice. I also believe that if Canada transitioned to a direct pay compensation model that it would be much more difficult to start a career in this industry, and many experienced advisors would leave. Consequently, a large number of people would lose access to an advisor.

Lorne Radke, CFP
Red Deer, Alberta

Performance varies year to year

Calendar year returns of Canadian & international markets

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Emerging Markets: 32.1%	Emerging Markets: 18.6%	Canadian Bonds: 6.4%	Canadian Small Cap: 68.9%	Canadian Small Cap: 35.2%	Canadian Bonds: 9.7%	Emerging Markets: 16.4%	U.S. Small Cap: 48.1%	U.S. Equity: 23.9%	U.S. Equity: 21.6%	Canadian Small Cap: 31.9%
Foreign Equity: 26.4%	Canadian Equity: 9.8%	U.S. Small Cap: -17.2%	Emerging Markets: 52.0%	U.S. Small Cap: 20.2%	U.S. Equity: 4.6%	Foreign Equity: 15.3%	U.S. Equity: 41.3%	Global Equity: 15.0%	Global Equity: 19.5%	Canadian Equity: 21.1%
Global Equity: 21.0%	Canadian Bonds: 3.7%	U.S. Equity: -21.2%	Canadian Equity: 35.1%	Canadian Equity: 17.6%	U.S. Small Cap: -1.8%	Global Equity: 14.0%	Global Equity: 35.9%	U.S. Small Cap: 14.3%	Foreign Equity: 19.5%	U.S. Small Cap: 17.1%
U.S. Small Cap: 17.9%	Canadian Small Cap: -1.2%	Global Equity: -26.9%	Global Equity: 13.0%	Emerging Markets: 13.0%	Global Equity: -2.7%	U.S. Small Cap: 13.8%	Foreign Equity: 31.6%	Canadian Equity: 10.6%	U.S. Small Cap: 14.6%	U.S. Equity: 8.1%
Canadian Equity: 17.4%	Foreign Equity: -5.3%	Foreign Equity: -28.8%	Foreign Equity: 12.5%	U.S. Equity: 9.1%	Canadian Equity: -8.7%	U.S. Equity: 13.4%	Canadian Equity: 13.0%	Canadian Bonds: 8.8%	Canadian Bonds: 3.5%	Emerging Markets: 7.7%
U.S. Equity: 16.1%	Global Equity: -6.6%	Canadian Equity: -33.0%	U.S. Equity: 9.3%	Canadian Bonds: 6.7%	Foreign Equity: -9.6%	Canadian Equity: 7.2%	Emerging Markets: 4.7%	Emerging Markets: 7.0%	Emerging Markets: 2.4%	Global Equity: 4.4%
Canadian Small Cap: 13.6%	U.S. Equity: -10.1%	Emerging Markets: -41.4%	U.S. Small Cap: 8.0%	Global Equity: 6.6%	Canadian Small Cap: -14.2%	Canadian Bonds: 3.6%	Canadian Small Cap: 4.3%	Foreign Equity: 4.1%	Canadian Equity: -8.3%	Canadian Bonds: 1.7%
Canadian Bonds: 3.8%	U.S. Small Cap: -16.5%	Canadian Small Cap: -48.6%	Canadian Bonds: 5.4%	Foreign Equity: 2.6%	Emerging Markets: -16.2%	Canadian Small Cap: -0.5%	Canadian Bonds: -1.2%	Canadian Small Cap: -2.8%	Canadian Small Cap: -16.3%	Foreign Equity: -2.0%

Sources: Fidelity Management & Research Company, Datastream. Total returns in CDN$. Note: It is not possible to invest directly in an index. Asset class performance represented by: foreign equity: MSCI EAFE Index; global equities: MSCI World index; emerging markets equity: MSCI Emerging Markets Investable Market Index ; U.S. equity: S&P 500 Index; U.S. Small Cap: Russell 2000 Index; Canadian equities: S&P/TSX Composite Index; Canadian small cap: BMO Small Cap Blended Weighted Index (Price Return); Canadian bonds: FTSE TMX Canada Universe Bond Index. As at December 31, 2016.

CSA

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I work for one of the big 4 brokerage firms in Canada. I have read your report on embedded fees. To clarify, I think deferred sale charge funds are not necessary in the industry. Low loads would also fall in that category.

Most of the mutual funds in my clients portfolios are sold as front end zero. In this case their costs are actually cheaper than fee based options with F class funds.

Banning embedded fees or trailers will actually increase costs to clients. Mutual funds have determined that the cost of advice for the most part is 1%. The cost of advice in fee based accounts for the most part is higher.

If your goal is to raise fees to clients, then go ahead.

Matt Morris

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Guelph on

N1h7b1

COMMENTS ON CSA CONSULTATION PAPER 81-408

I was impressed by its scope , thoroughness , evidence and honesty in exposing all that is wrong (plenty) with the current Investment Fund practices of the various forms of embedded commissions paid by investors and the resulting collateral damage .

Conflicts and misalignment of interests favouring dealers and investment managers , opacity and complexity of layers of fees , higher fees paid , need to navigate through variances between asset classes and fund series , lack of investors control or choice and awareness of what they are paying for . Often investors are receiving little value / advice for fees paid as evidenced in your report .

Few investors really know what they are paying ,(also evidenced in your paper) the CSA CRM 2 was supposed to fix this but sadly fell short of doing just that by not mandating that the MER should be included also . Clients should easily see the TOTAL costs they are paying not just the so called advice portion . Visible full disclosure ! Of course this might lead to sticker shock for too many .

Professional Pension Investment Managers would never accept these conditions and yet the individual investor who is trying to secure his or her own financial future and retirement income faces these obstacles leading to lower outcomes and quality of life . Few individual investors have the sophistication and / or time to understand and evaluate all of this .

Even Do It Yourself investors are victims of the present embedded commissions as when they purchase certain funds or structured products through their discount brokers are still paying invisible trailer fees for nothing without choice or control.

There are investment fund companies who are transparent and do not charge embedded fees but should be able to and want to operate on a level playing field so investors can compare apples to apples

Why not just put the advice back into financial advisor in a more visible manner by having investors who need advice negotiate a fee with their advisor which can be taken out of their account or paid separately along with the MER each broken out individually Educating clients on this fee for service is easier on an even playing field .

COMMENTS ON CONSULTATION PAPER 81-408 Con’t

In the end a client can still have a professional managed portfolio with advice at a lower more transparent cost more aligned with his or her service provider .

CSA needs to put the interests of the Canadian Investor first . ThIs Consultation paper overwhelmingly shows this is not presently happening . The industry will not disappear but will adapt by rolling out better more transparent , cost effective Investment options and reporting . The discontinuing of all embedded commissions is a good start .This will require stewardship , guidance and strong reform . After all these conflicts of interest and misalignment of interests were noted in Gloria Strombergs *Regulatory Strategies for the Mid 90's - Recommendations for Regulating Investment Funds in Canada January 1995 over 20 years ago why was there no action taken on this then ? Why did these practices go on for so long ??*

Stop the “handwringing “ , Canadians deserve ,want and expect regulatory action from their CSA on helping them secure their financial future by eliminating the financial roadblocks that should not be there in the first place !

Frankly the CSA language on page 5 *“ if we decide to move forward “ or on another page “what if any changes “*does not inspire a call to action or change . I hope I am wrong in this perception

Regards

Daniela Rempel
Individual Canadian Investor

To whom it may concern,

First, I struggled where to find a location to send comments back on your website, regarding embedded fees. All I could find was Contact Us: https://www.securities-administrators.ca/aboutcsa.aspx?id=99 So hopefully this is correct.

Next, I have not used funds with DSC fees since 2005-2006, only FE funds at 1%, with NO upfront cost. This hurt a lot in 2008-2009, but it was not the clients fault.

Since about 2011-12, I added in funds that allowed me to charge a 1% commission paid by the client, where relevant, possible (most are possible now) and makes sense to the client financially, which is my next point. By the time these regulations come out, I expect to have as many clients in this type of investment as possible, except where it does not make sense.

I have several clients that are companies or holding companies. For these clients (and they are large), I have left their investments in embedded fee funds, as some of them have NO active income. Therefore, if I were to un-embed (not sure if this is a word) them, the fees would be expensed inside the corporation and there would be NO income to write off the fees against. Additionally, there could be capital gains (or losses) incurred for these corporate clients. Would this not negatively affect them? Is the CSA going to offer to pay the taxes on the gains?

I also have several clients (non-corporate) that have funds outside of an RSP or TFSA as those have already been used up. Some of these funds will have a large capital gain to them, if there is a fee sold. I usually give those clients the option of going “fee based” or embedded, depending on each clients’ situations.

My costs (fees) to these clients are the same whether embedded or not, so that is not an issue to me.

I would suggest that if you are going ahead with this (I know you are), you may want to allow embedding inside corporate accounts, to alleviate this issue for those clients. These are NOT small clients… they have up to $1M invested in them. So, you are trying to help small clients, but hurt big ones. I have no idea how you could help the bigger non-registered clients avoid capital gains taxes… that is your job.

Frankly, if you do get rid of embedded comp (which I fully expect), I will only need to know one code for that fund, instead of two, so it will make my life easier, but you will be hurting these particular clients.

If this does not make sense or is not correct, you have my contact information. If this needs to be sent to someone else, please let me know or forward it to the appropriate person.

I expect there are other comments about things like this that I have not even thought about.

If you have read this far, I thank you for your attention in this matter.

Good luck.

Thanks,

Gord Clark

Investment Planning Counsel®
FINANCIAL SOLUTIONS FOR LIFE

VIA E-MAIL: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca
May 30, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

The Secretary
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Me Anne-Marie Beaudoin
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Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions (Consultation Paper)

On behalf of Investment Planning Counsel Inc. (IPC), we thank the CSA for the opportunity to provide comments on the Consultation Paper.

Our company

IPC is a diversified financial services company, operating on a national platform with over $26 billion in assets under administration as at March 31, 2017on behalf of approximately 260,000 investors across all provinces. Its subsidiaries include IPC Investment Corporation (IPCIC), an MFDA member, IPC Securities Corporation (IPCSC), an IIROC dealer member and Counsel Portfolio Services Inc., (Counsel), a mutual fund manager. IPC is part of IGM Financial Inc., which is a member of the Power Financial Corporation (PFC) group of companies.

General Comments

IPC has a strong interest in the discussion set forth in the Consultation Paper. Founded in 1996, IPC has always adhered to the philosophy that clients are best served through the comprehensive services of an independent financial advisor.

We are supportive of the CSA's overall objectives to set out a more explicit framework for addressing conflict of interest matters and to clarify the nature of the client-registrant relationship for clients, which we believe have been largely met through the Fund Facts pre-sale delivery disclosure (Point of Sale or POS) and Client Relationship Model (CRM) projects, as well as the current proposals in CSA Consultation Paper 33-404 (the CSA CP 33-404).[1] In our view, however, the regulatory option to discontinue embedded commissions will have far-reaching, and we believe, unintended outcomes.

We already have, as the CSA acknowledges, a highly concentrated fund distribution industry in Canada with deposit-taker and insurance owned fund distributors dominating fund distribution. We anticipate that a full transition to direct-pay arrangements will significantly impair the ability of a number of independent dealers and representatives from continuing to service mass-market households and more modest clients, which will diminish both the degree of product and advice choices for investors, as well as, impact the affordability of financial advice. A potential regulatory outcome that leads to an even more concentrated fund distribution industry is not, in our view, optimal for retaining a competitive and innovative financial services industry, nor does it facilitate good investment outcomes for Canadians. We strongly urge the CSA to reconsider the proposals in the Consultation Paper in this context.

Our submissions are structured as follows:

- How the current regulatory reforms underway will address the key investor protection and market efficiency issues identified in the Consultation Paper;
- The market trends and forces underway that arealso driving changes aligned with the CSA's objectives;
- Alternative regulatory options for the CSA to consider instead of discontinuing embedded commissions;
- The impact discontinuing embedded commissions could have on independent dealers, their representatives and their clients, and specifically for IPC.

In addition to our specific comments, we also wish to emphasize the following three key objectives that we believe must guide the CSA's decision-making process for both the Consultation Paper and the current proposals in CSA CP 33-404, which we've been told previously by the CSA to consider together.[2]

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[1] CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients (April 28, 2016).

[2] CSA Staff Notice 81-327 *Next Steps in the CSA's Examination of Mutual Fund Fees*, June 29, 2016.

1. Preserving financial advice for Canadians

Personal savings is a key component to the accumulation of financial wealth and retirement readiness. Among other things, households who have and keep an advisor (i) are twice as likely to save for retirement at all ages; (ii) have significantly higher levels of investable assets at all ages; (iii) improve their regular saving for retirement at all income levels; (iv) rate themselves as more financially knowledgeable; and (v) are more confident in their ability to achieve a comfortable retirement.[3] We also know that investors' primary source of financial information comes from their advisors.[4]

Beyond active management ("Alpha") and asset allocation ("Beta"), better financial planning decisions ("Gamma") have a significant impact on an investor's retirement outcomes. In fact, "Gamma" can increase approximately 1.59% in arithmetic "Alpha" on a portfolio.[5] Therefore, as part of the CSA's deliberations, we urge the CSA to be mindful of not proceeding with any regulatory changes that may have the potential to diminish the level of advice provided to Canadians.

2. Not disadvantaging the sale of securities vs. other financial services and products

We share the views expressed by our sister companies within PFC on this topic, that the obligations owed by registrants to their clients should not be dependent on the legal nature of the product being sold or the license held by the registrant. The securities industry is only one part of the financial services sector in Canada. Insurance and deposit products are also significant segments of the capital markets. We found it particularly disconcerting that the CSA suggests in the Consultation Paper that the high level of horizontal integration at deposit-taker and insurance owned dealers somehow leads these firms to focus less on any one business line and more on "gathering assets across all business lines and on directing clients to the appropriate business line". We submit there is evidence to the contrary.[6]To truly enhance the level of advice provided to Canadians, we need consistent reforms across securities, insurance and banking sectors. As part of the CSA's consideration, it will therefore be critical to ensure that any regulatory action does not result in product and regulatory arbitrage with clients being directed towards products that may not best meet their investment needs and objectives.

We believe it is noteworthy that in each of the jurisdictions that has introduced a complete ban on embedded commissions, the ban has extended beyond investment funds. This is a very important

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[3] Sources: CIRANO, *Econometric Models on the Value of Advice of a Financial Advisor* (2012) and *The Gamma Factor and the Value of Financial Advice* (2016). All advised households, at all age levels, are found to save at approximately double the rate of non-advised households, with advised households having higher net worth than non-advised households across all ages and income levels (Source: IFIC *The Value of Advice*, 2011).

[4]Key Highlights CSA Investor Education Study 2016 prepared for the CSA by Innovative Research Group, Inc. (April 2016).

[5] Source: Morningstar, *Alpha, Beta and Now… Gamma,* 2012.

[6]See: CBC News reports by Erica Johnson, http://www.cbc.ca/news/canada/british-columbia/td-tellers-desperate-to-meet-increasing-sales-goals-1.4006743 (March 6, 2017), http://www.cbc.ca/news/business/td-bank-employees-admit-to-breaking-law-1.4016569 (March 10, 2017), http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575 (March 16, 2017) http://www.cbc.ca/news/canada/british-columbia/bank-s-deceptive-titles-put-investments-at-risk-1.4044702 (March 29, 2017) and http://www.cbc.ca/news/business/financial-investment-rules-client-interests-1.4069847 (April 17, 2017).

distinction to the proposal in the Consultation Paper. While we welcome the CSA's support for a harmonized regulatory approach for similar products, and we appreciate that the Canadian Council of Insurance Regulators (CCIR) has indicated it will review the CSA policy direction on embedded commissions and assess its appropriateness for segregated funds, the potential for regulatory arbitrage remains. The Consultation Paper also gives no indication of the timeline for the CCIR's review or a commitment for coordinated action with the CSA, nor is there any discussion in the Consultation Paper of whether a similar review is being considered by the Office of the Superintendent of Financial Institutions (OSFI) with respect to banking products, such as GICs and daily interest accounts (DIAs).

3. The need to ensure advice remains affordable and accessible for modest investors

Finally, we believe it is critical for the CSA to ensure that financial services and advice remain accessible and affordable to all Canadians going forward. Research shows that fewer choices of compensation models can limit access to advice and result in higher overall cost if only fee-based compensation is available, particularly for households with more modest investment levels.[7] We believe that the decisions by some global regulators to not proceed with a ban on embedded commissions, in part because of the recognition of the importance of retaining independent dealers and manufacturers to preserve greater choice for investors in their markets, should not be overlooked. We encourage the CSA to consider and provide a more detailed analysis as to why the approaches taken in countries such as Sweden, Hong Kong, Germany, New Zealand and Singapore, among others, would not be appropriate for the Canadian market and for Canadian investors before a regulatory decision is made to discontinue embedded commissions in Canada.[8]

Comments on the Consultation Paper

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[7] In the United States, the average total cost of fee-based advice is comparable to the cost of advice in Canada (2.00% to 2.20%), however the cost is higher for modest investors with less than $100,000 of financial assets (2.40%) than for high net worth investors (1.70%) (Source: Investor Economics & Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canada-U.S. Perspective,* 2015). Where regulation has been changed to ban or limit commission, the absence of embedded compensation has been found to lower the cost of the product, but the cost of advice was seen to go up. It has also been found that in jurisdictions that have moved to fee-based compensation, those with less wealth or income found it more difficult to get advice than others. Ultimately, all forms of compensation affect advice and outcomes and there is not enough evidence indicating that fee-based compensation will lead to better long-term outcomes than commission-based compensation (Source: Mutual Fund Fee Research prepared for the Ontario Securities Commission on behalf of the Canadian Securities Administrators, written by Dr. Edwin Weinstein, PhD The Brondesbury Group (Spring, 2015) ("The Brondesbury Report")).

[8] Currently, only four countries have imposed a ban on embedded commissions: Australia, Netherlands, South Africa and the United Kingdom. In the Netherlands, the discontinuation of embedded commissions is a voluntary arrangement among the five large banks that dominate investment fund distribution. While under the MIFID II reforms, the imposed ban on embedded commissions only applies to independent financial advisors, which make up only 11% of the European market. Despite MIFID II, a number of jurisdictions have concluded not to impose a ban on embedded commissions, including: Belgium, Denmark, France, Germany, Ireland, Italy and Sweden. Additionally, we have seen a number of other jurisdictions decide not to proceed with the regulatory option to discontinue embedded commissions, among them: Brazil, Hong Kong, India, Israel, Japan, New Zealand, Singapore, South Korea and the United States.

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Current Regulatory Initiatives Address the Issues Identified
The CSA identified three key investor protection and market efficiency issues with embedded commissions. In our view, the POS and CRM projects, together with the CSA CP 33-404 proposals, once all reforms and/or guidance has been fully implemented, will substantially address each of these issues. To the extent there remains any gap, we submit market forces underway (which we discuss later in our submission) together with other possible regulatory actions (noted below) will achieve the CSA's desired objectives.

1. **Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors**

To suggest that investment fund managers who pay embedded commissions to dealers may be incentivized to rely more on those payments than on generating performance to attract and preserve assets under management is simply not our experience, nor do we believe it is an accurate portrayal of today's competitive market environment.

As we identify below in our discussion of market forces driving changes independent of regulation, our data indicates that the majority of embedded commissions offered by investment fund managers are substantially the same across asset classes and series and that manufacturer margins and costs (management expense ratios) are decreasing. We also note that the trend of dealers and advisors is to shorten the number of fund manufacturers with whom they are working, with the key drivers of dealers and advisors focused on overall performance of the company's products and consistent performance.[9] All of this means that investment fund managers are today aggressively competing on fund costs and performance.

The introduction of the proposals in CSA CP 33-404 will only further increase, in our view, the scrutiny by dealers and their representatives on investment fund costs and performance. The explicit requirements in the know-your-product (KYP) and suitability proposals will require registrants to take into account the impact on the performance of the product of all fees, costs and charges, including any embedded commissions paid as part of the suitability analysis. The reforms also propose that dealers and their representatives will have to assess whether any remuneration, including trailing commissions, could reasonably be expected to inappropriately influence how representatives deal with their clients. We strongly believe that with CSA CP 33-404, the CSA has effectively addressed any residual reliance there may still be today for fund managers to compete on embedded commissions to promote sales or retain assets.

The central purpose of the proposals in CSA CP 33-404 is "to better align the interests of registrants with the interests of their clients". As we've indicated, we believe that the proposals when implemented as rules and/or guidance will address the concerns expressed in the Consultation Paper that embedded commissions may encourage dealers and their representatives to recommend higher cost fund products, or promote a particular purchase option, that pays them a higher commission to the detriment of investor outcomes. In fact, we consider the breadth of the proposed conflicts of interest reform and accompanying guidance in CSA CP 33-404 on compensation arrangements and incentive practices to capture much more than simply any potential for influence caused by embedded commissions. The proposed reform requires dealers to assess whether any remuneration could reasonably be expected to inappropriately influence

[9] Source: Environics Research, *2015 Adviser Perceptions in Canada: A focus on the Future & Consumers* (2015).

how representatives deal with their clients. This approach recognizes that conflicts of interest and the potential for misalignment of interest exists in any fee model, not just with embedded commissions.[10]

2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

From the beginning, the POS project was intended to increase investors' awareness and understanding of embedded commission costs, as well as better equip investors to compare the costs of one mutual fund to another, and to understand the impact of such costs on their investment returns. Similarly, the CRM reforms introduced, in the first phase, new relationship disclosure to investors at account opening explaining the types of products and services provided by the dealer as well as more fulsome information on charges, including transaction charges, which they may expect to pay in connection with their investment.[11] Phase 2 of CRM (CRM2) next introduced new annual account level reporting on charges and other compensation of commissions and other amounts paid to dealers, including any embedded commissions in dollar amounts. Like the POS project, the CRM project was intended not only to increase investors' awareness and understanding of dealer compensation costs, but to also lead to better, more informed investor decision making when it comes to dealer compensation costs and the corresponding level of service that's being provided.

Investor knowledge, attitude and behaviour, registrant practices, fees and product offerings, have all been identified by the CSA as potential positive impacts of the POS and CRM2 projects.[12]Without the results of the CSA research project underway to measure the impacts of these projects, we do not believe it's appropriate for the CSA to conclude that discontinuing embedded commissions is necessary to create greater investor fee awareness, or opportunities to negotiate and have greater control over dealer compensation. This position also seems inconsistent with the continued regulatory focus by the Mutual Fund Dealers Association of Canada (MFDA) as well as the CSA to continue to enhance CRM2 disclosures to capture mutual fund management fees, as well as the non-cash incentives that may be paid to the dealer or advisor and its representatives.[13]

3. Embedded Commissions paid generally do not align with the services provided to investors

The concern raised by the CSA in the Consultation Paper of the need for advice and services to better align with the costs paid by investors (directly or indirectly through the trailing commission) is an important issue. However, in our view, this is an issue that may impact all forms of compensation (not just embedded commissions), and is not solved simply by discontinuing such payments. While the direct-pay option may be more transparent to the investor that fees are being paid, investors selecting this option may not be aware of the fees other investors are paying or the services they are receiving, nor will clients necessarily

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[10]All forms of compensation affect advice and outcomes (The Brondesbury Report,p 4).

[11]Including the initial sales charge and DSC options and any trailing commissions or other embedded commission paid.

[12]See press release: CSA to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model (August 22, 2016).

[13] MFDA Bulletin #0671-P – Report on Charges and Compensation – Consultation Regarding Cost Reporting for Investment Funds (December 18, 2015) and CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103, Companion Policy 31-103CP and National Instrument 33-109 (July 7, 2016).

have any market strength to negotiate fees or to realize or to be able to calculate the impact those (now external) fees have on the returns of their portfolio.

In fact, recently we saw the Investment Industry Regulatory Organization of Canada (IIROC) in their review of compensation related conflicts indicate that fee-based accounts may not always be in the best interests of clients.[12]

As noted in the Brondesbury Report, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation.[13] There is no standard fee for service structure in the market place: there can be flat fixed fee, flat fee based on percentage of assets, tiering of fees based on percentage of assets or fees based upon asset classes. IIROC dealer members also have fee for service structures associated with managed accounts in respect of which those fees are for the provision of discretionary investment management services along with other services.

Within our business model, embedded commissions are not strictly limited to providing advisor compensation in exchange for investment advice, but rather support a broad range of services provided by the advisor and dealer. For example, fees are used towards: reporting, portfolio rebalancing, compliance, insurance, regulatory fees, IIROC and MFDA investor protection fees, infrastructure, back-office systems and investor education and may be used towards financial planning and estate and tax planning.

We believe the increased performance reporting and saliency of fund costs and dealer compensation created by the POS and CRM projects will in fact lead to better alignment of overall services and advice with dealer compensation paid. These initiatives, fully implemented, are expected to cause investors to question the overall level of services and advice they are receiving, whether embedded or not, which in turn is anticipated to cause representatives to better demonstrate their value proposition or, lead to investors switching to lower-cost alternatives. If the articulated aims for the POS and CRM projects are met, investors will be empowered to make more informed decisions on whether the fees orcommissions they're paying, embedded or not, are commensurate with their specific needs, expectations and preferences for service and advice.

We expect thiswill prompt greater price and service competition of dealers and their representatives to demonstrate their value proposition and to promote the level of services provided to investors in exchange for dealer compensation. In fact, through our complaint intake management, we have already seen clients questioning their advisors with respect to the services rendered in exchange for the fees they are paying. Our experience is that clients have become more engaged in the discussion of how much they compensate their advisor and dealer, what services are being provided in exchange for such fees, and the frequency and level of engagement they expect from their advisor.

4. Market Forces are Already Driving Changes Aligned to Regulatory Objectives

We strongly believe that competitive market forces, influenced in part by recent regulatory reforms, are already effecting the industry changes that the CSA expects to occur from a ban on embedded

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[12]See IIROC Notice 16-0297 Managing Conflicts in the Best Interest of the Client – Status Update (December 15, 2016) and IIROC Notice 17-0093 Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review (April 27, 2017).

[13] The Brondesbury Report, p 18.

commissions. In particular, we are seeing today the growth and availability of direct-pay options andreductions in fund fees, increased price competition, decreasing fund management costs and market innovations in product distribution and advice.

The CSA is correct to identify that the share of mutual fund assets held in fee-based purchase options (F series) is growing, and growing quickly. Competitive market pressures are driving the growth of F series for many fund manufacturers, with frequent changes to the F series offering or pricing. Fee-based program assets as a percentage of total assets is gaining ground in IIROC platforms, and in full-brokerage the shift in advisor compensation is inline with the shift to fee-based.[14]Our own experience at IPCSC is that fee for service mutual fund holdingshas increased, from 4% to 21% from December 2011 to December 2016.

Where we disagree with the CSA is the discussion in the Consultation Paper that direct-pay options today are not available to all investors in all channels. While it is correct that IIROC dealers generally do not offer fee-based programs to mass-market households, generally because of a lack of scale and the cost to implement, there are direct-pay options available to MFDA representatives today looking for fee-for-service for smaller investors where the dealer program may be restrictive to high minimum investments or fees for the reasons identified.At IPC, in February 2006,we launched a negotiable advisor fee series, Series D for our Counsel funds. This manufacturer sponsored solution allows for the negotiation of an advice and service fee directly between the investor and dealer, through the representative, pursuant to an explicit agreement, and then for Counsel to facilitate the investor's payment of dealer compensation by collecting payments from the investor's investment (through periodic redemptions).Today many fund manufacturers have aSeries D equivalent(often named FB series) and there are other fund manufacturers who offer the same negotiable attributes of Series D in an existing series.

In the last few years, we have also seen a number of investment fund managers, including Counsel, announcing fee cuts, trailer fee cuts, administration fee cuts, preferred pricing programs as well as an increasing number of share classes with lower management expense ratios (MERs) year-over-year.[15]Asset-weighted (MERs) and management fees for long-term funds also continue to decline.[16]

Finally, Canada is now home to more than 80 fintech firms.[17] We believe the increasing innovation and technology we're seeing in the market from both fintech start-ups and from incumbents offers investors choices in product distribution and advice, as well as increase price and competitive pressure on incumbents to demonstrate alignment of fees with the overall level of services and advice provided. We welcome this, and anticipate representatives providing advice will be able to differentiate themselves from asset allocation, advice 'light' platforms.

5. Alternative Regulatory Options to Discontinuing Embedded Commissions

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[14]Source: Strategic Insight, Retail Brokerage and Distribution, Summer 2015.

[15]December 2014 – December 2015, source: Insight Advisory Service, July 2016.

[16]Excludes funds with performance fees, funds with management fees charged at account level and labour sponsored funds, source: Insight Advisory Service, July 2016.

[17]Source: PwC, Canadian Banks 2016 Embracing FinTech movement, 2016.

In our view, any potential incremental or possible "complementary" benefit that the CSA anticipates could be achieved through the discontinuation of embedded commissions will be minimal, by comparison to the very real and significant impact to some stakeholders, particularly medium to small independent dealers, their representatives and their clients.[18]To the extent the CSA continues to consider that any of their concerns are not fully addressed, we believe there are other regulatory options available to address such concerns.

(a) **Dealers Offer a Direct-Pay Option** – If the CSA concludesthat there continues to be a need to further enhance investor awareness, understanding and control of dealer compensation, we recommend the CSA considers the regulatory option of requiring all dealers who offer an embedded commission arrangement to also have a direct-pay arrangement option available to all investors. This option could take the form of dealers allowing investment fund managers to facilitate investor payment to dealers of compensation, as contemplated in the Consultation Paper.The inclusion of a direct-pay option would allow both compensation arrangements to be presented and explained to the investorat account opening, or by notification to existing investors, and then give investors a clear choice in remuneration methods while still preserving investor choice.

(b) **Enhanced Dealer Supervision of Advisory Services** –A more impactful and fulsome regulatory response for the CSA to consider to address the CSA's concern thatthe "one-size-fits-all" nature of embeddedcommissions may not align well with the services and advice actually being provided,would be to explicitly enhance the guidance to specify that the dealer has a supervisionobligation to ensure that a commensurate level of advice and service is in fact being provided in exchange for the payment by the dealer to the representative. This would be the case whether that payment is embedded or not.

(c) **Greater Specificity at Account Opening** - The CSA could also consider revisiting the guidance relating to CRM to requiregreater specificity in the current relationship disclosure delivered to investorsat account openingof the advice and services that will be provided in exchange for the dealer compensation to be paid.

(d) **Discontinuing Variable Trailers** - If the CSA takes issue with embeddedcommission rates that vary over the course of the investment, we would submit that it is certainly within the CSA's purview to provide notice that CSA staff will no longer receipt prospectuses with such arrangements

6. Impact on Independent Dealersand their Clients

A ban on embedded commissions will have considerable financial and operational impacts for IPC, and more importantly, on the level of service and advisory support we will be able to provide to our advisors and clients. As at March 2017,mutual fund trailing commissions accounted for 37% of the revenues in IPCSC, and upwards of 95% in IPCIC. Many MFDA dealer members will likely have similar dependencies on these sources of revenue. Evidence drawn from the MFDA Client Research Report indicates that of the assets

[18]As noted by the MFDA, advisors with a book size of less than $2 million are more reliant on DSC commissions to finance their operations. A mandatory switch to fee-based or direct-pay arrangements will therefore have a greater impact on those smaller advisors who are more reliant on DSC commissions (Source: MFDA Bulletin #0721-C – MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients, May 23, 2017, p14 (MFDA Client Research Report).

held by MFDA members, 6% are in no-load funds, 3% are in F class funds and 6% are in fund company administered fee based programs.[19]

As noted above, embedded commissionsare not strictly limited to advisor compensation in exchange for investment advice, but rather support a broad range of servicesprovided by the advisor and dealer to the investor. In addition to a potential loss in the level of services and advisory support we will be able to provide to our advisors and clients should a ban on embedded commissions proceed, we are also concerned that discontinuing embedded commissions may lead to fewer Canadians seeking financial advice.Canadian focused research suggests that despite the high level of trust and reliance investors'place on their financial advisor, only 16% of investorssurveyed would be willing to continue their advisory relationship if it resulted in upfront costs to them.[20]We also note that among Canadians, there's still a strong preference for taking guidance from a financial advisor over advice generated through an algorithm or robo-advisor.[21]

We anticipate that it will be unlikely that we will be able to transition all of the approximately 75% of our retail clientsnot currently in a direct-pay arrangement into a direct-pay arrangement. Coupled with the potential of fewer modest investors seeking advice, we may have feweraccounts to amortize fixed administrative and operational costs resulting inhigher fees for those investors who remain. Today our average fee-based account typically falls within the mid-market to affluent range, whereas most embedded commission accounts fall within the mass-market range. To date, we have been able to subsidizethe administrative and operational costs of more modest size accounts to service these investors through scale – a ban on embedded commissions will impede our ability to do so.[22]

Transitioning to direct-pay arrangements will also cause considerable disruption to investors, requiring accounts to bere-visited and re-papered in the absence of discretionary relief. As noted, IPC would have to take corrective action forapproximately 75%of its clients, which will take considerable time and cause considerable cost, as well as create the need for additional compliance oversight and reviews.

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[19] Ibid.

[20]Pierre Lortie, *A Major Setback For Retirement Savings: Changing How Financial Advisers Are Compensated Could Hurt Less-Than Wealthy Investors Most* (Vol 9, 13, April 2016)

[21] HSBC, *Trust in Technology: Country Report/Canada* (May 24, 2017).

[22]The MFDA Client Research Report (p 15) supports this conclusion, finding:

> Advisors may be using the embedded DSC commission paid by the fund company upon purchase to finance the cost of offering advisory services to mass market clients. If so, a ban of embedded compensation would eliminate the DSC commission and may result in advisors having to charge clients an upfront fee to cover the cost of their services. As mass market households are less likely to be able to afford direct-pay arrangements and are less likely to be eligible for fee-based programs, they would be the most impacted by a ban of embedded compensation.

With respect to transitioning to direct-pay arrangements, today IPCSC is carried by NBCN Inc. and relies on its systems for fee-based accounts. Accordingly, we will only be able to offer other types of direct-pay options that NBCN Inc. builds into its systems. For IPCIC, today we have our own nominee platform for fee-based accounts. To the extent other direct-pay options may be introduced, we will have to contract with our back office system supplier to make these available. The time for this transition, as well as cost, will in large part be in the hands of our service providers. For our IPCIC client name business, for anything other than using the fund manufacturer to collect fees based upon a percentage of assets (i.e.D series), we will have to build our own systems to charge and collect fees. All of these system changes will take significant time and cost and with a limited number of back office system suppliers, as we noted, the cost and timing of these changes will be uncertain. Until the back office systems are up and running and these different direct pay options are available,we will not be able to begin the process of transitioning our clients. A related issue that should not be overlooked is how to address clients in non-registered plans or registered plans who do not respond or refuse to move to a direct-pay arrangement. We anticipate that in such instances discretionary relief or regulatory guidance may be necessary.

Conclusion

We firmly believe that the impact of the regulatory actions taken to date, once fully implemented, together with the changes already underway in the market, will substantially achieve the CSA's objectives across all compensation models without the need to implement a ban on embedded commissions.We submit the CSA should allow for any change in business models to occur organically where there is evidence to suggest it is occurring. As theCSA continues to contemplate changes to mutual fund fee models, we urge the CSA to be mindful that discontinuing embedded commissions may have the unintended consequence on modest investors of limiting access to, and increasing the cost of, the very advice contemplated by CSA CP 33-404 to help Canadian investors achieve their long-term investment needs and objectives.

A ban on embedded commissions unnecessarily restricts consumer choice.In our view, there are alternative regulatory options to discontinuing embedded commissions that are able to address any residual issues identified by the CSA, without the same negative impact on independent dealers and their clients and without reducing competition and innovation in our markets that a ban on embedded commissions may cause.We urge the CSA to consider the importance of embedded commissions for dealers operating within the financial planning channel and the potential devastating impacts a ban may have on their operations and solvency, to the detriment of their clients.

An advisor's greatest value to an investor is their ability to help steer the investor's emotions and ensure that they stay the course and commit to their long-term financial plan. Anecdotally, and based on our experience, many do-it-yourself investors have the unfortunate tendency of 'buying high' and 'selling low'.[1]

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[1]Based on research completed by JP Morgan and Chase within its 2014 Guide to Retirement, an investor holding units of the S&P500 composite index between 1993 and to 2013, who missed out on the 10 best trading days would have annualized returns of 5.4%, relative to 9.2% had they remained fully invested(Source: https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets/viewer).

Just as we anticipate that each of the 11 targeted reforms and best interest standard proposed under CSA CP 33-404 will require considerable implementation time, so too will the transition to direct-pay arrangements. It is difficult for us to respond to the transition options in the Consultation Paper without a clear understanding of the CSA's direction with respect to both of these proposals. The question is not simply how long theprocess will take to transition to direct-pay arrangements, but how long it will take in combination with a number of other significant regulatory reforms underway. Taking a lesson from CRM2 implementation, we urge the CSA to work collaboratively and early with the MFDA and IIROC and with all registrants as the consultation process continues, so that there is a shared appreciation of thetimeframes needed. For example, we believe further consideration will be needed as to what the CSA would expect regarding the transition to direct-pay arrangement with respect to each client, and whether or how advisors will gather the consent of each client and document the account. The CSA's willingness to grant or codify discretionary relief to facilitate various aspects of a transition under CSA CP 33-404 and the Consultation Paper will also be relevant in determining the implementation time that dealers, their representatives and their clients will need.

Finally, in the Consultation Paper the CSA seem to have positioned the discussion of active vs. passively managed funds as active management being an undesirable outcome for investors that will be remedied through the discontinuation of embedded commissions. In our view, both passive and actively managed investment products are important for our client base, and for maintaining an efficient and vibrant capital markets. As currently expressed by the CSA, we are concerned that some registrants will be inclined to favour passively managed products, not because it is what's most suitable for the client, but because of the perceived regulatory bias and compliance pressures against actively managed funds. We ask that the CSA be mindful of this issue going forward.

We thank you for the opportunity to provide comments on the Consultation Paper. Please feel free to contact me if you wish to discuss this further or require additional information.

Yours truly,
Investment Planning Counsel, Inc.

John G. Novachis

Executive Vice President,
President of IPC Investment Corporation
President of IPC Securities Corporation

INVESTOR ADVISORY PANEL

May 31, 2017

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
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Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

The Investor Advisory Panel is pleased for the opportunity to respond *to Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions*. The Panel is an initiative by the Ontario Securities Commission (OSC) to enable investor concerns and voices to be represented in its rule and policy making process. Our mandate is to solicit and represent the views of investors on the Commission's policy and rule making initiatives.

Executive summary
In our view, the CSA has produced a well written, thorough and evidence-based analysis of the negative effects of embedded commissions on investors. The Panel agrees with the CSA's main conclusions that "*embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors*", that they "*limit investor awareness, understanding and control of dealer compensation costs*," and that embedded commissions paid "*generally do not align with the services provided to investors.*"

Investors are entitled to independent objective and professional advice. However, all too often, they receive advice that is based not on what is the best or even the most suitable product for them, but on what is most enriching for their advisor or firm. Embedded commissions paid by product manufacturers to registrants who sell their products harm investors. CSA commissioned research has provided compelling evidence that embedded commissions and other forms of conflicted compensation do harm to investors. There is also ample evidence that prohibiting embedded commissions as the UK did in its retail distribution review results in less biased recommendations and better outcomes for investors.

The Panel therefore strongly supports a ban on embedded commissions paid by third parties on the sale of all securities, not only on mutual funds, non-redeemable investment funds and structured notes. We call for the prohibition of any compensation or embedded commissions that put the interests of firms and registrants ahead of clients or create a conflict of interest between firms or registrants and investors.

We also agree with the CSA that "*investors should be provided with a compensation model that empowers them and that better aligns the interests of investment fund managers, dealers, and representatives with those of investors*." However, we believe that all forms of conflicted compensation must preferably be addressed at the same time.

The *CSA Staff Notice 33-318 "Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*" documents firm business models whose compensation and personnel policies are explicitly designed to incentivize and reward registrant behaviour that profits the firm and its employees at the expense of the client. The Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) also conducted firm compensation practices reviews that provide compelling evidence of systemic conflicted practices which harm investors (*MFDA Bulletin 0705-C, IIROC Notices 16-0297* and *17-0093*). We call on the CSA to address these and all forms of conflicted compensation as well. Specifically, the Panel would like to see prohibited all forms of compensation practices, direct and indirect, that harm investors, beginning with those currently identified in the above-mentioned documents.

Part 1 - Embedded commissions must be banned

The Panel wholeheartedly supports a ban on embedded commissions paid by third parties on the sale of all securities and we ask the CSA to prohibit any compensation or embedded commissions that put the interests of firms and registrants ahead of clients or create a conflict of interest between firms or registrants and investors.

Indeed, there is much evidence that conflicted compensation harms investors. Here are just a few studies that prove this:

> Professor Douglas Cumming's paper, "A Dissection of Mutual Fund Fees, Flows, and Performance," (2015) found that conflicted compensation in the form of sales and trailing commissions paid by fund companies, dealer affiliation and the use of deferred sales charge arrangements materially affects representative/dealer behaviour to the detriment of investor outcomes and market efficiency.
>
> The OSC's 2015 "Mystery Shopping Report" found that, when first meeting with a representative, investors were likely to hear about products and services offered (78%) and discuss their investment goals (89%), but less likely to hear about product fees (56%), the risk/return relationship (52%) or registrant compensation (25%), making it difficult to comparison shop for financial advice, especially on important aspects such as fees and costs;
>
> In 2015, mutual fund fee research prepared for the CSA by the *Brondesbury Group* looked at the extent to which the use of fee-based versus commission-based compensation in mutual funds changes the nature of advice and impacts investment outcomes. It did not find evidence that fee-based arrangements produce better outcomes for investors, however the paper found conclusive evidence that commission-based compensation creates problems that must be addressed. They found, among other things, that funds that pay a commission (sales loads and trailing commissions) underperform those that do not, whether looking at raw, risk-adjusted or after-fee returns.
>
> A paper from the Executive Office of the President of the United States - The Effects of Conflicted Investment Advice on Retirement Savings (2015) – "found that conflicted advice leads to lower investment returns"; "savers receiving conflicted advice earn returns roughly 1 percentage point lower each year (for example, conflicted advice reduces what would be a 6 percent return to a 5 percent return)."

The evidence shows that embedded commissions and conflicted compensation harm investors.

The myth of the advice gap

The Panel would also like to take this opportunity to address the argument being made by some corners of the industry that a so-called "advice gap" will result if embedded commissions are eliminated. We agree with the CSA consultation document which states that they "don't anticipate a significant advice gap will exist" if embedded commissions are discontinued.

Aside from the above-noted research showing how destructive embedded commissions and conflicted compensation are for investors, there is ample evidence that advice is not being used by all Canadians at this time – in fact, just over 50% of Canadian investors work with an advisor according to the CSA 2016 Investor Education Survey.

Far from creating an advice gap, the banning of embedded commissions in the UK and Australia has led to positive strides forward. In the UK, The Financial Conduct Authority's independent post-implementation review of the Retail Distribution Review (2014) found the ban had reduced product bias from advisor recommendations and led to better investor outcomes.

When it comes to an advice gap, let's be very clear: no industry should address the concerns of people who do not want to pay for a service by charging them anyway and hiding the costs. This is not a healthy business model and it should not be acceptable in the Canadian investment industry. It is not transparent nor is it fair.

The only advice gap that needs to be urgently closed is the one between independent and compromised advice – the CSA is in a position to do that.

<u>Panel responses to consultation questions</u>

Q8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;

b. referral fees; and

c. underwriting commissions.

As noted below, the Panel is opposed to creating exceptions in these areas and supports discontinuing these payments.

Q11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

Having fund managers collect fees on behalf of dealers is a concern because it will continue the lack of transparency that presently exists with respect to the payment regime. There will also be additional costs for investors as securities are sold (and who gets to decide which ones are sold?) to pay for the fees as well as tax consequences for investors.

Q16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- **Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?**

The concern about payment arrangements is that most dealers will probably opt for fee-based compensation. For investors who tend to hold their investments for long periods of time with little trading activity happening, that would mean they could be paying for but not receiving corresponding services from the dealer.

IIROC's s review states that they found "*a bias on the part of most dealers towards fee-based accounts over commission-based accounts. Most dealers provide the highest possible grid payout to representatives for fee-based revenues. Our concern is that clients may be moved into fee-based accounts whether or not such accounts are consistent with the client's best interest. Certain dealers also stated that, given the attention placed on embedded commissions by the CSA, they are focusing on fee-based accounts as an alternative.*"

Q18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

- **Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?**

The dependence of the industry on the embedded commission revenue stream would indicate it is unlikely to voluntarily do away with them.

<u>Part 2 - Embedded Commissions are the tip of the iceberg</u>
Embedded commissions are not the only compensation practices that are harmful to investors. In fact, they are just the tip of the iceberg. There are many other practices that must be addressed along with embedded commissions, most of which are outlined at length in the CSA's own Staff Notice 33-318 "Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives," which uncovered numerous examples of poor practices that leave investors underserved and at risk.

This CSA review, which was issued in December 2016, looked at practices at some of the largest firms in the industry both in terms of assets under management and number of approved persons. It considered both direct and indirect forms of compensation and incentives and outlined conflicts observed under each.

The report chronicles a host of troubling forms of compensation and incentive structures that show the extent to which these practices harm investors and erode their trust in

advice. Also prominent on the list of findings are misleading titles and monetary and non-monetary incentives designed to favour proprietary products, a practice used by integrated firms that own both distribution and asset management or product manufacturing.
At integrated firms, staff can also be paid through compensation grids that provide higher payout rates for proprietary products or subsets of products.

According to the report, referral arrangements are, in fact, a significant problem.
As the CSA report noted, the practice of referral arrangements:

"… may encourage representatives to search through their existing books of business to find those clients that could be sold the targeted product or service whether they need it or not. In the case of related party referral arrangements, it may encourage representatives to send their clients to another arm of their firm, even when third party product and/or service options may be more suitable. It may also encourage representatives to shift clients to more profitable business lines within the firm with little or no benefit to the client."

Given the CSA, MFDA and IIROC report findings, the Panel believes that embedded commissions are only one part of a whole spectrum of conflicted compensation practices that are systemic across the industry.

In addition to banning embedded commissions, we call on the CSA and OSC to immediately address the compensation structures and incentives referred to in CSA Staff Notice 33-318.

Part 3 - Embedded commissions – No exceptions approach
Given the CSA report findings that show how investors are harmed by conflicted compensation practices beyond embedded commissions, the Panel opposes the CSA's proposal to leave other forms of compensation unaddressed in its embedded commission ban, including:

- *referral fees paid for the referral of a client to or from a registrant*
- *dealer commissions paid out of underwriting commissions on the distribution of securities of an investment fund or structured note that is not in continuous distribution under an initial public offering*
- *payments of money or the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105*
- *internal transfer payments from affiliates to dealers within integrated financial service providers which are not directly tied to an investor's purchase or continued ownership of an investment fund security or structured note*

The MFDA compensation review expressed concerns about referral arrangements:
"*Compensation arrangements between referring parties that include bonus commissions or initial incentives to enter the arrangement are not specifically prohibited for referral arrangements as they are in a distribution agreement between a dealer and a manufacturing company. There is a risk that firms may look to structure sales arrangements as referral arrangements rather than distribution agreements to avoid certain regulatory requirements*."

Creating exceptions to the ban will only provide room for creative registrants to devise ways to overcome it. Staff Notice 33-318 amply demonstrates the inventiveness of the industry.

<u>Part 4 – Final Recommendations</u>
In order to address the harmful effects of embedded commissions and other conflicted compensation practices, the Panel recommends the following:

A ban on embedded commissions and a plan to address all forms of conflicted compensation – In line with our comments above.

Update and enforce NI 81-105, Mutual Fund Sales Practices – NI 81-105 came into effect in May 1998. This instrument is nearly 20 years old and needs to be updated to reflect the latest practices used to induce sales and must be extended to products beyond mutual funds. As of the date of the Consultation paper there has never been a single enforcement action of NI 81-105. Rules without enforcement are meaningless.

Title and proficiency reform – As the CSA report notes, misleading titles are a very real problem for investors. The CSA, IIROC and MFDA compensation practices reviews document instances of firms awarding titles as rewards for meeting sales targets, a clear abuse that misleads investors.

Titles must be supported by the appropriate level of education, including far more extensive ethics education and demonstrated competency in putting that knowledge to work properly.

Move ahead with Best Interest and targeted reforms – The Panel urges the OSC to move ahead with best interest and the targeted reforms outlined in *CSA Consultation Paper 33-404 - Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients*. This is more important than ever and the Panel supports the Ontario and New Brunswick Commissions as they move forward despite lack of support from other provinces.

In addition, we agree with the statement made in *CSA Consultation Paper 81-408* that "*The discontinuation of embedded commissions also complements the proposals outlined in CSA CP 33-404. Generally, jurisdictions that have enhanced the advisor's standards and obligations have eliminated embedded commissions at the same time (as outlined in Appendix C) because they have recognized that these payments are one of the main obstacles preventing the advisor from working in the interest of their clients. Research suggests that these payments are a conflict that is very difficult to manage or mitigate, except through avoidance*."

OBSI - Move ahead with the recommendations in the Independent Evaluation of the Canadian Ombudsman for Banking Services and Investments' (OBSI) Investment Mandate which was completed in 2016 by Deborah Battell and Nikki Pender.

Rigorous and Regular Enforcement – The Panel strongly believes that effective enforcement of the entire investor protection regime is essential. Rules without enforcement are useless. Equally important, dealers must always be held accountable and liable for their registrants' and agents' improper acts.

To reiterate, we call for the prohibition of any compensation or embedded commissions that put the interests of firms and registrants ahead of clients or create a conflict of interest between firms or registrants and investors. We also call for the prohibition of all forms of compensation practices, direct and indirect, that harm investors, beginning with those currently identified in the above-mentioned documents.

In addition, we ask regulators to take care in implementing any such rules in order to avoid inadvertently advantaging one industry sector over another or invoke other unintended consequences.

Collectively, the actions noted above would result in an investor protection regime that is more consistent with the G20 High-level Principles on Financial Consumer Protection and would vastly improve upon the existing regime -- and it would provide better financial results for investors.

It's time to move forward.

Yours truly,

Ursula Menke
Chair, Investor Advisory Panel

Via email May 31st 2017

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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf

It is great to **once more** have an opportunity to publish my comments on this subject. I am a retiree who is now 83, who has had an engrossing bad experience with the conflicted sales advice emanating from mutual fund commissioned salespersons. Any contribution I can make towards ending this unsavoury practice will then help to prevent this happening to others.

Before I open up with my current commentary, I have one question to ask of the CSA. What happened to all the constructive information the CSA received from 99 respondents to the - *CANADIAN SECURITIES ADMINISTRATORS DISCUSSION PAPER AND REQUEST FOR COMMENT 81-407 MUTUAL FUND FEES Issued Dec. 13, 2012 ?* It seems like next to nothing has progressed towards a resolution over the past 4½ years because here we are again now debating the same arguments for and against embedded commission issues. Hopefully, this time there will be an investor focused resolution!

Here is why I am still a skeptic when examining the concept of hidden embedded commissions

In preparation for this CSA Submission, I contacted the CSA with five questions related to the disposition of embedded commissions under certain changing "Advisor" to investor relations. I did not get answers to my questions. Instead, I received a response that I should click on a provided link to the OSC and rummage through **74** Rules, Instruments & Policies papers that should be related to my quest. That was a very good suggestion because coincidentally it led me to the **99** respondents to the CSA 81-407 December 13th 2012 Request for Comments. Right there was my 4-page Submission raising some questions about the very issues related embedded questions that are still the subject of this new CSA 81-408 Consultation !

Here is my April 2nd 2013 CSA 81-407 Submission - http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130402_81-407_whitehouse_y_p(1).pdf

The following will in all probability duplicate some of my 2013 previously expressed views

Dealing Representatives (aka "Advisors") should not be receiving sales commissions from the fund company being recommended. It is pure conflict-of-interest (which I will later explain). A payoff - a kickback ! Embedded commissions can also lead to an invitation for other investor abuses such as selling 7-year DSC funds for immediate de-accumulating RRIFs to the elderly and infirm without disclosing the associated liabilities of early redemption fee penalties for the investor. There is also the improper use of Home Equity loans (leveraging) to invest, as well as designing unbalanced portfolios full of expensive equity mutual funds.

Advisors rarely ever recommend a low-cost Index fund or ETF. The more a client invests in mutual funds, the more in trailer commissions a salesperson makes, while at the same time exposing client accounts to subpar performance and greater risk. The situation is even worse and accentuated when the salesperson works to a Commission Grid that increases the commission rate as sales increase. These Commission Grids only skew the advice even more. There is no focus on the investor at all. Commission grids, embedded commissions and sales quotas are wholly incongruent with the ethics of professional advice. **(There is a simple, genuine sales incentive alternative that can provide additional remuneration to the Advisor salesperson that obsoletes the guaranteed embedded commissions and Commission Grids which I will later explain).**

The last two paragraphs sound like echoes from the past

The CSA, the OSC, IIROC and the OBSI cannot pretend that the subject of the inequity and one-sided unreasonableness of embedded commissions is a recent discovery. Why was it necessary to wait until there was a hue and cry of dedicated investor advocates, as well as aggrieved investors, before the subject was again escalated to a debating marathon with the Investment Dealers and their associations ? The damage of the incredible drain on investor assets over the past 20-years or so and into the open pockets of the Investment Dealers and their employees/agents has been a great incentive for attracting individuals to "Financial Advising" careers. And here we are today with a process that is now well engrained, not for the best interests of the investors, but rather for the best interests of Financial Advisors and the Investment Dealers and the Dealer management. Resistance to change of the status quo of embedded commissions should neither have been unexpected nor permitted.

There is more to the embedded commission remuneration process than meets the eye

In the process of examining my Submission, I would like to emphasize that there is more to the reasons why Investment Dealers, their Advisor employees and their associations have been resisting the removal of embedded commissions.

To those parties, the feature of embedded commissions represent more than just being an integral part of a remuneration. Of note, there has been a recent exposure of hidden double commission dipping by a particular group of Investment Dealers that has come home to roost. With embedded commissions, the "Financial Advisors" and the Investment Dealers do even better than the double dipping feature.

These are the additional beneficial attributes enjoyed by "Financial Advisors" and their employer Dealers when they sell embedded commission mutual/investment funds -

- The "Advisor" can negotiate a front-end sales commission with the investor when the "Advisor" is giving advice by recommending a particular mutual fund investment.

- Under the present regulatory rules, the "Advisor" is permitted to convince the investor that no front-end commission would be charged if the "Advisor" sells the mutual fund to the investor on a Deferred Sales Charge (DSC) basis. Hidden from the investor is the 5 ½% to 6% sales commission that would be immediately paid to the dealer/"Advisor" by the MF company when such a transaction is concluded. With this large commission paid to the Dealer/"Advisor" for giving the related investment "advice", there is no commitment to future loyalty to the investor by the "Advisor" ! There is no regulatory requirement that this rate of sales commission be announced to the investor prior to the sales transaction. Also, there is no obligation on the part of the "Advisor" to convey the detrimental impact associated with purchasing on a DSC sales basis. (The absence of DSC sale conditions full declarations opens up a very serious related regulatory issue with the past non-delivery of mutual fund prospectuses (and/or Fund Facts) that I will be happy to convey in greater detail). (IIROCs response to the reported non-delivery of mutual fund prospectuses was that IIROC was happy with the dealers procedures and maybe the prospectuses got lost in the mail !)

- When an "Advisor" sells mutual funds with embedded trailer fee commissions, the "Advisor" then becomes a partner with the investor without having to risk any money. The "Advisor" is guaranteed to continue to get trailer commissions every quarter while ever the "Advisor" convinces the investor to retain the investment. That feature can become conflicting advice for the investor. Arguments put forward by the Investment Dealer interests that the continuing embedded trailer fee commissions from a mutual fund sale is an inducement for the "Advisor" to stick around to give future advice for free is an absolutely bogus projection !

  The facts are, if the investor has a continuing need for making new investments or realigning investments, (ie. RRIFs), the "Advisor" can earn a negotiated front-end commission for that advice when transacting that . next sale, To consider that embedded trailer fee commissions are needed to give advice on the next purchase and then the investor pays a front-end commission or is cajoled into purchasing on a DSC basis, is tantamount to double-dipping.

- If the "Advisor" follows the rules, the "Advisor" will extract confirmation that the investor understands that the investment carries no guarantees that it will hold their original value or increase in value. Over time, the investor can lose valuable assets, however, every quarter the Investment Dealer and the "Advisor" are always guaranteed continuing embedded commissions as long as the investor retains the MF investment. This Investment Dealer and their "Advisor" employee regulatory allowed practice is an inequitable and repugnant unpublished privilege. (I have a personal experience of how our "Advisor" initially walked away with incredibly high 5 ½% and 6% Commissions selling us 80% of our RRIF investments with high risk mutual funds on a DSC basis, then continued to receive trailer commissions after the investments lost about 40% of their original value over a 2 ½ year period.. I am prepared to divulge the shocking full details of this unchecked deception.) This must stop !

- When the “Advisor” sells mutual funds with embedded trailer commissions to their lineup of client investors, the “Advisor” immediately creates an asset value with no cost to the “Advisor”. With some agreement with their Investment Dealer employer, the “Advisor” can sell their list of clients to another “Advisor” (ie. Selling the Book). The relative value of the client list is greatly enhanced by the presence of continuing mutual fund trailer fee commissions. This is one more conflicting hidden financial incentive for the “Advisor” to load down the investor with mutual funds with embedded trailer commissions that must be prohibited.

Embedded commission hidden manipulations that are outside of the investors control

Prior to my contacting the CSA with questions related to the embedded commission issue, I made a request to the OSC and asked them for answers to the same questions regarding the disposition of embedded commissions under certain conditions. There was no answer from the OSC to my questions but they did respond by saying that embedded commissions are sent from the mutual fund company to the Investment Dealer who then distributes the embedded commissions on some pre-arranged agreement with the “Advisors”

Here are the questions I asked of the OSC but received no answers –

1. What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with their Financial Advisor. Who gets the future embedded commission payouts ?
   Q1. Is it just the Dealer ? If so why, when the investor gets nothing in return for the Dealer receiving the embedded commissions.

2. What happens to the continuation of the embedded commission payouts when a Financial Advisor employed by Investment Dealer "A" resigns from an investor's account.
   Q2. Who gets the future embedded commissions payouts ?

3. What happens to the continuation of the embedded commissions payouts when the investor's Financial Advisor employed by Investment Dealer "A" sells the investor's account (selling the book) to another Financial Advisor employed with the same Investment Dealer "A" ?
   Q3. a) Who gets the future embedded commission payouts ?
   Q3 b) This raises the question as to who owns the investor's accounts.

4. What happens to the continuation of the embedded commissions payouts when the Investment Dealer resigns from the investors account ?
   Q4. Who gets the future embedded commission payouts ?

5. What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with a Financial Advisor employed by Investment Dealer "A" and the investor transfers their account to Investment Dealer "B" ? .
   Q5. Who gets the future embedded commissions payouts ?

6. Considering the above questions, what are the regulations when applying the above questions to proprietary in-house mutual funds ?

The Mutual Fund Dealers (MFDA) Report, referred to in the May 23rd 2017 Investment Executive article entitled, “Ban on embedded commissions could take a toll on non-bank dealers”, confirms why the Deferred Sales Charge (DSC) basis sales are promoted for the self-interests of Financial Advisors, which is in direct conflict with the investors best interest.

Here is the link to the full article “Ban on embedded commissions could take toll on non-bank dealers”

http://www.investmentexecutive.com/-/ban-on-embedded-commissions-could-take-toll-on-non-bank-dealers

The article subtitle explanation reads, "New MFDA report also finds that a switch to direct-pay arrangements will "have a greater impact on those smaller advisors who are more reliant on DSCs". This is an incredulous MFDA admission in their Report that, unbeknownst to the unsuspecting investor, they are being deceived to blindly believe that purchasing on a DSC basis is for the benefit of the investor, **when in fact the DSC sale is really for the financial benefit of the "Advisor" and the Investment Dealer with increased hidden commissions over competitive front-end commissions.**

The "Ban on Embedded Commissions" article reports that the MFDA acknowledges that the repugnant excessive 5 1/2% to 6% sales advice commissions of DSCs is needed to help keep a section of independent "Advisors" in business. The MFDA fails to consider and comment on the detrimental implications of unpredictable penalties that the investor must absorb when there is an unexpected need to change or redeem the DSC purchased investments. The potential for this liability for losses to the investor goes unmentioned.

This means that the MFDA condones the conflict of interest that is introduced and the need for investors to subsidize the way of life for a particular group of salespersons who should not be in business if they cannot provide beneficial investment advice worthy of reasonable fees. It would be very unintelligent for an adequately pre-informed investor to agree to take on a DSC liability so that the mutual fund salesperson can take home 5½ % to 6% commission, when the investor could negotiate a 1% or max 3% front-end commission, with no DSC early redemption penalty liabilities !

More importantly, by the MFDA making their observations on the continuing need for "Advisor" salespersons to sell DSC mutual funds in order to stay in business, the MFDA are inadvertently confirming that there is an inherent conflict of interest for the purpose for continuing embedded commissions. That's all the evidence the CSA needs to take immediate action to ban hidden embedded commissions.

***** A full read of the (below linked) May 23rd 2017 MFDA Bulletin Compliance **#0721-C** will help to verify the questionable foregoing information that is used by the SRO MFDA to try to influence a continuance of embedded commissions and especially the continuance of DSC basis mutual fund sales.

http://mfda.ca/wp-content/uploads/Bulletin0721-C.pdf#viewer.action=download

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When investments include locked-in embedded commissions, there is a conflicting self-interest incentive in the hands of the Investment Dealer

There are closely connected issues that require the CSA to examine and redefine, such as –

- Who should have the ultimate controlling and overriding influence over the investor interests once a Financial Advisor solicits investments from an investor and then opens up an account with the Investment Dealer employer ?

  Under the present operational practices that are permitted by the CSA, the Investment Dealer actually assumes ownership of the investor's account immediately after it is opened up by the Financial Advisor. This causes the investors interests thereafter to be subordinated to those of the Investment Dealer. This is wrong, because it is the investor who has the money at stake and who takes all the risks, not the Dealer. The dealer is only there to provide a transaction service, so how can the Dealer assume the power of the ownership of the investor's account when the time comes for the investor's account to be transferred from that Dealer to some other Dealer ?

- The investor pays administrative charges to the Investment Dealer for maintaining the investor's account. This is in addition to any embedded or other sales commissions. Therefore the Investment Dealer should have no legal right to apply discretionary operational practices as though the Investment Dealer owns the investor's account. That is now the case as you will see !
- There is imposing evidence that once a Financial Advisor has opened up an investor account with their Investment Dealer employer, the investor can be subjected to a variety of financial penalties should the investor close out their account because they are dissatisfied with either or both the Investment Dealer or their employee Financial Advisor. In other words, the Advisor can be providing unsatisfactory advice or, in the case of the Investment Dealer, unsatisfactory service. Yet, the investor has to pay penalties to withdraw their account. **This prejudices the investor interest in favour of the Dealer.**
- This discretionary freedom for the Investment Dealer to levy financial penalties is even more egregious when the Dealer causes an involuntary termination of the investor's account. This is a non-theoretical, very real situation that is well explained in a later narrative.

  This involves a case of where the Investment Dealer creates a situation that is against the investor's best interests. The Dealer then reacts by applying a punitive response when the investor moves their account to another Dealer, in order to protect the investor's own best interest.

Here is the real case demonstration that calls for immediate CSA intervention to set up new rules

As a result of recently announced changes in the operations of the Investors Group, there are some basic principles of their operational changes that likewise apply to all Investment Dealers that need to be addressed by the CSA/OSC. This relates to the disposition of investors portfolio investment accounts, especially those with embedded commissions, when Financial Advisors are terminated as employees of the Investment Dealer.

It is important to bring these real live associated issues to the attention of the CSA and the OSC for them to direct some policy decisions and apply appropriate rule changes.

The first issue this Investors Group scenario raises is the overriding very serious question that is, once the investor has been solicited by a Financial Advisor and has purchased investments with embedded commissions through that Advisor, who owns the responsibility for the portfolio account ? Is it the Advisor or the Dealer or the investor ?

Conflicting self-interest discretion of the Investment Dealer

This question of the ownership of the investor portfolio account looms very large when the investor negotiates with the Financial Advisor and understands and places trust that a satisfactory relationship will continue between those two parties. This relationship principle is disrupted and cannot coexist where there is an Investment Dealer discretionary freedom allowed for the Dealer to terminate Financial Advisors like the Investors Group are implementing. The result is that the unsuspecting investor is then at the mercy of the conflicting self-interest discretion of the Investment Dealer.

Here is the May 26th 2017 Investment Executive article detailing the Investors Group operational changes they are making as a result of their dismissing **400** of lower producing "sales force" down to 4,754 older "Advisors".

Here is the link to the IE article –
http://www.investmentexecutive.com/-/investors-group-moving-clients-to-experienced-advisors?utm_source=newsletter&utm_medium=nl&utm_content=investmentexecutive&utm_campaign=INT-EN-morning

Uninvited Investor punitive practices by the Investment Dealer

It is important for the CSA and the OSC to understand and reconcile the detrimental impact of the actions described in the IE article when an Investment Dealer terminates **400** "Advisors" (sales people). These operational actions demonstrate that it is the Investment Dealer who has the discretionary power over the investor's account, not the investor.

There are implications that will have a costly impact on the investor's inherent interests. Investors are being treated like a merchandise inventory when there is a terminating relationship between the Investment Dealer and the Advisor. The net result is that the unsuspecting investor then becomes an additional source of remuneration for the Investment Dealer, their management and a bequeathed successor Advisor, **when the Dealer initiates their employee termination.**

The Investment Executive article explains the Investors Group changes that will be undertaken resulting from the terminating of **400** Advisors, but the article does not offer any critical commentary ! The CSA and the OSC should consider the critical commentary of the impact from any Investment Dealer making similar changes to those being applied by the Investors Group, as covered in the IE article. Here is what the article says -

- Investor accounts whose "Advisors" have been terminated will be re-assigned (handed off) by Regional Managers to other veteran Advisors who have had absolutely no previous or ongoing relationship with the investor. It can only be assumed that this new "Advisor" will immediately inherit and start receiving the embedded commissions, although they have contributed nothing to the interests and relationship with the investor.
- This raises the question, who owns the investor's account, is it the Investment Dealer or the Advisor ? This is an especially pertinent question if the Advisor brought the investor account with them from another Dealer when joining the new Investment Dealer.
- Any investor who wishes to go along with the departing Advisor will be financially penalized for taking their account portfolios away from the Investors Group. But wait, this is a conflict of interest by the Investors Group against the investor, for it is the Investors Group who are seeking the benefit of reducing their sales and management costs at the expense of the investor. This is especially onerous when it involves investors being subjected to DSC early redemption penalties.
- A major consideration with some investment Dealers is that in all probability the Advisors would have sold in-house proprietary mutual funds which raises the question of should the proprietary mutual fund investments be transferable to other Investment Dealers without penalties ?

Considering the forgoing commentary, I highly recommend that the CSA prohibit embedded commissions for all investment products, not just investment funds, without undue delay.
All conflict-of-interest should be avoided- definitely do not depend on disclosure as an investor protection tool.

Investment firms have to do away with such special incentives and inducements, and leave the financial advisor undistracted in seeking the best investment vehicles of financial advice for the client. I urge the CSA to require securities firms and Financial Advisor salespersons to be subject to the more stringent fiduciary/Best Interests standard, as opposed to the looser suitability standard that traditionally has bound them and allowed much misselling and overcharging.

I especially like the idea of unbundling the cost of advice from the product. This will give investors a chance to evaluate the value-add of the advice. When it comes to the life span of a mutual fund, it should be the survival of the fittest, not the ones with the greatest sales financial influencing incentives for the Investment Dealers and their "Advisor" employees. Advice should not be tied to a product sale or retention !

<u>Here is a practical remuneration incentive system to encourage "Advisors" to provide "advice" to all investors, regardless of the size of their investable assets</u>

The arguments put forward by Investment Dealers and their affinity associations that investors with smaller investable assets need the services of embedded commissions because the smaller investors could not afford to separately pay the declared fees for the "advice" delivered. This theory may pass for education in a kindergarten class, but what is the difference between paying an annual 1½% to 2% as <u>declared upfront</u> "advice" fees, in quarterly segments versus hiding 1½% to 2% hidden embedded commissions ?

The idea that hidden embedded commissions are some form of subsidy for smaller investors to get investment "advice" just does not hold water. The facts are that the present hidden embedded commissions are a <u>guaranteed remuneration scheme for the Advisor and the Investment Dealer</u> without any commensurate guaranteed result for the investor. That is both inequitable and totally unacceptable !

Here is the structure of an Advisor remuneration system that is equitable for the value of the advice given to the investor and the performance capabilities of the "Advisor".

After a fully detailed KYC profile of the investor's investing needs are determined and agreed upon, the following agreement would be entered into -

1. At the time of the investor is engaging the services of an Investment Dealer and the "Advisor", there is a mutual agreement between the parties as to the front-end percentage commission or a dollar fee agreed upon for the investment purchases.

2. There is a mutual agreement that the investor will pay fees for the "Advisors" advice services –

(a) Every quarter the Advisor will provide the investor with a comment summary of the performance of the investor's portfolio.

(b) If the investor's portfolio has maintained its value, including any redemptions, the parties agree on a percentage fee or dollar fee <u>that would be paid directly by the investor to the Investment Dealer/Advisor</u> for the quarterly "advice" performance reporting summary.

(c) If the investor's portfolio has gained in value, in addition to the quarterly Advisor "advice" service fee, the Advisor would also receive a bonus percentage of the portfolio gain that is agreed upon by the parties. <u>This is an incentive for the Advisor concentrate on maximizing the performance of the investors portfolio.</u>

(d) If the investor's portfolio would lose value over the quarter, the parties would agree on a scale of reduction of the quarterly advice performance reporting fees. <u>This is an incentive for the Advisor to concentrate on adjusting the investors portfolio to maintain its performance.</u>

==

I, like many other Canadians, should depend on trustworthy advice to manage my retirement account in my best interests. That clearly has been absent from my personal experiences with a bank-owned Investment Dealer over a 7-year period.

There is also the issue that many seniors are deceived by so-called "Free lunch" educational seminars. This is even more divisive when the investing sales presentation is promoted with the inviting title of "Wine, Women and Wealth Seminar". I highly recommend that more precise rules be imposed on how these seminars are promoted and conducted. In the vast majority of cases they are nothing more than sales pitches.

I also urge the CSA to prevent bank-owned investment dealers sending complainants to an "internal Ombudsman". At the best, all that results is a low ball restitution recommendation, not to mention the experience of an outright rejection of valid claims. As there is no regulatory disciplinary oversight of the internal bank Ombudsman when they make false and misleading reasons for rejecting a claim, it is time to remove the bank-owned Ombudsman entirely from the dispute resolution process. If a Dealer rejects a claim they should be directed to OBSI and NEVER to the unregulated entity of the bank "internal Ombudsman", as so many bank brochures do.

This debate on embedded commissions has been going on for decades. It's now time for the CSA to make a bold decision in the face of unrelenting industry opposition. No more monitoring- it's time for ACTION.

A reread of commentary on the **1995** Glorianne Stromberg Report critical of the undisciplined investment industry privileges would now be in order.

Here is the Stromberg Report -
http://www.sipa.ca/library/SIPAdocs/20040409_StrombergSub_NI%2081-107.pdf

Ten years later in **2005**, it seems that very little changed to discipline the undisciplined freedoms enjoyed by the investment industry. Here is the commentary -
http://investorvoice.ca/PI/1647.htm

A further twelve years later in **2017**, the beat goes on looking for the Regulatory authorities to take action to remove the inequitable investing conditions that have unfairly drained hundreds of millions of dollars from thousands of unsuspecting investors into the pockets of condoning Investment Dealers and their "Advisor" employees.

I sincerely hope that the CSA will finally take action to protect Canadians from skewed financial advice. I hope this feedback is useful to you as you set regulatory policy.

I agree to public posting of this letter.

Respectfully,

Peter Whitehouse
An 83-yearold Investor

1er juin 2017

Mémoire de M. Claude Sanche, courtier en valeurs mobilières et courtier en assurances de personnes, sur les enjeux de l'industrie des services financiers.

Présentation :

J'œuvre dans le domaine des services financiers depuis avril 1986.

J'ai toujours été associé avec une firme de courtage indépendante, et j'ai bâti ma clientèle au fur et à mesure, en faisant du démarchage.

Je connais très bien l'enjeu de l'industrie et la difficulté à bien informer les gens.

Problématique

L'industrie s'interroge sur la pertinence de l'abolition des commissions intégrées et des conflits d'intérêts potentiels.

L'objectif de ce mémoire vise à présenter l'opinion d'un conseiller d'expérience, qui vit de ces commissions et aide les gens à mieux planifier leur patrimoine.

Point de vue

Même si les REER existent depuis 1957, les gouvernements tentent constamment d'inciter les gens à penser à leur futur. Ils ont introduit les CELI, puis le RVER et pensent à augmenter les cotisations au RRQ pour financer et augmenter le régime.

Le principal problème de l'épargne, c'est que les gens n'y pensent pas ou n'en font pas leur priorité.

Définitivement, que les gens ne sont pas prêts à débourser, pour recevoir des conseils sur les finances personnelles.

Les gens ne sont même pas prêts à débourser, pour rédiger un testament, qui est une première étape dans la bonne gestion des finances personnelles. Pourtant, il s'agit d'un coût relativement minime, à débourser, souvent, une seule fois.

Depuis déjà plusieurs années, je propose uniquement des fonds à frais d'entrée, en chargeant 0% de frais d'acquisition.

Mon travail est ainsi rémunéré et me permet de suivre :

- des cours de formation sur les valeurs mobilières, sur les assurances,
- l'évolution des marchés,
- l'évolution des lois fiscales,
- de donner du service aux clients,
- de répondre aux questions d'ordre générales sur les finances personnelles des gens
- de payer un loyer et le salaire de mes assistantes
- d'expliquer les aléas des marchés pour que le client ne laisse pas ses émotions gérer son portefeuille,

J'ai bâti ma clientèle et ma crédibilité, sur mes conseils et mon suivi personnalisé. Si j'avais été en conflit d'intérêt avec des fournisseurs, les clients ne me seraient pas restés fidèles. Mes patrons ne sont pas payés en boni sur les actifs. Mes patrons sont mes clients et si je ne livre pas le service auquel ils s'attendent, je vais les perdre.

Les commissions de suivi de crée pas de conflit d'intérêts, comme il en existe dans l'industrie, qui sont pourtant très réels.

1- Que pensez des fonds maisons offerts aux clients au détriment de la concurrence, souvent avec des frais de gestion plus élevés
2- Que pensez des firmes qui imposent des comptes minimaux, avant de redonner au conseiller les commissions générées,
3- Que pensez des firmes qui ferment les yeux sur des transactions répétitives, pour que les objectifs des directeurs soient atteints,
4- Que pensez des firmes qui fixent des quotas de production
5- Que pensez des firmes, qui re-dirigent les plus petits comptes en succursale, pour favoriser la vente de produits maisons, ou des produits à faible taux (tel que les CPG)
6- Afficher la commission de suivi, ne donne pas l'information juste aux clients, il faudrait plutôt, afficher le ratio de frais de gestion global, pour permettre aux clients de faire sa propre comparaison.

Ce sont les ménages avec des actifs de moins de $250000, qui ont le plus besoin de conseils financiers, pour maximiser leurs avoirs parmi les différents véhicules (REER, CELI, REEE, gestion de la dette, des assurances).

Quand on monte un bon portefeuille diversifié, on inclut des fonds mutuels, mais aussi des obligations, des CPG, des actions , et des billets garantis,...

Pour certains de ces produits financiers, le client doit payer une commission à la transaction ou elle est déjà intégrée dans le produit. Si on converti ces comptes, en compte en honoraire, le client se trouve à payer un honoraire sur tous les produits, y compris ceux qui ne devrait pas payer. En bout de ligne, le client se trouve à payer plus cher.

Ce sont alors les firmes qui engrangent plus de revenus, au détriment du client.

Avec le MRCC2 et les feuilles de fonds que nous devons fournir aux clients avant les achats, ceux-ci sont beaucoup mieux informés des frais et les aident à la compréhension, des différents produits financiers.

Il ne faudrait pas non plus, oublier la relève.

Déjà celle-ci est minime, voire inexistante.

Avec l'élimination des frais reporté, il est très difficile à un jeune de commencer dans l'industrie. Si on abolit les commissions de suivi, on va éliminer le peu de relève qui existe.

Ma fille travaille à mes côtés depuis plus de 3 ans. Si je n'avais pas été là, pour la supporter financièrement, juste au niveau des différents coûts, elle ne serait pas là aujourd'hui.

Avec les lois fiscales qui changent constamment, les options de placements qui se multiplient, les gens ont de plus en plus besoin, d'un conseiller indépendant et disponible, pour répondre à leurs besoins, et les suivre, tout au long de leur vie financière.

C'est une grande richesse pour ces gens de compter, sur un conseiller disponible, mais malheureusement, ils n'en connaissent pas la vraie valeur, et en général, ils ne sont pas prêts à payer pour de tels services. C'est pourquoi, le maintien des commissions de maintien est essentiel pour la réussite financière des consommateurs.

[redacted]

Claude Sanche

Courtier en placement chez VM Peak

Courtier en sécurité financière

[redacted]

À votre service
depuis 1988

Yves Lavigne
A.V.A.
Planificateur financier
Conseiller en sécurité financière
Conseiller en assurance et rentes collectives
Représentant de courtier en épargne collective

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[redacted]

Montréal, le 1er juin 2017

À qui de droit,

Je suis contre l'abolition des commissions intégrées pour différentes raisons.

Je suis très triste de voir mon modèle d'affaires remis en question. Depuis bientôt 30 ans (j'ai commencé en janvier 1988), j'offre des services de consultations en services financiers. J'ai le titre de planificateur financier depuis novembre 1997. J'accompagne tant l'entrepreneur, le professionnel, le salarié, la personne qui vient de perdre son conjoint ou en perte d'autonomie que les enfants de ces personnes qui vivent des moments difficiles. J'accompagne mes clients lors de réclamations en assurances de toutes sortes (vie, salaire ou soins de santé). Nous prenons le soin de trouver et remplir les formulaires avec les clients sans demander de rémunération, car les commissions reliées aux produits vendus permettent de faire fonctionner mon cabinet depuis mes débuts dans la carrière. Rares sont les personnes qui n'auront pas besoin d'être conseillées pour faire les bons choix de produits en fonction de leurs besoins. Une majorité des personnes que je rencontre s'en remettent à notre cabinet pour leur trouver des réponses à leurs questions, des produits qui se mouleront à leurs besoins (pas aux produits d'une institution financière en particulier). J'ai le plaisir d'annoncer que je suis un conseiller indépendant et j'ai la conviction d'être indépendant dans le choix des produits que mon cabinet propose. Je n'offre jamais un produit parce que c'est le produit du mois. En près de 30 ans, personne ne m'a dicté de privilégier tel produit plutôt que tel autre parce que c'est la saveur du mois...parce que cela va aider à me classer dans un pour un concours de vente...J'ai la chance de ne jamais avoir été obligé de faire de telles choses et j'espère pouvoir continuer à être libre de pouvoir agir ainsi jusqu'à la fin de ma carrière. Mais l'abolition des commissions sur les produits financiers m'inquiète. C'est comme si du jour au lendemain le versement de commissions devenait une pratique illégale et pourtant combien de clients pourraient témoigner des conseils qu'ils ont reçus gratuitement (payés par le truchement des commissions versées sur les produits).

Combien de fois un client qui souhaitait acheter un CELI sortait du bureau avec ma recommandation de rembourser des dettes coûteuses comme une carte de crédit?

Combien de fois j'ai recommandé à des clients de ne pas racheter leurs investissements (lors de chutes boursières) afin d'attendre la remontée des cours boursiers?

Pourquoi ne pas laisser libres les consommateurs comme actuellement? S'il souhaite ne pas verser de commissions au conseiller, il a le loisir de le faire actuellement. Cela vient en général avec une facture d'honoraires ou la formule sans conseils et le client qui opte pour cela accepte les conséquences de ses choix.

À l'heure actuelle, les gens qui épargnent le plus sont ceux qui ont un conseiller. On ne peut pas se permettre, comme société, de ne limiter l'accès au conseil financier qu'aux mieux nantis. Oui, je suis inquiet! Notre gouvernement semble actuellement bien mal guidé et songe à prendre des mesures très dommageables.

Est-ce bien cela que nous voulons au Canada, des institutions financières plus puissantes (je pense aux banques) et moins de choix? Les banques vont-elles vraiment offrir des conseils? Vont-elles les prodiguer comme elles le font actuellement, en suggérant souvent de prendre des certificats de dépôt parce que c'est la façon la plus facile et

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économiquement profitable pour elles de se financer? Cela leur assure du financement stable et garanti pour une période équivalente à l'échéance du CPG (3, 5 ou 10 ans), à des taux dérisoires (1, 2 ou 3 %, par exemple). Et elles peuvent prêter cet argent à des taux beaucoup plus élevés. Pourquoi prendre du temps à éduquer et recommander des placements qui en fin de compte sont moins intéressants pour ces institutions financières?

Si les commissions intégrées sont abolies pour les fonds communs, devraient-elles l'être également pour les obligations d'Épargne Placements Québec, les placements à terme liés au marché, les primes d'assurance et les prêts hypothécaires?

Les petits épargnants souffriraient de l'abolition des commissions intégrées. Plusieurs n'auraient tout simplement pas les moyens de payer des honoraires et se tourneraient alors vers de grosses institutions financières. Ce n'est pas une famille qui arrive à mettre 100 $ par mois dans un REER qui pourra payer des honoraires à son conseiller. Pourtant, cet investisseur a besoin autant sinon plus de conseils.

La nouvelle recherche du CIRANO examine aussi l'accumulation de patrimoine des personnes ayant cessé de consulter leur représentant entre 2010 et 2014 par rapport à celles qui ont continué à en avoir un. Résultat, les premières « ont perdu un pourcentage important de la valeur de leur actif », tandis que les secondes « ont vu la valeur de leur actif augmenter ».

La discipline associée aux conseils financiers de longue date et aux taux d'épargne plus élevés est la clé pour expliquer les grands écarts observés entre la valeur des actifs accumulés par les investisseurs ayant un représentant et celle de ceux n'en ayant pas », précise l'Institut.

Je me demande pourquoi nos élus ne réagissent pas davantage. Au cours des 40 dernières années, l'État n'a cessé de se désengager face à la retraite des Canadiens et des Québécois en créant des REER, des CELI, et plus récemment les RVER. Les initiatives sont nombreuses pour que les gens s'en occupent eux-mêmes. Dans cette optique, il s'avère essentiel de sauvegarder l'accès au conseil financier pour tous les ménages canadiens, pas seulement les riches. L'abolition des commissions pourrait mettre à mal les épargnants de la classe moyenne.

De grâce, apprenons des erreurs des autres comme le Royaume-Uni qui a décidé d'abolir les commissions intégrées en 2013. Résultat? Le tiers des conseillers ont disparu. Est-ce ce genre de situation que l'État souhaite pour notre société?

[redacted]

Yves Lavigne, A.V.A.
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CAPITAL GROUP℠

Mark Tiffin
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BY ELECTRONIC MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

June 2, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
étage Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs/Mesdames:

Re: CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Capital International Asset Management (Canada), Inc. ("CIAM") is writing in response to the CSA's consultation paper 81-408 (the "Consultation") regarding a consultation on whether to prohibit embedded dealer compensation and require investors to enter into direct pay arrangements.

CIAM's responses below are intended to address the three key investor concerns identified in the Consultation as set out below. While we are supportive of investor protection initiatives and generally agree with the disclosure reforms that are currently underway, we do not believe that banning embedded commissions would either (i) resolve the concerns identified in the Consultation or, (ii) be in the best interests of investors.

In addition to our comments below, CIAM supports and agrees with the comments provided by the Investment Funds Institute of Canada in their response letter dated June 9, 2017 (the "IFIC letter") to the Consultation.

While CIAM is registered in the categories of investment fund manager, portfolio manager and exempt market dealer, our responses below are primarily from the standpoint of an independent investment fund manager and address the three key investor protection and market efficiency issues identified by the CSA in its Consultation.

As a private firm with an independent charter, we are focused on doing what's right for investors over the long term. In Canada, the majority of Capital Group's assets are fee-based; Capital Group has never offered a full (5%) DSC option, and our fees have declined as assets have increased.

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

Consistent with the Brondesbury report, we believe that conflicts of interest are inherent in any type of compensation scheme, whether through the payment of embedded commissions or through fee-based arrangements. While the nature of conflicts may be different in varying compensation models, conflict mitigation strategies could be applied to appropriately address the specific conflicts in order to better align the interests of investors with those of market participants. This was evident in recent reviews conducted by the CSA, IIROC and MFDA regarding the impact of compensation arrangements and related incentives including conflicts associated with such arrangements.

We commend the CSA's survey conducted in 2014 to identify compensation arrangements and incentive practices used by SRO firms to motivate their representatives which resulted in its Staff Notice 33-318 (dated December 15, 2016) and identified several conflict-based practices used by firms to incent its representatives. Such practices included monetary and non-monetary incentives favouring proprietary products, higher grid payout rates for accounts such as fee-based accounts, revenue recognition biases towards types of products sold, product and service-specific promotions and competitions to encourage sales of specific products, among other related practices.

Similarly, related findings pursuant to reviews conducted by the MFDA and IIROC are summarized below:

MFDA Research: The MFDA published its results on May 23, 2017 of a client research report which was conducted in June, 2016 to further evaluate its members' business operations and various business models. As approximately 95% of MFDA members AUA includes mutual funds, the information in the MFDA report identified those business models, advisors and clients on which the CSA Consultation would have the greatest impact in the event embedded fees were prohibited. The MFDA research summarized the following impacts on such stakeholders.

Financial advisory firms (those that almost exclusively employ advisors as agents who are responsible for developing their own book of business and financing their own operations) would likely be most impacted. According to the MFDA report, approximately 56% of advisors with financial advisory firms have small books of business and predominantly rely on DSC commissions to finance their operations. Their clients include mass market clients (i.e. smaller retail investors) who are serviced by advisors who are generally dually-licensed to sell both insurance and mutual fund products. Since the ban on embedded compensation would not apply to insurance products (such as segregated funds), such advisors may be encouraged to recommend products that may not necessarily be in the investor's best interests or those that are subject to the same regulatory requirements and protections. In its summary remarks, the MFDA report states that in its consideration regarding embedded compensation, "regulators will also need to be mindful of all conflicted compensation arrangements that raise similar or even greater regulatory concerns". In addition to insurance offerings, the MFDA report noted concerns with exempt securities and referral arrangements, not covered by the CSA Consultation.

IIROC Compensation Review: The IIROC report dated April 17, 2017 based on a compensation review that focused on (i) business models; (ii) compensation program and (iii) supervision and compliance processes revealed a number of conflict-related concerns with respect to compensation. The IIROC report highlighted a compensation bias in favour of fee-based accounts over commission-based, since: "most Dealers provide the highest possible grid payout to representatives for fee-based revenue… significant number of Dealers provide additional incentives to representatives in the form of performance bonuses linked to fee-based assets." In this regard, IIROC identified potential conflicts regarding fee-based accounts such as reverse churning and several instances where clients in fee-based accounts paid additional fees or where the advisor received additional compensation (i.e. "double-charging"). Another "significant concern" identified related to dealers providing a higher payout for proprietary products which did not result in cost savings for their clients.

According to its report, IIROC will continue to assess dealers' compensation grids, conduct targeted substantive testing of specific NI 81-105 areas related to compensation conflicts and include a new risk factor that considers compensation arrangements in their future compliance reviews.

Next, we would like to address the CSA's assertions in the Consultation based on Professor Cumming's research that embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance and inhibit competition in the industry. The Consultation supports the entrance of lower-cost product providers such as passive ETFs as a means of increasing the competitive landscape if embedded commissions were discontinued.

It appears the marketplace is already addressing this issue. As noted in the IFIC letter, there are strong growth trends for both ETFs and fee-based series of funds. Numerous reports, including those from McKinsey, Morningstar and Investor Economics, support the observation that results are the most important contributor to growth of assets.

Capital Group constantly seeks ways to reduce fees to bring economies of scale to our investors. Our funds, which are distributed primarily by third-party dealers, are sold on the basis of their respective long-term performance, low fees and competitive MERs, our marketing materials reflect that we are focused on delivering consistent long-term results using high-conviction portfolios, rigorous research and individual portfolio manager accountability. None of our marketing materials promote the payment of trailer fees; to the contrary, we promote our funds' low MERs in comparison to industry averages.

As noted in the IFIC letter, there is a dominant industry trend towards lower management, administration fees and fee simplification. The competitive market-place is driving constructive change at a notable pace.

We are concerned that the CSA seems to be favouring passive ETFs and index funds in the Consultation. A passive product, while having merits including potentially lower fees, may not necessarily be in the best interests of or be suitable for all types of investors. We believe the market-place, including registered financial advisors, as opposed to the CSA, can best determine which product is most suitable for investors based on a variety of criteria including KYC, KYP, investor risk tolerance and choice.

An unintended consequence of banning embedded compensation is that the cost of advice will likely increase. The IFIC letter documented the value of advice in mitigating detrimental investor behaviour traits. As the MFDA report noted, a typical entry-level fee-based account carries a 150bp fee for services. A typical 60% equity, 40% fixed income portfolio of mutual funds with embedded compensation would have a trailing commission for advice and service of 80bp.

A second unintended consequence, documented in the IFIC letter and MFDA report, is the possibility of an advice gap for investors with lower account balances.

2. Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs

The Consultation comments that the complexity of fund fees increases information asymmetry between investors and product manufacturers and dealers. We agree with the CSA that investor awareness of fees and product structures could be enhanced. While the amount of embedded commissions is already transparent to investors as they are currently receiving annual reports which include the amount of trailing commissions paid in dollar terms, we believe the CSA should focus on enhancing targeted reforms to better educate investors.

In this regard, we commend the CSA's efforts with the implementation of CRM2 and POS and strongly encourage the CSA to consider further amendments to those initiatives to both educate investors and increase fee transparency. Future CRM2 reports could be standardized to show performance and cost information, including MERs, which would serve the dual purpose of increasing investor awareness and competition among market participants. The POS Fund Facts documents could also be enhanced to include:

- the components of the MER in efforts to better educate investors; and
- an investment objective of the fund which is consistent with the objective disclosed in the fund's prospectus. This is particularly relevant as the industry constructively evolves to goals-based investing.

An additional alternative to increase investor awareness would be to consider capping or standardizing embedded fees, as suggested in the IFIC letter. This would assist in leveling the playing field amongst market participants and eliminate the perceived conflict associated with embedded compensation.

3. Embedded commissions paid generally do not align with the services provided to investors

The CSA is concerned that the 'one-size-fits-all' nature of trailing commissions misaligns services and customized advice provided based on investor's specific needs and expectations. Since the overriding concern is with conflicts of interest, we strongly urge the CSA to pursue some of the policy options retained in the Consultation, namely the regulatory reforms referenced above, reviewing sales incentives pursuant to 81-105 and implementing a regulatory conduct standard on advisors per its prior proposal under 33-404.

The perceived misconduct by advisors could be addressed through a code of conduct governing standards that are consistent with legislative obligations similar to the efforts underway in New Zealand by their Ministry of Business, Innovations and Employment. Focusing on the "conduct" of the advisor rather than an ambiguous "best interest" standard, we believe would enhance the advisor-client relationship and thereby, the services provided to investors.
In addition to the above, we strongly support a review and application of the existing NI 81-105 sales practices as an alternative to banning embedded commissions. Currently, these sales practice rules only apply to the distribution of prospectus-qualified mutual fund securities including investment fund managers and dealer firms who offer or distribute such funds. As mentioned above, this limited application to mutual funds creates opportunities for regulatory arbitrage for other market participants. Since its implementation in 1998, NI 81-105 has not been amended to reflect new industry developments. While we are in agreement with the spirit of these rules, we believe there are significant amendments that should be considered to address current issues and conflict-related concerns.

Concluding comments

As discussed above, we believe that banning embedded commissions would have a significant impact on mass market clients without reducing or eliminating the compensation conflict concerns that the CSA is attempting to address in the Consultation.

Thank you for the opportunity to provide our comments. If you have any questions, please feel free to contact the undersigned.

Yours truly,

CAPITAL INTERNATIONAL ASSET MANAGEMENT (CANADA), INC.

(signed) "Mark Tiffin"

Mark Tiffin
President

De : consultation-en-cours@lautorite.qc.ca [mailto:consultation-en-cours@lautorite.qc.ca]
Envoyé : 2 juin 2017 13:46
À : Consultation-en-cours
Objet : Dépôt d'un commentaire - consultation publique

Un commentaire a été envoyé concernant la consultation **« Document de consultation 81-408 des ACVM : Consultation sur l'option d'abandonner les commission intégrées »**. Voici les détails :

Prénom : Julie
Nom : Roy
Courriel : [redacted]

Commentaires : 82% de ma clientèle ne détient pas 100,000$. Tous mes clients sont très satisfaits des rendements, du service, de ma disponibilité . Ils ne veulent pas que ça change.

AGF | COMMUNIQUÉ

Une nouvelle enquête révèle que les investisseurs sont très satisfaits des conseils financiers fournis au Canada

L'enquête, menée par The Gandalf Group, indique également que les investisseurs ne souhaitent pas modifier la méthode de rémunération de leurs conseillers, auquel cas un « effondrement des services de conseils » pourrait avoir lieu.

Toronto, le 31 mai 2017 – Une nouvelle enquête menée récemment par The Gandalf Group révèle que les investisseurs canadiens s'estiment satisfaits des services actuels de conseils financiers au pays et de la méthode de calcul de rémunération des conseillers. Cette enquête visait à répondre à plusieurs questions concernant les investisseurs particuliers, le secteur des services de conseils, les fournisseurs de fonds et les autorités de réglementation, notamment sur les sujets suivants : les conseils fournis, les frais imputés, la transparence et les options de placement, le rôle des conseillers et les nouvelles exigences de divulgation, la connaissance et la perception des différents types de commissions et de frais appliqués.

« Nous avons chargé The Gandalf Group de conduire une enquête factuelle, objective et centrée sur les intérêts des investisseurs canadiens en ce qui concerne les mesures de réglementation, déclare Blake Goldring, président et chef de la direction de La Société de Gestion AGF Limitée. En tant que société établie depuis longtemps dans le secteur des services financiers, nous avons toujours plaidé pour des changements réglementaires sensés et adaptés aux besoins des investisseurs. »

« Nous sommes heureux de voir que cette enquête couvre précisément ces sujets. Quand il s'agit de l'investissement, nous voulons savoir ce qui préoccupe le plus les Canadiens, afin de nous assurer que les conseillers avec lesquels nous travaillons au quotidien disposent des outils de recherche, des produits et des services nécessaires pour aider les clients à atteindre leurs objectifs financiers », ajoute-t-il.

Les conseillers, une valeur ajoutée

D'après cette étude, la plupart des investisseurs canadiens s'en remettent au moins en partie à un conseiller lorsqu'il s'agit de prendre des décisions concernant leur portefeuille. Près de la moitié d'entre eux déclarent faire appel à un conseiller pour toutes leurs décisions ou presque en matière d'investissement.

Toujours selon l'enquête, les investisseurs suivis par un conseiller sont très satisfaits de la relation avec ce dernier. Aussi, 70 % d'entre eux s'estiment particulièrement satisfaits, tandis que seulement 3 % se disent très mécontents. La plupart des investisseurs suivis par un conseiller se déclarent extrêmement satisfaits de ce dernier, pour ce qui est de leur fournir des conseils objectifs, des informations transparentes au sujet des frais et de les aider à gérer les coûts de l'investissement.

Les profits sont la principale raison de cette satisfaction : les investisseurs qui sont épaulés par un conseiller sont nettement plus susceptibles de considérer la croissance et le rendement de leur portefeuille à la hauteur de leurs attentes, que les investisseurs qui font cavalier seul.

La rémunération des conseillers : les frais et les commissions de suivi

L'enquête révèle également que la majorité des investisseurs trouvent les commissions de suivi acceptables et qu'il s'agit d'une forme de rémunération des conseillers comme une autre. Bon nombre admettent ne pas être très au fait des commissions de suivi qu'ils paient et la moitié avouent ne pas en avoir entendu parler ou presque pas, mais les personnes qui s'estiment bien informées sur le sujet ont plus tendance à juger ces commissions de suivi acceptables.

Pour comprendre la perception qu'ont les investisseurs de ces frais, il est primordial d'examiner la façon dont ils préfèrent rémunérer leurs conseillers et les méthodes de calcul qu'ils privilégient. L'enquête montre que s'ils doivent choisir, les investisseurs préfèrent payer des commissions en fonction de la valeur et du rendement de leur investissement plutôt que des frais de service ou des tarifs horaires. Ils préfèrent même davantage déduire ces frais de l'actif de leur portefeuille, plutôt que de recevoir une facture distincte.

Par ailleurs, l'enquête révèle que si les investisseurs n'étaient plus en mesure de rétribuer leurs conseillers par l'intermédiaire de leurs produits d'investissement et s'ils devaient les payer directement au conseil ou au service fourni, 24 % s'estimeraient moins enclins à faire appel à leur expertise. Ce potentiel « effondrement des services de conseils » est uniformément perceptible auprès de toutes les catégories d'investisseurs, depuis ceux qui disposent d'un actif inférieur à 50 000 $ jusqu'aux bien nantis possédant plus de 500 000 $.

« En tant que société, AGF s'engage à donner le choix aux investisseurs et à leurs conseillers. Nous croyons que les conseillers et leurs clients méritent de pouvoir négocier un modèle de rémunération adéquat, de façon transparente et parfaitement adaptée à leurs besoins respectifs. Par conséquent, nous leur offrons les gammes de produits qu'ils réclament pour assembler des portefeuilles », a expliqué M. Goldring.

Divulgation et déclaration

The Gandalf Group a également mis en évidence que la plupart des investisseurs lisent leurs relevés, du moins de façon occasionnelle; la moitié (soit 51 %) dit consulter chaque relevé. La majorité se déclare satisfaite des renseignements reçus de la part des conseillers, des fournisseurs de fonds et des institutions financières. En effet, nombre d'entre eux (39 %) ont noté des améliorations ces dernières années quant à la quantité d'informations communiquées dans le cadre des relevés. Sur dix investisseurs suivis par un conseiller, six sont au courant des nouvelles exigences de divulgation mises en place l'année dernière.

« Ces résultats viennent étayer notre conviction selon laquelle les changements réglementaires, comme le MRCC2, ont permis d'améliorer les processus et d'accroître la transparence dont bénéficient les investisseurs canadiens, et au sein de l'industrie financière de façon plus générale, a souligné Mark Adams, vice-président principal, chef du contentieux, Placement AGF Inc. Tous les intervenants de l'industrie doivent attendre que ces changements soient correctement déployés et qu'ils stabilisent le secteur avant de proposer d'autres modifications. »

Méthodologie

Les résultats de cette enquête ont été établis après consultation d'un échantillon de 1 299 investisseurs canadiens particuliers.

Un rapport détaillé des résultats peut être téléchargé sur le site Web de The Gandalf Group, à l'adresse **www.GandalfGroup.ca** (en anglais seulement).

Les entrevues dans le cadre de cette enquête ont été menées en ligne, du 7 avril au 5 mai 2017. La méthodologie de recherche employée a été conçue par The Gandalf Group, un cabinet de consultation établi à Toronto et spécialisé dans les recherches par sondage et autres méthodes de recherche quantitative ou qualitative.

Pour en savoir plus sur cette étude, veuillez communiquer avec The Gandalf Group à l'adresse **info@gandalfgroup.ca** ou en appelant le 416-644-4120.

Au sujet de La Société de Gestion AGF Limitée

Fondée en 1957, La Société de Gestion AGF Limitée est une société de gestion de placements diversifiés à l'échelle mondiale qui gère des actifs pour des clients au détail et institutionnels, de même que des actifs non traditionnels et des avoirs de particuliers bien nantis. En tant que société indépendante, nous nous efforçons d'aider les investisseurs à réussir en offrant l'excellence en matière de gestion des investissements et en procurant à la clientèle une expérience exceptionnelle. Notre gamme de solutions d'investissement diverses s'étend à l'échelle mondiale à une vaste clientèle, depuis les conseillers financiers jusqu'aux investisseurs particuliers, en passant par les investisseurs institutionnels comprenant des caisses de retraite, des programmes d'entreprises, des fonds souverains, des fonds de dotation et des fondations.

AGF a des bureaux et des équipes de service à la clientèle sur place, en Amérique du Nord, en Europe et en Asie. Avec un actif géré de plus de 36 milliards de dollars, AGF offre ses produits et services à plus d'un million d'investisseurs. AGF est inscrite à la Bourse de Toronto sous le symbole « AGF.B ».

Les représentants des médias peuvent communiquer avec la personne suivante pour de plus amples renseignements :

Amanda Marchment
Directrice, Service des communications de l'entreprise
416-865-4169
amanda.marchment@agf.com

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

June 2, 2017

Re: CSA Consultation Paper 81-408 Consultation on the Option of Discontinuing Embedded Commissions

The Emerging Managers' Board is grateful to the CSA for the opportunity to provide comments on Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions.

Executive Summary

The Emerging Managers' Board is strongly supportive of the proposal to discontinue embedded commissions. We believe the measures should be implemented as quickly as possible. However, we strongly object to the 'mitigation measures' proposed by the CSA. We believe these proposed measures are actually worse than the existing embedded commission system. These mitigation measures replace one form of "bank tax" with another "tax" that is less efficient to administer and results in a worse outcome for fund manufacturers and the investing public.

Introduction to the Emerging Managers' Board

Background: The Emerging Managers' Board or EMB is a non-profit organization whose mission is to promote and contribute to the growth of Canadian emerging managers. It strives to educate asset allocators and investors about the benefits of investing with local talent. We have approximately 120 member firms in Quebec and Ontario, who are primarily independent manufacturers of investment funds. The AUM of the majority of our firm members is below $1 billion.

Confidentiality: All members of the Emerging Manager Board are regulated by a CSA member. As well, their business operations depend critically on broker/dealers for the custodial services, prime brokerage activities and access to their investment platforms for marketing their funds. In order to be able to express our views without fear of repercussions in their businesses, the authors of these comments have requested to remain anonymous.

Responses of the Emerging Managers' Board to Specific Questions

Question 2. *Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.*

Response of the Emerging Managers' Board: Embedded commissions effectively function as a tax, one that is imposed by brokerages and dealers to pay for access to their platforms. There should be no pretence that the level of embedded fees is justifiable in relation to the amount of due diligence conducted by an Investment Advisor. Fund manufacturers are forced to give up 50% of their management fees (in most cases, their only source of fees) for the privilege of access to a dealer's investment platform. The existence of this *de facto* tax continues to stifle the development of an independent asset management industry and reduce competition, to the detriment of both Canadian investors and firms – particularly newer ones – looking to raise capital. The fact that Canada has one of the highest cost investment fund structures in the world is testament to the negative effects of embedded commissions. The elimination of embedded commissions will promote fair and more efficient operations in Canada's capital markets.

Question 4. *For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption: mutual fund, non-redeemable investment fund, or structured note, should the product be subject to the discontinuation of embedded commissions? If not, what would be the policy rationale for excluding it? What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?*

Response of the Emerging Managers' Board: To avoid regulatory arbitrage between the Exempt and Prospectus markets or between different types of investment funds, there should be no exclusions from a discontinuation of embedded commissions. Further, all types of embedded fees should be included within this ban.

Question 5. *Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?*

and

Question 6. *Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?*

Response of the Emerging Managers' Board: We are not aware of other investment products that have embedded commissions; however, our conclusions would not change: all investment funds should be subject to discontinuation of embedded commissions.

Question 7. *Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?*

Response of the Emerging Managers' Board: Yes, we agree. Again, all investment funds should be subject to discontinuation of embedded commissions.

Question 8. *Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:*

a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;
b. referral fees; and BUT won't banning referral fees hurt consumers by removing incentives for intermediaries to forward clients onto other intermediaries for their subject matter expertise or access to particular products?
c. underwriting commissions. BUT won't banning underwriting commissions especially hurt start-ups and hinder consumer access to securities?

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

Response of the Emerging Managers' Board: Yes. All embedded fee structures should be subject to discontinuation, including underwriting fees and referral fees especially in the distribution of related entity fund products. Entities that have internal distribution channels (i.e. major bank-owned retail dealers), should not be able to charge underwriting commissions, a significant conflict of interest, while systematically restricting the distribution of non-related entity fund products from their retail platforms. Concurrent with the discontinuation of embedded commissions, attention must be given to the use of non-monetary benefits, as these benefits will become more prominent.

Question 10 a. *With respect to internal transfer payments: a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?*

Response of the Emerging Managers' Board: Clearly NI 85-105 is not effective. Canada has one of the most concentrated asset management and one of the most concentrated brokerage sectors in the world, resulting in wide-spread conflicts of interest. This conflict is exacerbated by the systematic practice of limiting third party managed funds to the retail networks of the large integrated financial services providers. Investors' choices are unquestioningly reduced with limited means of redressing the uneven playing field between internal proprietary funds and third party funds.

Question 10 b. *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*

Response of the Emerging Managers' Board: Internal transfer payments should also be discontinued. Internal fund managers, brokers, and other financial planners are regularly pressured to purchase related party products. Tactics employed include: moral suasion, grid payout discrimination, minimum asset requirements for types of services, etc. Eliminating internal transfer payments within integrated financial service providers will unquestionably reduce conflicts of interest and allow internal fund managers and brokers to actually act in the clients' best interests.

Question 11. *If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.*

Response of the Emerging Managers' Board: Absolutely not. We strongly object to the 'mitigation measures' proposed by the CSA. As we noted at the outset, we believe these proposed measures are actually worse than the existing embedded commission system. These mitigation measures replace one form of 'bank tax' with another 'tax' that imposes higher operating costs on the administrator which is ultimately passed on to investors. Neither investors nor independent fund manufacturers will have any bargaining power in whether to adopt this practice or not. We will simply end up substituting embedded commission fees with an administratively less efficient 'tax' of similar magnitude. Investors will be no better off.

Question 15. *What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular: What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*

Response of the Emerging Managers' Board: Removal of embedded commissions will result in lower fees, greater investment product choice, reduced conflicts of interest and an opportunity for new asset manager entrants to contemplate creating a business and; thereafter, potentially thrive. An example of the resulting lower fees is in respect of the full service charges that are imposed on DIY investors. According to the Embedded Commission Consultation Paper 81-408, $25 billion of $30 billion held by DIY mutual fund investors are 'sold' full trading commission fund series, so "many DIY mutual fund investors [in the online / discount brokerage channel] . . .indirectly pay for services they do not receive." [1] These DIY investors do not do so by choice. They simply acquiesce to the terms on offer, since all bargaining power lies with their brokerage. If a DIY investor wishes to purchase a fund on a broker platform, the choice is between buying the full commission series or not investing in that fund. Effectively, this is a transfer of wealth from the fund manufacturer to the broker / dealer for no services provided nor advice given; ultimately subsidized by the DIY investor. At the industry standard 1% embedded commission rate, this is a $250 million annual transfer from investors and fund manufacturers to the owners of online / discount brokerages. By eliminating embedded commissions, the revenue of most independent fund manufacturers will effectively double. It will make the fund management industry more competitive at the distribution level and provide investors with greater choice. Investors will clearly benefit from a more competitive fund management industry. In many areas of commercial activity which involve a large, sophisticated organization and a single individual, the harmful consequences of this asymmetry in bargaining power would be addressed by regulatory means. This is what we propose.

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[1] CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commission, January 10, 2017, page 41

Question 18. *Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action?*

Response of the Emerging Managers' Board: We see no chance whatsoever that the embedded commissions model will simply wither away on its own. Due to the presence of their existing sales forces – both "captive" or in-house and independent advisors or representatives – existing distributors have a powerful incentive to continue the commission model. In the absence of an economic imperative, only regulatory action will work.

Question 20. *We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?*

and

Question 21. *Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4?*

Response of the Emerging Managers' Board: Canada has one of the most concentrated asset management sectors in the world as well as one of the most concentrated brokerage sectors. Non-monetary incentives and moral suasion are powerful tools used by integrated parties to promote other purchase options over fee-based series. Embedded commissions are effectively a transfer of wealth from the fund manufacturer to owner of a broker platform. By eliminating embedded commissions, the revenue of most independent fund manufacturers will effectively double. It will make the fund management industry more competitive and provide investors with greater choice. Investors will clearly benefit from a more competitive fund management industry and industry concentration should improve. The discontinuation of embedded commissions will undoubtedly lead to new, lower-cost entrants to the market, as a significant barrier to entry will have been eliminated.

To be clear, full adoption of the fee-based series is not a solution in itself. Without rigorous and meaningful conflict of interest guidelines, brokers will explicitly and implicitly promote internal related products over third party investment products.

Question 22. *What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular: Is there any specific operational or technological impact that we should take into consideration?*

and

Question 27. *How practicable are the mitigation measures discussed and how effective would these measures be at assuring: choice of payment arrangements for all investor segments, and a level playing field amongst competing investment products?*

and

Question 29. *Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular: would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.*

and

Question 32. *For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications.*

Response of the Emerging Managers' Board: We strongly object to the 'mitigation measures' proposed by the CSA, namely the proposal to "allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf." Effectively, each month, an Investment Fund Manager will have to redeem a portion of each fund for every unitholder and remit these tiny amounts to their unitholders' Investment Advisors. Redemptions remain a manual process. The back offices of Administrators and Investment Fund Managers are not designed to deal with huge numbers of tiny transactions. The imposition of such "mitigation measures" will serve as yet another barrier to entry for small independent fund manufacturers and increase the operational costs of these Investment Fund Managers solely for the benefit of Investment Advisors.

Further, investors would be subject to taxation on any such redemption. Both investors and Investment Fund Managers are better off under the current embedded commission system than under the CSA's proposal. The proposed measures will serve to further tilt the playing field against smaller independent Investment Fund Managers and fund manufacturers.

Le 2 juin 2017,

Bonjour,

J'ai pris connaissance de votre mémoire et j'avais bien l'intention de compléter votre liste de question de la consultation.

Beaucoup trop lourd, et honnêtement les commentaires sur le marché, il semble que votre décision est déjà prise. Je tente ma chance en émettant mon humble commentaire sur le sujet.

Je suis dans le domaine depuis 1996, et j'ai à cœur ma profession. Dans chaque domaine activité, il y a des bons et des mauvais travailleurs.

Je gère les portefeuilles de mes clients avec respect, avec toute la transparence concernant les frais associés. Depuis plusieurs années, à nos Congrès et même les compagnies de fonds mutuels nous martèlent que l'industrie est maintenant au compte à honoraire. Encore aujourd'hui, j'analyse mes portefeuilles, je fais une comparaison avec les fonds réguliers et les fonds en part F. Le client est fortement désavantagé, la firme et le représentant ont plus d'argent dans leur poche.

En espérant après cette consultation, que vous aurez des tables rondes pour analyser les choix proposé pour trouver une solution afin de garder cette forme de rémunération.

Déjà la compagnie de fonds Mutuels Dynamic a fait l'annonce de l'abolition des ventes de fonds à frais reportés. Moi, de mon côté depuis plus de 2 ans, et le bureau en général, nous utilisons frais d'acquisition à l'entrée, **nous chargeons aucun montant à l'entrée** et ainsi le client n'a aucun frais de rachat.

Merci de prendre le temps de lire et prendre connaissance de mon modèle d'affaire.

Hélène Aubin
Conseillère en placement
Directrice de Succursale
VM Peak

Pacific Spirit | Investment Management Inc

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02 June 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Dear Friends:

Re: Embedded Commissions – CSA Consultation Paper 81-408

We thank you for this opportunity to submit our thoughts on CSA Consultation Paper 81-408 (Embedded Commissions).

Pacific Spirit Investment Management Inc. is licensed as a Portfolio Manager in the Provinces of British Columbia, Saskatchewan, and Ontario. Our firm works exclusively with individual investors and we do not manage funds for institutional investors. We manage approximately $170 million for approximately 170 client families.

We manage each client account separately – each account holds its own investments which are consistent with the Investment Policy Statement for that account. We do not offer any proprietary products – no proprietary funds, no proprietary pools. We are fee-only. The only compensation we receive is the portfolio management fee that we invoice our clients quarterly. **We do not receive any commissions, referral fees, trailer fees, or soft dollars**.

We generally prepare a basic retirement plan for clients as part of the onboarding process when we enter into a new client relationship. We believe that the preparation of a plan serves as an excellent communication tool between ourselves and our client and the plan provides inputs for the Investment Policy Statement.

We have two registered Advisers (Portfolio Managers) who both hold the CPA, CFA, and CFP designations.

Our clients may hold individual equities and fixed income investments as well as mutual funds and ETFs.

When we make mutual fund investments we generally will invest in F class funds to reduce the cost to our clients. However, we will use regular class mutual funds – those that pay a trailer fee to the custodian – where, in our opinion, the cost to the client would be lower holding the regular class fund compared to the F class fund.

Brokerage firms may charge a commission for an F class trade of up to $29 per trade. This would apply to both a purchase and a sell of an F class fund. There are no fees associated with buying or selling a regular class fund. For smaller amounts it is better for our clients to purchase the regular class fund than the F class fund.

A specific illustration will provide some detail. For short-term idle cash we have a choice of leaving the cash in the brokerage account where it earns no interest and is exposed to the creditors of the brokerage firm, or we can purchase CDIC insured mutual funds that pay up to 1.75% per annum F class or 1.5% per annum for regular class. The difference in the rates is the trailer fee (0.25% per annum) paid to the broker. If we have $1,000 to invest in the short-term we would purchase the regular class fund and earn the 1.50% per annum. To cover the $58 potential round trip commission on the F class fund from the extra return (1.75% versus 1.50%) we would need to have the funds in the money market fund for 23 years. Funds with trailer commissions can be a good deal for our clients – especially if the amounts invested are small.

Please do not take away the opportunity for us to use these low cost investment vehicles for our clients.

Pacific Spirit | Investment Management Inc

Thank you for this opportunity to submit our thoughts.

Sincerely,

PACIFIC SPIRIT INVESTMENT MANAGEMENT INC.

John S Clark

John S Clark CPA, CA, CFA, CFP
President

I want to express my concern with the potential banning of embedded commissions. My concerns are tied specifically to the rise in popularity of so called "robo advisors". "Wealth Simple" is one company in particular that has been gaining in popularity. I am 34 years old and many of my peers have asked me about Wealth Simple. Wealth Simple has been very aggressive in it's marketing and has been doing presentations at many companies as well as invests heavily in advertising on social media and on the STM (Bus & Metro). It clearly has a target market: people of my age range that are comfortable investing online. I explored the service myself in order to gain an understanding of it. If you invest over $100,000, you have the option of having an advisor visit you to provide added value. Otherwise, an algorithm provides you with a portfolio based on your risk tolerance.

This is my concern: If embedded omissions are banned, clients that invest less than $100,000 (which is the majority of Quebecers) will not receive any guidance. The advisors that remain in the business under a fee based practice will focus on the larger accounts. Online robo-advisors like Wealth Simple will also discriminate based on assets. This will result in many investors with no where to turn.

Just yesterday, my client who has about $75,000 in her RRSP looked at me and said "I honestly could not and would not have been able to save this much without your guidance, your encouragement and your support". This is the reality for many investors, they rely on the guidance of their advisors, especially those with smaller accounts.

I worry that the banning of embedded commissions, albeit a move which may have good intentions, will result in the ever-broadening gap between the rich and the poor. Wealthier investors will have many avenues at their disposal while smaller investors will have no where to turn.

As regulators, we should we looking for ideas which make the investment landscape more accessible to everyone. If we move to bad embedded commissions, it truly would be a sad day for the average person who is trying to improve their financial situation in life.

Thank you for reading and I wish you the wisdom and the courage to make the right choices.

-Daniel Enayatzadeh

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June 5, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission
New Brunswick Superintendent of Securities
Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

The Secretary
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Me Anne-Marie Beaudoin
Corporate Secretary
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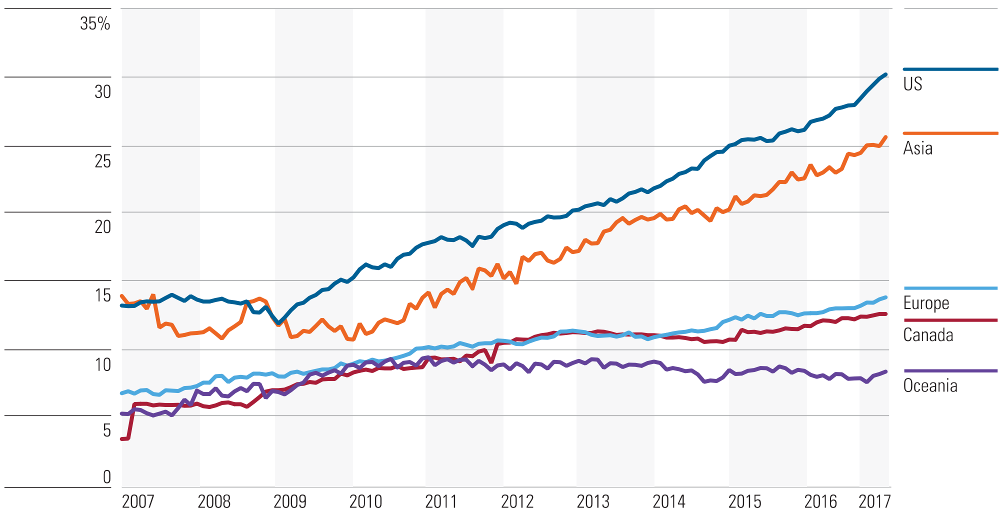
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

RE: CSA Consultation Paper 81-408; Consultation on the option of discontinuing embedded commissions

Ladies and Gentlemen:

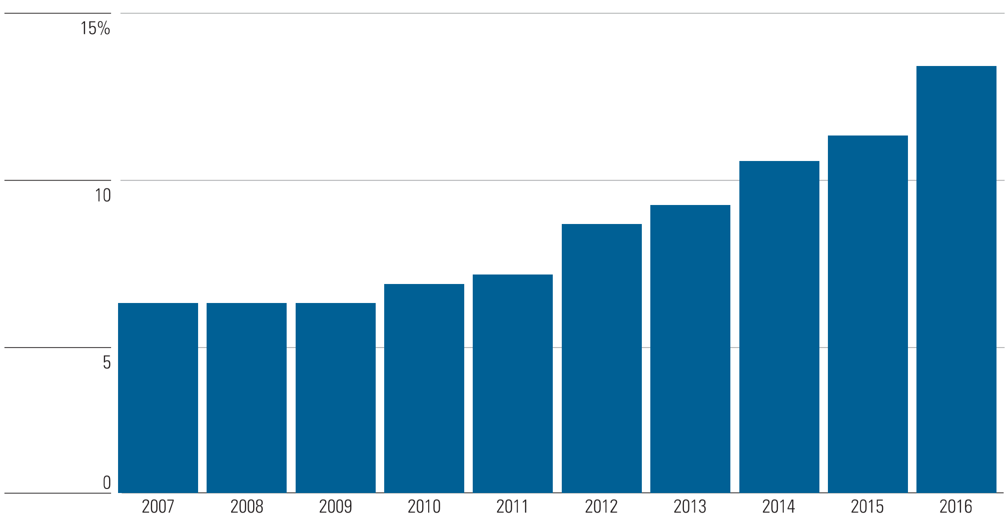
Morningstar Research, Inc. welcomes the opportunity to address the questions posed in the Canadian Securities Administrators' Jan. 10, 2017, paper discussing the proposed discontinuation of embedded commissions. Morningstar Research, Inc. is a leading provider of independent investment research, and our mission is to create products that help investors reach their financial goals. Because we serve individual investors, professional financial advisors, and institutional clients, we benefit from a broad perspective on the impact of the proposed rule and its possible effect on the advice that investors receive.

Exhibit 1 Index Fund Share Across Major Markets, 2007-Present



Source: Morningstar. Data as of March 31, 2017.

Exhibit 2 Index Fund Market Share, United Kingdom, 2007-16



Source: The Investment Association, Data as of January 31, 2017.

Morningstar believes embedded commissions should be discontinued because they align the financial interests of advisors with asset managers rather than with individual investors seeking advice. While clients' best interests are served by holding lower-cost funds, asset managers have an incentive to promote higher-cost alternatives from which they generate more revenue from fees. Asset managers use embedded commissions to give advisors incentive to favour higher-cost funds, creating a conflict of interest. For example, the commission paid to actively managed funds typically is at least twice that for passively managed funds.

Exhibit 3 Historical Management Expense Ratios, 2011-15

Category	Distribution Channel	2011	2012	2013	2014	2015	2016	Change (2011-2016)
Canadian Dividend & Income Equity	Commission–based	2.29	2.29	2.3	2.29	2.29	2.26	–0.04
	Fee-based	1.22	1.22	1.22	1.22	1.2	1.16	-0.06
Canadian Equity	Commission–based	2.21	2.2	2.3	2.24	2.22	2.18	–0.03
	Fee–based	1.17	1.2	1.26	1.17	1.15	1.1	–0.07
Canadian Equity Balanced	Commission–based	2.32	2.32	2.34	2.31	2.3	2.29	–0.02
	Fee–based	1.26	1.29	1.27	1.24	1.21	1.21	–0.05
Canadian Fixed Income	Commission–based	1.53	1.56	1.55	1.55	1.54	1.53	0
	Fee–based	0.94	0.94	0.92	0.91	0.89	0.87	–0.07
Canadian Fixed Income Balanced	Commission–based	1.95	1.94	1.93	1.94	1.93	1.92	–0.03
	Fee–based	1.03	1.04	1.03	1.02	1.01	0.99	–0.04
Canadian Focused Equity	Commission–based	2.46	2.44	2.45	2.43	2.44	2.41	–0.06
	Fee–based	1.27	1.29	1.3	1.3	1.29	1.28	0.01
Canadian Neutral Balanced	Commission–based	2.23	2.2	2.2	2.17	2.17	2.15	–0.08
	Fee–based	1.18	1.16	1.13	1.1	1.09	1.07	–0.11
Global Equity	Commission–based	2.59	2.54	2.55	2.53	2.54	2.52	–0.07
	Fee–based	1.43	1.37	1.38	1.35	1.33	1.32	–0.11
Global Equity Balanced	Commission–based	2.5	2.5	2.48	2.46	2.45	2.43	–0.07
	Fee–based	1.34	1.31	1.32	1.3	1.27	1.24	–0.09
Global Fixed Income	Commission–based	1.91	1.89	1.91	1.91	1.82	1.8	–0.11
	Fee–based	1.1	1.08	1.13	1.08	1.01	1.02	–0.08
Global Fixed Income Balanced	Commission–based	2.21	2.16	2.14	2.12	2.08	2.07	–0.14
	Fee–based	1.24	1.14	1.19	1.13	1.1	1.08	–0.16
Global Neutral Balanced	Commission–based	2.38	2.35	2.32	2.31	2.29	2.29	–0.09
	Fee–based	1.24	1.25	1.24	1.2	1.18	1.17	–0.07
International Equity	Commission–based	2.43	2.41	2.42	2.38	2.36	2.37	–0.06
	Fee–based	1.28	1.27	1.29	1.28	1.24	1.24	–0.04
US Equity	Commission–based	2.29	2.23	2.31	2.28	2.27	2.23	–0.06
	Fee–based	1.28	1.21	1.27	1.22	1.19	1.17	–0.11

Source: Morningstar, Data as of April 30, 2017.

As a result, advisors in Canada overwhelmingly favour actively managed funds: Index funds constituted 1.3% of commission-based assets as of March 2017, virtually unchanged from January 2007. By contrast, total Canadian indexed assets overall grew from 3.4% to 12.4% over this stretch, thanks mainly to the use of exchange-traded funds by fee-based advisors, institutions, and do-it-yourself investors. Index funds also made inroads in most other major markets, especially the United States, as Exhibit 1 illustrates.

Morningstar expects discontinuing embedded commissions would accelerate flows into lower-cost active funds and index funds. After the United Kingdom introduced new rules outlawing trailing commissions in December 2011, index funds' market share rose sharply after years of stagnant growth, as Exhibit 2 indicates. Index fund assets grew from 6.9% to 13.5% of industry assets from

January 2012 through December 2016. When asset managers could no longer give advisors incentive to favour more-expensive active funds, fewer advisors chose them. We welcome such competition from cheaper passive alternatives, not to displace active managers but to pressure them to become cheaper.

It does not take an imaginative leap to envision what the post-embedded-commission landscape could look like. With increasing numbers of advisors adopting fee-based business models, the proportion of Canadian funds sold without commissions has grown markedly in recent years. While fee-based share classes accounted for 3% of advised fund assets in 2011, they now account for 15%, according to Morningstar data. Price competition was stronger in the fee-based channel over the period. For example, the average fee-based Canadian Equity management expense ratio fell 7 basis points from 2011-16, versus a 3-basis-point decline for the average commission-based fund in the category. We observed similar patterns across most major CIFSC categories, which we depict in Exhibit 3. Without embedded commissions to attract assets, fund managers compete, at least in part, on cost. Removing financial incentives to favour some funds over others encourages advisors to focus on investment quality, of which cost is an important indicator. This result is unambiguously good for fundholders: Lower management fees mean better returns for investors.

Proponents of embedded commissions often characterize the commissions as fees for advice. In most cases, however, these commissions are fees paid by asset managers in exchange for funds sold, not for advice. Under the embedded-compensation model, investors receive varying levels of service but pay a single, set price. Costs may be transparent but what investors get in return is not. Unbundling administrative and operational fees makes the cost of advice explicit. We anticipate that greater transparency will require advisors to offer services commensurate with the fees they charge.

Some have argued that discontinuing embedded commissions risks leaving investors who have relatively small balances without access to advice. But rather than abandoning or de-emphasizing these investors, we anticipate that the delivery of advice for this segment will change and technological innovations in advice will serve this segment. These solutions, commonly referred to as "robo advisors," fill the gap between no-frills discount brokerages and full-service wealth managers. We view the rise of digital advice solutions as positive for investors, as these solutions democratize sophisticated asset-allocation models that had been available only to large institutions.

By inducing competition and lowering costs, improving transparency and accountability, and driving technological innovation, Morningstar believes investors will be well-served by discontinuing embedded commissions.

Very Truly Yours,

Christopher Davis
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The Pros and Cons of Discontinuing Embedded Commissions by Regulatory Fiat

Comments submitted to the
Canadian Securities Administrators

by

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June 5, 2017

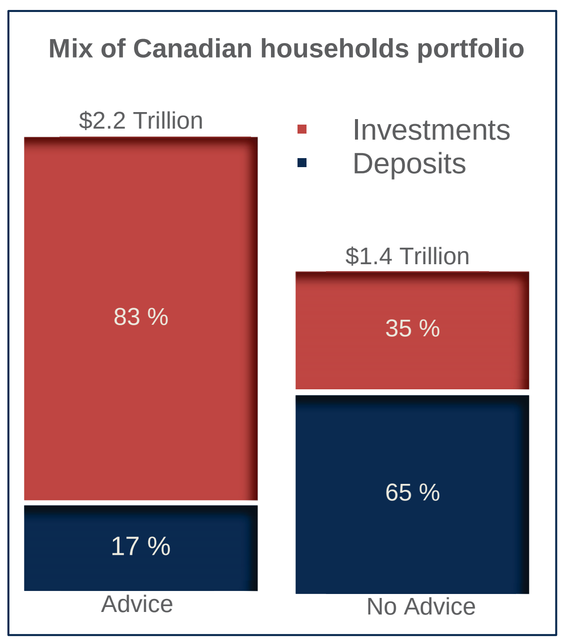
The opinions expressed in this paper are those of the author and do not necessarily reflect the views of Dentons Canada

The Pros and Cons of Discontinuing Embedded Commissions by Regulatory Fiat

The CSA published Consultation Paper 81-408 - *Consultation on the option of Discontinuing Embedded Commissions* in January 2017 (the "Paper"). One of the main virtues of the Paper is the detailed information it contains on the structure of the Canadian fund market and the characteristics of its participants. Our concern is that the policy prescription advocated in the Paper is framed by how the CSA defined the issue of moral hazards inherent in the financial advisor-retail client relationship it seeks to address without much consideration for the critical issue of wealth accumulation, the dominant motivation for households to invest in financial products.

The fundamental role of the financial intermediation function is to facilitate savings and promote sound financial asset management. It follows that the litmus test for retail finance regulations is whether a policy favors and facilitates wealth accumulation by Canadian households. We believe that had this basic tenet been placed at the center of the analysis, the conclusions and the policy prescription would have been quite different from those advocated.

The Paper reports that 63 percent of households do not own investment funds. That some of "these households will typically hold more conservative financial products instead, such as cash, GICs, etc." (p. 28) is a fact. Given the structural modifications in the design of public and private pension programs that have shifted investment performance, inflation, longevity and markets risks onto the cohorts of future retirees, this "reckless" investment conservatism should not be characterized as cautious behavior, but considered the result of a huge "advice gap" that entails considerable socio-economic consequences.



The traditional view is that the dispersion in wealth accumulated at retirement is driven mainly by savings decisions when young.[1] Recent studies emphasize the fact that the allocation of savings between riskless and risky assets, and the choice of risky assets drives returns on individual portfolios. Sound investment practices are thus a powerful force increasing wealth inequality.[2] We also know that households with lower financial capability need to trust their financial adviser in order to invest in risky assets. This reflects in part the fact that a large proportion of households define risk in terms of a loss of capital, not with the range of metrics for measuring investment risk used by academics and the financial industry.

1 Steven F. Venti and David A. Wise, 2001, *Choice, Chance, and Wealth Dispersion at Retirement*, Chapter 1 in Seritsu Ogara, Toshiaki Tachibanaki and David A. Wise eds., *Aging Issues in the United States and Japan*, NBER, University of Chicago Press.

2 Thomas Piketty, 2014, *Capital in the Twenty-First Century*, Harvard University Press.

The Paper does not explain how banning embedded commissions will assist in shrinking this "advice gap" and encourage Canadian households to operationalize the "prudent investor rule" which posits that an investor should undertake to maximize return and minimize risk, matching the risk and expected return of their overall investment portfolio to their particular circumstances.

Observing that "only 22 percent of mass-market households held investment funds" (p.28), the potentially negative impact on this market segment of a regulation disallowing embedded commission is dismissed on the grounds that mass-market households will gravitate towards vertically integrated deposit-taking institutions and insurance firms. The Paper expresses no misgivings with such a regulatory-induced restructuring despite the conclusion of the CSA's own commissioned research to the effect that "affiliated dealer flows showed no flow-performance sensitivity at all which was found to be relatively more detrimental to investors relative to all trailing commission paying purchase options for non-affiliated dealer flows."[3] We will return to this issue.

We agree with the Paper that, in line with the changes observed in other markets, Canadian financial intermediaries are gradually shifting their business model towards a fee based on the value of assets under management ("AUM"). This trend is driven by the strategic intent of broker-dealer firms and other fund distributors to dampen the volatility of revenues arising from a business model based on transaction-related commissions. As the value of assets under management is much more stable, broker-dealers and financial advisors compensation tied to the value of AUMs well serves corporate purposes: stability of revenues, an incentive to grow the AUM and, incidentally, to encourage retail clients to keep up their savings habit. The practical consequence of this change of the business model is that, as the Paper reports for Canada, investors who desire advisory services but who wish to pay for them directly rather than through embedded commissions have limited options because direct pay arrangements for access to professional financial advice are typically available only through dealers servicing higher net worth investors (p. 13), notably IIROC dealers that "typically aim to service households with investable assets of $500,000 or more" (p. 37). The disallowing of embedded commissions will invariably accelerate and accentuate the adoption of the AUM fee-base model with the ensuing consequences concerning access to professional financial advice.

As long as the transition in the financial advice business model is the result of market forces, one would expect the structure of the industry to evolve towards another competitive equilibrium. Regulation should encourage choice. Canadian investors should have access to a wide range of competing products and financial intermediaries, regardless of whether advice is delivered using commission or fee-based advice models.

■ A Preliminary Question

The Paper identifies many areas where the Canadian retail market for funds should and can be improved. It does not, for reasons set out below, make a solid case for disallowing embedded commissions by regulatory fiat. Nor does it address a preliminary question: does the Autorité

[3] Douglas Cummin, Sofia Johan and Yelin Zhang, *Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance Report*, CSA, 2016.

des marchés financiers ("AMF") have the right to prohibit an industry practice common around the world in the face of strong evidence that households investing with the guidance of a financial advisor, the majority under the prevailing pricing regime, accumulate substantially larger financial wealth than those who do not?

The AMF's mission includes the supervision of the activities related to the distribution of financial products and services.[4] The meaning of "supervision" is to oversee, superintend, keep under surveillance, monitor. It is a dubious proposition to suggest that the phrase covers the imposition of a business model for the distribution of financial products and the outright ban of a practice that has long been accepted and has been proven to be effective in facilitating access to financial advice.

The standard of judicial review that concerns parliamentary delegations of legislative authority to administrative agencies addresses whether an agency action is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory rights". Courts have held that an administrative agency's power to regulate in the public interest must always be grounded in a valid grant of authority from the legislator and that the ambit of the rule must not be in excess of statutory jurisdiction, authority, or limitation, or short of statutory right.[5]

In this regard, it is worth noting that with respect to the churning of accounts, Article 193 of the Québec Securities Act specifically provides that "no dealer or adviser may multiply transactions for the account of a client solely to increase his remuneration". As far as embedded commissions are concerned, Québec securities legislation is silent.[6] In contrast, in Europe, the MiFID II Directive which imposes limits to the use of commissions and stricter requirements for product distribution and design and mandates improved disclosure of costs and charges in the financial retail markets was adopted by the European Parliament on 15 April 2015[7].

Hence, the preliminary question: can the AMF impose a ban on embedded commissions in the absence of an explicit mandate from the Québec National Assembly?[8]

■ THE PRINCIPAL-AGENT CONUNDRUM

The central thesis of the Paper is that financial advisers are in a situation of conflict of interest vis-à-vis their clients, a position exacerbated by embedded commissions. Therefore, by prohibiting embedded commissions to broker-dealers, the problem is solved.

There is no denying that because financial advisers generally perform the dual function of advising clients and selling financial products, it exposes financial consumers to both adverse selection and moral hazards. Although the commingling of the advice and sale roles is typical of technically complex product markets, academics and policy-makers in Canada and abroad have, as the Paper does, questioned the appropriateness of arrangements where the remuneration of financial intermediaries distributing financial products and providing advice is

[4] Act respecting the Autorité des marchés financiers, art. 4.
[5] "It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress." Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988).
[6] Act respecting the Autorité des marchés financiers and the Québec Securities Act.
[7] The Directive is set to come into effect for all investment firms on 3 January 2018, four years after its adoption.
[8] This preliminary question applies to all other securities commissions in Canada.

embedded in the price of the financial products and dependent on commissions and other contingent fees from the manufacturers of financial products rather than being paid directly by their customers. It remains that the wisdom of an unbundling policy is not a forgone conclusion. There exists little empirical evidence to support the assertion that fee-based pricing favor behavior more responsive to client interest. Weinstein, in a study commissioned by the CSA, concludes from his review of the literature that "it is not yet clear whether moving from commission-based to asset-based compensation will result in a net improvement in the overall return to the investor."[9] Very little is known "about individual responsiveness of financial advice outside an environment with moral hazard"[10] and what is known about advice taking and receiving does not favour the superiority of the neutral advice hypothesis.[11]

The findings of several academic studies suggest that when evidence does exist that the financial advice given as a matter of course was not optimal, concerns about the role of commission-based arrangements were not as problematic as those set out in the Paper. An analysis of a sample of 12,000 individual investment accounts for a 34-month period at a large retail German bank leads to the conclusion that the "empirical evidence is broadly in line with honest financial advice."[12]

One important factor overlooked in the Paper is that financial advisers want to sustain their business over time; the repeated-game nature of the relationship provides an incentive to offer accurate advice to their clients or, at the very least, not to knowingly provide biased information.[13] Within financial institutions and professional organizations, conflicts of interest infrequently materialize in corrupt actions – the domain of enforcement; rather, biased advice is generally the result of unintentional and unconscious motivations.[14] The results of three comprehensive studies support these critical points and suggest a fundamentally different diagnosis of the underlying dynamics between financial advisers and their clients than the one centered on conflicted behavior advanced in the Paper.

- Using a unique set of data on Canadian financial advisers and their clients, a study shows that most advisers invest their personal portfolios just like they advise their clients, in line with their beliefs about their investment choices and own practices. Only a small fraction of advisers exhibited a conflicted behavior. The authors conclude that their "estimates suggest that correcting advisers' misguided beliefs, through screening or education, may reduce the cost of advice more than policies aimed at eliminating conflicts of interest."[15]

- A rigorous examination of the investment portfolios of Canadian households at three large Canadian financial institutions found that the composition of the advisers' portfolio

[9] Edwin Weinstein, *Mutual Fund Fee Research*, The Brondesbury Group, 2015.
[10] Angela A. Hung and Joanne K. Yoong, *Asking for Help, Survey and Experimental Evidence on Financial Advice and Behaviour Change*, WR-714-1 (RAND Corporation, 2010), 5.
[11] Upta Bhattacharya et al., *Is Unbiased Financial Advice To Retail Investors Sufficient? Answers from a Large Fiels Study*, Review of Financial Studies (2012).
[12] Ralph Bluethgen et al., *Financial Advice and Individual Investors' Portfolios*, Abstract, March 2008.
[13] Luis Garicano and Tano Santos, *Referrals*, American Economic Review 94, 3 (2004); 499-525; Patrick Bolton, Xavier Freixas and Joel Shapiro, *Conflicts of Interest, Information, Provision, and Competition in the Financial Services Industry*, Journal of Financial Economics (February 2006).
[14] Don A. Moore and George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflict of Interest*, Social Justice Research 17 (2004): 189-202.
[15] Juhani T. Linnainmaa, Brian T. Melzer, Alessandro Previtero, *Costly Financial Advice: Conflicts of Interest or Misguided Beliefs?*, December 2015.

"is far and away the strongest predictor of the risk taken in their client's portfolios even after controlling for adviser and client characteristics."[16]

– A study of 401k plans in the United States reaches a similar conclusion: the composition of client 401k plans was similar to their financial adviser's plan.[17]

These findings indicate that most advisers give the advice they give not because they are influenced by conflicts of interest, but rather because they personally believe that their recommendations will outperform alternatives. Regulations attempting to "sterilize" the relationship by imposing a ban on embedded commission are more likely to prove ineffective because such a policy does not address the primary factor which is the financial advisers' beliefs about the value of the financial products they recommend … and acquire for their own portfolio. Thus, not only would such a policy miss the mark, its implementation would create a lot of collateral damage by hampering easy access to professional financial advice by a broad segment of financial consumers, a matter we address below.

The results of the studies mentioned above are consistent with those examining the influence of financial advice on wealth accumulation, which is not the case for those based on transactions and benchmark comparisons that form much of the substrate underlying the Paper's conclusions.[18] The Paper gives short shrift to the results of empirical studies that examine the impact of professional financial advice on the accumulation of financial wealth by households. This omission is regrettable because the findings are critical, particularly those that describe and measure the impact of financial advice over time on a wide range of financial households. This empirical evidence deserves to be emphasized since it makes no sense that it not inform public policies:

– In the United States, using the 2004 and the 2008 waves of the U.S. National Longitudinal Survey of Youth shows that financial advice has a strong positive impact on net worth and retirement savings (controlling for income earned in prior 14 years).[19]

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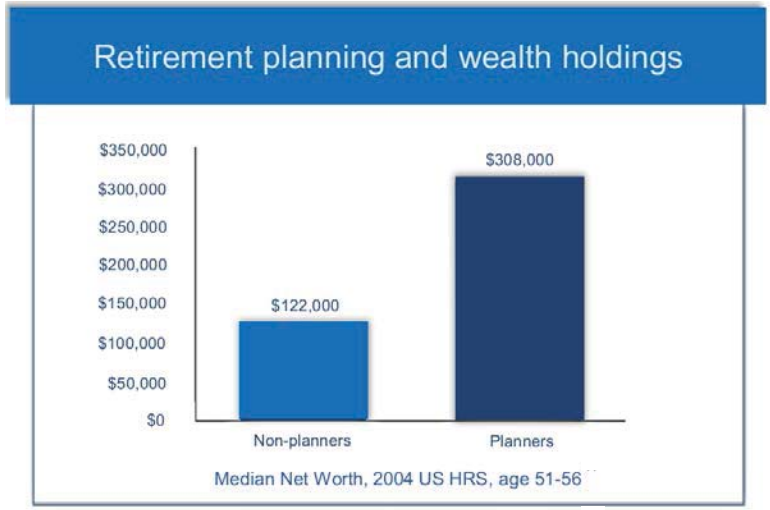
16 S. Foerster, J.T. Linnainmaa, B.T. Melzer, A. Previtero, *Retail financial advice: Does one size fit all?*, Journal of Finance. Forthcoming. 2015.

17 T. Dvorak, *Do 401k plan advisors take their own advice?*, Journal of Pension Economics and Finance 14 (1), 55-75, 2015.

18 Care must be taken when comparing actual mutual fund performance to an index. Even if mutual funds did not charge expenses, their performance would still likely be different from the return on an index for a number of reasons. First, by purchasing and selling securities, they incur a transaction cost that reduces their return below that of an index. Second, funds need cash management policies to handle inflows and outflows from investors and policies regarding the timing of the reinvestment of dividends. Funds can choose their policies, while index returns are calculated based on a mechanical rule for reinvesting dividends and assuming no inflows or outflows. Third, funds can choose how they handle sales and purchases caused by changes in the companies contained in the benchmark index. Again, these changes are handled mechanically when calculating a return on an index. Fourth, funds need to have policies on how to handle tender offers and mergers while these are handled mechanically in index construction. Finally, funds can lend securities and earn a return on the securities that are lent; the index return cannot do so.

19 Terrance Martin and Michael Finke, *A Comparison of Retirement Strategies and Financial Planner Value*, Journal of Financial Planning 27, 11 (2014): 46-53.

- In another U.S.A. study, it was shown that households that used a financial adviser where five times more likely to have calculated their retirement needs, a key factor associated with much improved wealth holdings; and that those who knew their retirement needs saved significantly more than households without a plan and "generated more than 50 percent greater savings than those who estimated retirement needs on their own without the help of a planner."[20]



- In Canada, the results of a rigorous econometric study show that, on average, individual investors assisted by a financial adviser accumulated significantly more financial assets than did non-advised respondents with comparable age, income levels and other socio-economic characteristics. This benefit of financial advice grows with the length of time households have received advice: after four to six years, the advised households have accumulated 1.58 times the amount accumulated by non-advised households; after 15 years, the difference has increased to 3.9 times.[21]

- The converse also yields a major lesson. Looking at households that discontinued the use of a financial advice between 2010 and 2014, another study finds that they accumulated 45 percent less asset value than was the case for those who retained a financial adviser. Obviously, their decision to "go alone" proved costly.[22]

- The findings concerning the contribution of financial advisers to wealth accumulation by Canadian investors are congruent with those obtained in The Netherlands. Using the longitudinal data of about 16,000 Dutch individual investors over a 52-month period, the author found that the characteristics and portfolios of advised and self-directed investors differ remarkably: advisers add value through better diversification, lower idiosyncratic risk and reduced trading activity. The findings that financial advisers add positive value to portfolios are confirmed by the results of investors that switched from execution-only to advice.[23]

By providing insight into the underlying dynamics of the adviser-financial consumer relationship, the results of these studies suggest that strong countervailing factors, including the repeated-game nature of financial advisory services, are present to maintain the relationship fair and honest. These results also raise questions about the validity of the assertion often make in the

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20 John Ameriks, Andrew Caplin and John Leahy, *Wealth Accumulation and the Propensity to Plan,* Quarterly Journal of Economics (2003): 1008-1009; and Annamaria Lusardi, *Explaining Why so Many Households Do not Save,* mimeo (University of Chicago, 2000).
21 Claude Montmarquette and Nathalie Viennot-Briot, *The Gamma Factor and the Value of Financial Advice,* CIRANO, August 2016.
22 Claude Montmarquette and Nathalie Viennot-Briot, op.cit., 2016.
23 Marc M. Kramer, *Financial Advice and Individual Investor Portfolio Performance*, Financial Management, 2020, 41-2: 395-428.

Paper that the Canadian market for financial advice is not efficient or that it would be made more efficient by a ban on embedded commissions by regulatory fiat.

TRUST: A KEY DETERMINANT OF THE DEMAND OF FINANCIAL ADVICE

The value of financial advice and its considerable effect on wealth accumulation by households who avail themselves of the service cannot be explained by asset performance alone. It stems from its ability to counterbalance human idiosyncrasie by instilling and encouraging more disciplined savings and investment behavior and better balanced and diversified portfolios. Examination of investment behavior in eight industrial countries reveals that wealthier households who generally work with a financial adviser "take more risks and earn higher average returns both through risk taking and through the form in which risk is taken."[24] Moreover, a large body of evidence shows that the capacity to plan for retirement is closely tied to working with an adviser.[25]

To be successful in influencing savings and investment practices, financial advisory services must take the form of a relational exchange imbued with a high degree of contextual understanding, not the transaction form implicit in the Paper. Compared to transactional exchanges, relational exchanges have a longer duration, a higher degree of contextual understanding and a stronger complement of trust, loyalty and cooperation. Results from the 2016 Natixis Global Survey of Individual Investors bear this out: investors want a strong and personalized relationship with their financial adviser – one that helps them "see beyond daily market noise, helps them refine personal goals, and helps them become stronger, more confident investors. What they want most is help with making more informed investment decisions."[26]

Several studies conclude that trust is a key determinant of the propensity to seek professional advice and plays an essential role in client-adviser relationships and financial decision-making. Surveys consistently find that retail investors cite "trust" as the most important determinant in seeking a financial adviser. Comparisons of the attitudes of individual investors who have or do not have a financial adviser show that:

i. the trust towards financial advisers is about 30 percent more likely for advised investors than a similar non-advised respondents;
ii. about 70.8 percent of advised investors have high confidence towards their financial adviser versus 31.2 percent for non-advised respondents with regard to financial advisers;
iii. the confidence of an advised investor that he or she will have enough money to retire comfortably is significantly higher than for non-advised investors, which is consistent with consumer survey findings that a large majority of investors (82 percent) credit their financial adviser with helping them achieve savings and sound investment habits.

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[24] John Y. Campbell, *Restoring Rational Choice: The Challenge of Consumer Finance*, Fourth Conference on Household Finance and Consumption, European Central Bank, December 2015. The study examined the situation in Canada, France, Germany, Italy, Netherlands, Spain, the USA and the UK.

[25] Mitchell Marsden, Cathleen D. Zick, Robert N. Mayer, *The Value of Seeking Financial Advice*, Journal of Family and Economic Issues 32, 4 (2001): 625-643.

[26] Natixis, *2016 Global Survey of Individual Investors*.

The Paper is dismissive of the proposition that trust acts as a behavioral constraining mechanism in a principal-agent relationship and of the role of disclosure, the most commonly prescribed remedy to mitigate the risks stemming from "conflicted" situations arguing that in certain circumstances, this "solution" may have perverse effects (p. 80). It cites research that suggest that people generally do not discount advice from biased advisers as much as they should, even when advisers' conflicts of interest are disclosed, and that disclosure may increase the bias in advice because – caveat emptor – it provides the advisers with the moral licence to engage in self-interested behaviour, thereby exacerbating biases.[27] However, the Paper fails to mention subsequent studies published in the same academic journal showing that other institutional factors, including sanctions, can effectively mitigate these effects of disclosure![28] In this regard, the Paper also fails to consider the role and influence of Canadian securities legislation and case law that impose a statutory duty on retail client advisers to deal fairly, honestly and in good faith with their clients. These statutory obligations impose on financial advisers and registered firms a duty of care, which is comprised of "know your product" and "know your client" obligations, along with fair and reasonable compensation. The duty of loyalty encompasses the disclosure of the terms and conditions of the relationship and material conflicts of interest and their resolution in a manner consistent with the interest of the customer. These obligations are detailed in securities regulations and the self-regulatory organizations' requirements, including the extension of the duty of loyalty to the client beyond the initial purchase, sale or recommendation of any security that is unique to Canada.[29]

The implicit message one draws from the Paper is that the trust individual investors place in their financial adviser needs to be considered with caution because it is likely that individual investors "do not know better", a classic case of cognitive dissonance. A recent survey of U.S. financial consumers designed to identify the factors that lead to paying for professional financial advice and the type of services purchased showed that financial consumers who pay for comprehensive financial advice are predominantly middle-aged, college educated, financially knowledgeable and wealthy.[30] The Paper reports similar results for Canada: the great majority of investment fund owning mid-market (66 percent) and affluent households (72 percent) used an adviser (p. 29). These facts are inconsistent with the argument that the level of trust observed through the surveys arises because financial consumers are naturally trusting and credulous toward their financial adviser. Moreover, there are indications that advised investors do terminate a financial advisory relationship when they feel a disconnect with their adviser and the advice they receive. Surveys of financial consumers who have terminated an advisory relationship cite investment performance as the primary factor (41 percent), followed closely by two more telling factors: (i) failing to understand their savings and investment goals (32 percent) and (ii) investment views that differ from their adviser's (30 percent).[31]

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27 Daylian M. Cain, George Loewenstein and Don A. Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interests*, The Journal of Legal Studies 34, 1 (January 2005): 1-25.

28 Bryan K. Church and Xi (Jason) Kuang, *Conflicts of Interest, Disclosure, and (Costly) Sanctions: Experimental Evidence,* The Journal of Legal Studies 38, 2 (June 2009).

29 The Investment Industry Regulatory Organization of Canada (IIROC) Rule 42.2 provides explicitly that: "The Approved Person must address all existing or potential material conflicts of interest between the Approved Person and the client in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients." The Mutual Fund Dealers Association of Canada (MFDA) Rule 2.1.4 is to the same effect.

30 Finke, Huston, and Winchester, *Financial Advice*; Jason West, *Financial adviser participation rate and low net worth investors*, Journal of Financial Services Marketing (2012).

31 Natixis, 2016 Global Survey of Individual Investors.

The high levels of confidence, satisfaction and trust expressed by "advised" investors are the relevant indicators of the value they ascribe to their relationship with a financial adviser. The role of trust in reducing the incidence of self-serving behaviours and, as demonstrated by recent research, that it acts as mediating factor in the relation, need to be explicitly recognized.[32] This also makes it imperative that constant care be taken to ensure that investors' trust in a competent and professional financial advice industry is not misplaced. It remains that the effectiveness of policies designed to "maintain standards of professionalism that inspire consumer confidence and build trust" does not depend on the disallowance of embedded commissions.

THE MOST LIKELY IMPACT OF A REGULATORY BAN ON EMBEDDED COMMISSIONS

The success of Canadian households in accumulating substantially more wealth despite the costs associated with the management of individual accounts with the assistance of a financial adviser is critical to the effectiveness of voluntary retirement savings programs and the long-term performance and resilience of the Canadian retirement income system. Given the empirical evidence that individual investors relying on the support of financial advisers are, on average, more successful than non-advised investors in accumulating and managing their financial assets, and that the socio-economic benefits stemming from broad access to formal advice sources are considerable, a key question arises: Under what conditions are the supply of and demand for regulated financial advice most likely to be socially optimal?

THE PECULIAR ECONOMIC NATURE OF FINANCIAL ADVICE

Investment advisory services differ from consumer goods and services because they are abstract and there exists an asymmetric information discrepancy between the buyer and the seller, who is deemed to be a subject matter expert, whereas consumers are unable to evaluate confidently, even after repeated purchases, the quality and the reasonableness of the cost of the professional services they obtain. Are good financial returns the result of luck or of investment savvy? How confident can an investor be in the explanation that inactivity was the best strategy since he cannot distinguish "actively doing nothing" from "failing to do something"? The uncertainty is about the value and the quality of the services. In economic terms, financial advice falls within the category of "credence goods." This characteristic is precisely the crux of the matter: the information costs to evaluate "credence goods" are always significantly higher than for search ("normal") goods, often unbearably high.

The "credence good" nature of financial advice has significant consequences for consumer behaviour and, consequently, on the suppliers, the financial intermediary firms and the financial advisers in their employ. Individuals with higher education and income, financially sophisticated and with larger amounts of financial assets, exhibit a much greater demand for advice from financial intermediaries — a rational outcome given that, as a rule, they tend to be more financially literate and sophisticated and for them, the opportunity cost of abstinence is much higher — whereas individuals who are non-financially literate and non-affluent are reluctant to

[32] This attribute is observed in Canada, the United States and in recent European studies. See for instance, *Understanding the relationship between bank-customer relations, financial advisory services and saving behavior*, Cecilia Hermansson, Centre for Banking and Finance, KTH Royal Institute of Technology, Stockholm, 2015; Carlander, A. and Johansson, L.O., *Trust as a strategy to cope with uncertainty in delegated portfolio management*, MINEO; Jim Engle-Warwick, Diego Pulido, Marine de Montaignac, *Trust Ambiguity and Financial Decision-Making*, CIRANO, August 2016.

seek financial advice.[33] Their attitude reflects the fact that non-affluent households tend to equate financial advice with financial risk, which they avoid because they fear it. They will resist paying upfront fees for financial advice because they do not understand what working with a financial adviser entails and they are unable to discern the benefits, which are abstract, delayed in time and with an uncertain outcome. Viewed from their perspective, paying upfront for financial advice is equivalent to "locking in" a sure loss since they just can't fathom the benefits. This loss aversion is compounded by the fact that financial planning involves a long-term time frame. Even though it is generally accurate, the warning "past performance does not guarantee future results" that accompanies mutual funds and similar financial products can hardly be considered an unabashed encouragement to incur the upfront cost. Consumer surveys confirm these observations.

A survey of Australian retail investors found that a substantial proportion were not prepared to pay for advice more than 10 per cent of the annual cost of providing the service and, if this was not possible, they would forgo the advice. The Australian Securities and Investments Commission (ASIC) reports that "a common attitude was that financial advice was too expensive when there were no guaranteed returns."[34] In the United Kingdom, studies seeking to understand financial consumers' decision-making behaviour conclude that they are most reluctant to pay upfront for advice.[35] Delmas-Marsalet had obtained similar results in France.[36] A study involving retail investors from eight European countries found that between 26 to 30 per cent of respondents were unwilling to pay upfront for advice.[37] In Canada, even though 94 per cent of Canadian mutual fund investors agreed that they trust their advisers to give them sound advice and 90 per cent agreed that they obtain better returns than they would if investing on their own,[38] only 16 per cent indicated that they would continue their relationship with their financial adviser if a shift to a fee-for-advice regime resulted in an upfront cost to them. The observed idiosyncrasies of individual investors are remarkably similar between countries, which suggest that they reflect innate human proclivities.

The fundamental issue is not that individual investors do not value financial advice; rather, it is the reluctance of a large segment of the retail market to pay for it upfront that needs to be addressed. In so doing, financial consumers may be much more rational than what they are given credit for: the quality of the information provided is shown to be enhanced when the compensation is contingent over time rather than paid concurrently with the transaction.[39] The bundling of mutual funds with financial advice through embedded and trailing fees addresses this consumer reaction by establishing proportionality between the price of advice and the duration of the service.

■ INVESTORS REVEALED PREFERENCES AND NEEDS

In his 1996 American Finance Association Presidential address, Martin Gruber sought to resolve the puzzle as to why "actively managed mutual funds have grown so fast, when their

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33 Finke, Huston, and Winchester, "Financial Advice."
34 ASIC, "Access to financial advice in Australia" (2010), 49.
35 James F. Devlin and Sally McKechnie, "Consumers and Financial Advice in the UK: A Research Agenda," Financial Services Research Forum, June 2006; Andrew Clare, "The Guidance Gap" (Cass Business School, January 2013).
36 J. Delmas-Marsalet, "Report on the Marketing of Financial Products for the French Government" (2005).
37 Chater, Huck and Inderst, "Consumer Decision-Making."
38 Pollara, "Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry," The Investment Funds Institute of Canada (2013), 5.
39 Joel S. Demski and David E.M. Sappington, "Delegated Expertise," *Journal of Accounting Research* 25, 1 (1987): 68-89.

performance on average has been inferior to that of index funds."[40] His conclusions based on the empirical evidence he assembled were that "investors in actively managed mutual funds may have been more rational than we have assumed." This "puzzle" has since been examined through many lenses with head-scratching conclusions.

The puzzle remains mysterious until it is accepted that although all investors value higher net portfolio returns, a large proportion seek both financial advice and portfolio returns and that they are willing, within reasonable limits, to trade-off after-fee returns and financial advice and services to achieve their overall objectives. The heterogeneity of investors' behaviour is manifest.[41] In 2012 in Canada, 66 percent of investment fund owning mid-market households and 72 percent of affluent households used an adviser (p. 29). In the United States, 82 percent of U.S. households owning mutual funds have a financial adviser; in Germany, roughly 80 percent of individual investors rely on financial advice for investment decisions. In addition to the revealed preference of investors in Canada and abroad to invest in mutual funds through advice channels, there exists ample anecdotal evidence to support the point. This is a global phenomenon which warrants respect.

In retail markets, search costs can be onerous, if not in monetary terms at least in time spent for the task. In investment matters, the magnitude of search costs is blown-up since investors are confronted with a huge universe of investment options that extends beyond the capabilities of any one financial analyst, let alone an individual investor. The large proportion of mid-market and affluent financial consumers that retain a financial adviser makes it clear that they attach value to the information search and consolidation provided by financial advisers and to the emotional benefits stemming from the satisfaction and security of having and following a savings and wealth accumulation plan and the mitigation of psychic costs, such as anxiety over investment performance or retirement preparedness. Although it is difficult to quantify the monetary value of the intangible benefits of financial advice, they are nevertheless of paramount personal and societal importance. Surveys in Canada and the United States consistently show that more than 70 percent of adults "stressed about money at least some of the time" and half of them acknowledge that their concerns for their financial situation distracts them at work, resulting in disengagement, a higher rate of absenteeism and a lack of productivity.[42]

Other studies indicate that having a financial adviser increases the probability of a respondent declaring confidence in achieving a comfortable retirement by more than 13 percent relative to non-advised respondents.[43] Employee surveys report similar results: those who engage with a financial adviser have a significantly higher overall sense of financial well-being and are more likely to experience positive emotions about their finances.[44] These results strongly suggest that financial advice yields significant benefits not only for the advised households but for society as a whole.

[40] Martin Gruber, *Another Puzzle : The Growth in Actively Managed Mutual Funds*, Journal of Finance, Vol. 51 (3), pp. 783-810.
[41] This is well demonstrated by the data presented in Part 4 of the Paper.
[42] *Stress in America*, American Psychological Association Survey, 2015.
[43] *Employee Financial Wellness and its Impact on Canadian Business*, Manulife, March 2016.
[44] *Financial Security : Mind the Gap*, Mercer, 2017.

Individual emotional state vis-à-vis one's financial situation

	Advice	No Advice
Informed	64%	39%
Relieved	52%	30%
Calm	60%	35%
Confident	61%	37%
Optimistic	63%	41%

Source: *TIAA 2016 Advice Matters Survey*, September 2016

THE IMPACT ON THE SUPPLY SIDE

The Paper suggest that competition in the "manufacturing" and "distribution" sectors of the Canadian fund industry is tame, unable to force the exit of sub-performance funds and exert effective pressure on price levels and practices.

The facts are that concentration and barriers to entry in the mutual fund industry have, to this date, being lower than in other sectors of the Canadian financial industry: investors can acquire mutual funds through several channels which are in robust competition, pricing within the industry is dispersed, market shares evolve over time, a strong indication that enough investors are sensitive to comparative returns net of fees to impact market positions. At the end of 2015, the financial planner/adviser channel "which had possessed the largest share of investment fund assets ten years ago, was still the second most important distribution channel at the end of 2015" (p. 33). This channel is comprised of the majority of independent mutual fund dealers and the one with the lowest participation of deposit-taker/insurer firms.

The Paper reports that in 2015, 78 percent of investment fund and fund wrap assets were held in deposit taker/insurance owned channels, a market share increase of 9 percent since 2005. Interestingly, the Paper does not appear to assign any influence to this high level of concentration, notably in the banking sector, on the pricing and remuneration practices in the fund industry it laments, choosing rather to blame embedded commissions as the main culprit. The Paper errs in its analysis; a ban on embedded commissions is most likely to compound the inefficiencies in the fund market and increase the cost of professional financial advice to retail consumers.

Another major development in the competitive landscape has been the introduction of exchange-traded funds (ETF) that are positioned as a direct substitute to mutual funds. Despite being touted in many fora as a superior savings vehicle with much lower financial intermediation costs, ETF's assets under management (AUM) represent less than 7.5 percent of the AUM managed by the Canadian mutual fund industry. This timid market penetration of ETFs in Canada corresponds to the shares of market observed at the global level and, therefore, cannot be attributed to the structure of the Canadian financial sector.

THE POLICY LEADS TO A SOCIETALLY INFERIOR INDUSTRY STRUCTURE

The typical industry response to the elimination of embedded commissions is a migration from a horizontal to a vertical industry structure dominated by a small number of firms that act as the distribution arm of the institution proprietary products. This is clearly what occurred in the United Kingdom where, following adoption of RDR, large asset managers and financial companies have expanded their direct sales forces and direct-to-financial-consumer offerings and actively promote their self-directed execution-only platforms. It is also important to note that the internalization of the sales force allows the "manufacturer" to continue the embedded commissions regime since the MiFID II Directive does not prevent financial advisers providing "tied" advice from receiving embedded commissions from the manufacturer.

The same development towards a vertical industry structure occurred through market forces in the United States. It is no coincidence that the large fund manufacturers in North America are at the forefront of the deployment of automated advisory services that provide retail investors (and financial advisers) with online access to investment advice at low cost.

The transformation of the financial advice industry from a horizontal to a vertical structure — from an environment where dealer firms and financial advisers have access to the financial products of several manufacturers to one where the industry is dominated by a small number of firms that act as the distribution arm of the institution's proprietary products — should be of particular concern to Canadian policy-makers for two major reasons.

Horizontal Structure	Vertical Structure
Promotes competition where strong financial product manufacturers compete to serve independent retail distributors.	In Canada, six banks control 90 percent of bank assets.
Diversity in the industry and access to several independent manufacturers exert pressure to: • enhance the range of choices available to financial advisers and their clients • improve the quality of the financial products/advice	A vertical setting: • limits the breadth of advice since financial advisers tend to recommend in-house products as a matter of course Empirical evidence suggests that funds sold through affiliated dealers perform worse.*
Better diversified portfolio.	Tendency to privilege bank deposits rather than higher yielding financial assets and encourage "reckless conservatism".

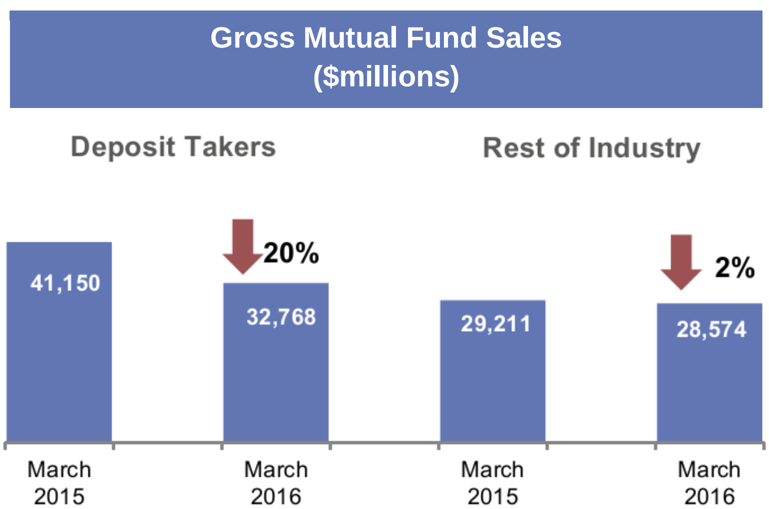
The first pertains to the breadth of advice provided in a captive setting. The Paper notes that "the majority of assets in the MFDA channel today are administered by dealers that focus on proprietary funds" (p. 35). In the branch network of deposit-taking institutions, fund distribution is solely that of proprietary funds. The evidence suggests that financial advisers at captive distribution firms are incentivized through several mechanisms to promote in-house products "regardless of the form of compensation."[45] Synovate finds that EU banks tend to recommend

[45] Edwin Weinstein, "Mutual Fund Fee Research" (The Brondesbury Group, 2015).

their proprietary products more than 80 per cent of the time.[46] A similar bias was documented in U.S. firms with proprietary funds.[47]

The second reason stems from the dysfunctional effects arising from a high level of concentration in an industry structured around a small number of vertically integrated financial organizations that manifest themselves through fund-flow patterns and fund-return performance.[48] In Canada, the process would accentuate the dominance of Canadian deposit-taking institutions. For the AMF in particular, one can only note the profound disconnect between its advocacy for a regulatory ban on embedded commissions and the consequences it would entail on the structure of the industry and its strategic orientation to "prioritize high impact initiatives for the growth and development of Québec's financial sector."[49]

A concentration of the funds industry around deposit-taking institutions would have far reaching consequences. Currently, one-third of financial wealth of Canadian households is held in deposits. Basel III incentivizes sales of daily interest accounts and GICs by deposit takers to manage capital requirements. This led to a disproportionate drop in bank mutual fund sales in the first quarter of 2016.



These results show that the assurances often repeated in the Paper that the CSA should be successful in reaching agreements with other Canadian regulators to avoid regulatory arbitrage between financial products and place IIROC and MFDA registered firms and representatives at a competitive disadvantage are of little comfort. The fact of the matter is that bank deposits and GICs issued by a chartered bank or by registered financial services cooperative are exempt from the application of most parts of securities law.[50] They also point to an important fact: the regulatory framework and financial performance pressures that apply on large financial corporations may lead to the implementation of internal policies that are not innocuous for

[46] Synovate, *Consumer Market Study on Advice Within the Area of Retail Investment Services* (European Commission, Director General Health and Consumer Protection, 2011).
[47] Michael A. Jones, Vance P. Lesseig and Thomas I. Smythe, "Financial advisers and multiple share class mutual funds," *Financial Services Review* 14, 1 (2015).
[48] Douglas Cummin, Sofia Johan, Yelin Zhang, op.cit., 2015.
[49] Autorité des marchés financiers, *2017-2020 Strategic Plan.*
[50] V-11, *Québec Securities Act*, art. 3.

financial consumers nor in their long-term best interest as evidenced by the table above. The Paper is silent on this important matter.

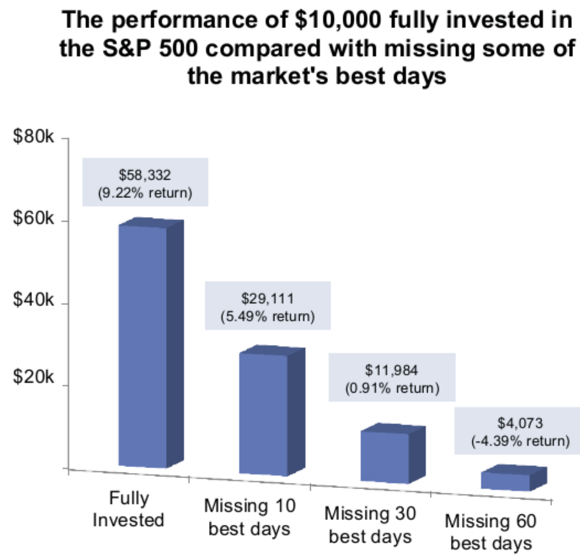
■ THE SOCIO-ECONOMIC CONSEQUENCES ON THE DEMAND SIDE

The "credence good" nature of financial advice incites a large proportion of financial consumers to shun the service. Deprived of the ability to use embedded commissions in their dealings with non-affluent households leads fund distribution firms to implement pricing policies calibrated to weed-out accounts that do not yield sufficient levels of continuous streams of revenues. The norm in the industry where embedded commissions have been discarded, either by regulatory fiat or market forces, is an AUM-based pricing model with a minimum asset threshold. It is estimated that in Canada this minimum asset threshold is about $150,000. In Canada, 80 percent of Canadian households own less than $100,000 in investable financial assets. It is noteworthy that 47 percent of them have an account with a financial advisor and that 69 percent of retail investors opened an account with a financial adviser when they had less than $50,000 in investible assets.

Canadian retail investor accounts per channel (2014)	
	Average Asset Value ($)
Canadian Banks	430,000
Small and mid-size mutual funds dealer	49,000
Branch-based mutual funds dealer	109,000
Independent full-service securities brokerages	169,000

Considering the average account value in the different channels shown above, it is difficult to believe that a ban on embedded commissions and the adoption of the AUM pricing regime that ensues will not "disfranchise" a large number of households. The most likely outcome is that, with a regulatory ban on embedded commissions, effective and practical options to access professional financial advice will be closed for a large number of middle-income households. Needing financial advice but lacking enough financial assets to make the provision of regulated financial advice an economic business proposition under a fee-for-advice or asset-under-management pricing model, they are most likely to be denied access to affordable financial advice and led to engage in financial transactions without the protections granted to investors dealing through a regulated financial adviser.

Left without professional financial advice, individual investors are prone to anchor decisions on known facts and make poor timing decisions. Empirical data suggest that poor timing decisions reduce annual returns by about 1.56 percent. [51] The response of U.S. individual investors to the 2007 recession differed significantly depending on whether or not they received professional financial advice and were impervious to their self-proclaimed financial knowledge. A study based on individual account data at a large independent financial services company found that: (i) an individual who paid for financial advice was 65 percent more likely to maintain long-term investment objectives, as measured by the decision to rebalance the portfolio but not moving into more of a cash position during the market downturn; and (ii) self-reported financial knowledge had little impact since only 5 percent of investors who were financially knowledgeable were more likely than those with low levels of financial knowledge to be prudent investor.[52] These findings are consistent with the results of a Canadian study that concludes that "sticking with an adviser induces more disciplined behavior during periods of market volatility."[53]



The bottom line is that "because investors are willing to tradeoff broker services and after-fee returns, it is welfare reducing to move investors with a revealed preference for interacting with brokers to lower-fee funds in the *direct* channel that lack these services and that it is not appropriate for a regulator to impose such an upheaval without an explicit legislative mandate."[54]

The assumptions contained in the Paper that the total cost of financial advice and financial products paid by retail investors will be reduced through the implementation of a ban on embedded commissions stretch credibility.

First, the suggestion that retail investors will be able to negotiate favorable pricing arrangements with their financial adviser because they now have detailed costing of the services rendered is unrealistic, except for very affluent individuals. Who believes that a retail investor with $150,000 in investable assets can bend the pricing grid established by a bank or an insurer or their affiliated broker/dealers? Supermarkets display the price of each product on their shelves; a very transparent market. This does not give consumers the power to negotiate prices at the check-out counter!

Second, industry-wide cost transparency is required to exert effective price competition and reduce price distortion. In retail markets, competitive pressure is exerted by the combined effect of consumers and competitors seemingly acting in concert in reaction to public information concerning the price and quality of services (or products) of a given firm. The supermarket

[51] G. Friesen, T. Saap (2007), *Mutual fund flows and investor returns: An empirical examination of fund investor timing ability,* Journal of Banking & Finance, 31(9), 2796-2816.

[52] Danielle D. Winchester, *Investor Prudence and the Role of Financial Advice in Three Essay on the Impact of Financial Advice*, Texas Tech University, May 2011.

[53] Claude Montmarquette, Nathalie Viennot-Briot, The Gamma Factor and the Value of Financial Advice, CIRANO, 2016s-35.

[54] Diane Del Guercio, Jonathan Reuter, Paula A. Tkac, *Broker Incentives and Mutual Fund Market Segmentation*, National Bureau of Economic Research, Working Paper 16312, August 2010.

industry is a case in point, as was recently demonstrated with the entry of Walmart. Similarly, in the financial advice market, "supply-side competition through commissions adds efficiency" that benefits financial consumers.[55] Comparability is a necessary condition for market efficiency.

In the United States, the unbundled fee-based model is the rule for about 80 per cent of the gross sales of mutual funds to retail accounts. Since U.S. dealer firms distributing mutual funds pursue different pricing strategies and tend not to disclose publicly the actual charges they demand from their customers, detailed fund distribution costs (and fees) are not widely available, except for the portion paid through a 12b-1 fee. As a result, accurate comparisons of total cost of ownership between financial intermediaries inaccessible to individual investors and competing firms. We find a similar situation in the U.K. The RDR post-implementation review indicates that the price for retail investment products has been falling whereas the cost of financial advice increased. However, the evolution of the total cost could not be determined: "The ranges in pre — and post — RDR estimates of platform, product and adviser payments, and the various ways in which these feature in different investments, means it is not yet clear whether declines in product and platform prices are more of less offset by increases in advice costs."[56]

The market dynamics unleashed by a structural shift that separates the provision of financial advice from the sale of financial products tend to benefit financial intermediaries at the expense of individual investors.[57] The lack of industry-wide transparency on the total cost of ownership lessens scrutiny on fees and the market pressure to keep costs within the bounds robust competition would allow. U.S. broker-dealers acknowledge that their revenues generated in commission-based platforms are lower than in a fee-for-advice platform that incites them to promote AUM-based-fee relationships. Strategic Insight concludes that "in total, the unbundling of fees has resulted in an increase in the total shareholder costs for many mutual fund investors — with such increases amplified due to tax considerations at times."[58] The finding of Investor Economics concerning the evolution of the cost of ownership of mutual funds in the United States confirms Strategic Insight's conclusion "that a move to unbundled fee-for-advice models has not resulted in a reduction of investor costs of mutual fund ownership."[59]

The same occurred in the United Kingdom following the adoption of regulations imposing the fee-for-advice regime on the financial industry. In 2014, the average revenue generated per financial adviser amounted to £107,166 compared to £90,197 in 2012 with a corresponding increase in pre-tax gross margin at financial adviser firms. This increase occurred even though the average number of clients per adviser has not changed. Average pre-tax profits of financial adviser firms are higher than what they had been in the years prior to 2013.[60] Market pricing is now blurred, rendering it very cumbersome — if not impossible — to make comparisons between firms.

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55 Roman Inderst and Marco Ottaviani, "Competition through Commissions and Kickbacks," *American Economic Review* 102, 2 (April 2012): 780-809.

56 Financial Conduct Authority (FCA), *Post-implementation review of the Retail Distribution Review — Phase 1* (December 2014).

57 Bolton, Freixas and Shapiro, "Conflicts of Interest."

58 Strategic Insight, "A Perspective," 5.

59 Investor Economics, "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canadian-U.S. Perspective, 2015 Update" (The Investment Funds Institute of Canada, 2015), 11.

60 APFA, *The Advice Market*.

The Paper acknowledges "that a transition to direct pay arrangements would reduce the transparency of dealer compensation costs as investors would have no benchmark to help them assess the reasonableness of the fees they are paying for advice" (p. 79). However, the suggestion that this issue will be dealt with after the ban on embedded commission is implemented will only ensure that, if ever an effective industry-wide cost disclosure mechanism is put in place, the higher cost to retail investors that is sure to follow the ban will become the new floor. The apparent disregard for the critical importance of industry-wide cost transparency as an essential condition to ensure the efficient working of markets is a matter of concern.

■ CONCLUSION AND POLICY IMPLICATIONS

The fundamental role of the financial-intermediation function is to facilitate savings and promote sound financial asset management. The evidence strongly suggests that the functioning of the Canadian retail financial fund and advice industry has so far yielded beneficial results for households obtaining the service, and for society as a whole.

Under the current remuneration arrangements, access to and affordability of financial advice is increased, the advised population is much larger than would otherwise be the case under other remuneration models, the propensity to save is increased and the accumulation of wealth is enhanced through better saving habits and investment practices. While market risks and the moral hazard inherent to the principal-agent relationship are real, non-participation in financial markets and poor investor savings practices and investment decision-making have much larger negative impact on household wealth accumulation and society, in general.

Accordingly, the regulation of retail financial advice should aim at:

- Promoting easy and affordable access to professional financial advice by individual investors on terms that meet their expressed preferences;
- Strengthening consumer protection through full cost disclosure and timely performance reports to individual clients;
- Encouraging competition within the industry and market efficiency through the promotion of industry-wide price transparency;
- Emphasizing the need to achieve and maintain high levels of trust with regards to the financial advice industry, a key determinant of the demand for professional financial advice.

In the Canadian environment there is no evidence that a regulatory ban on embedded commissions will:

- Bring about the desired change in behavior;
- Broaden access to financial advice;
- Reduce or contain the cost of financial advice and, more generally,
- Help Canadians accumulate more wealth than would be the case otherwise; and,
- Assist retirees make an efficient draw-down of their wealth.

If the policy is adopted, the reverse is almost sure to be the case.

Québec, le 5 juin 2017

Objet : consultation sur l'abandon possible des commissions

À qui de droit,

C'est en tant que cliente que je m'adresse à vous.

Suite à une discussion avec mon représentant en fonds mutuels, j'ai été très étonnée de l'objectif des autorités règlementaires d'abolir les commissions. On dit que les représentants sont en conflit d'intérêts!!!! Alors, on dit quoi des banques et de Desjardins? Qu'ils travaillent pour les clients? Avec tout ce qui sort dans les informations présentement et de la pression que les conseillers ont à l'interne pour vendre leurs produits??

Comme cliente, j'ai connu 2008, 2011 et malgré tout, j'obtiens des rendements nets (tout compris) de plus de 8% / année…je sais très bien que, pour mon représentant, son salaire dépend de son volume. Alors, je n'ai absolument aucun problème avec le fait qu'il reçoive 1% en commission de suivi parce que sans lui, je ne pourrais pas faire ces rendements. Et même si ça m'en avait coûté 4%, il m'en reste encore 8%... Ce n'est certainement pas avec Desjardins, à 0,75% que je réussirais à m'enrichir! Comme cliente, ce qui m'intéresse c'est de savoir combien j'ai mis, combien ça vaut et c'est quoi le rendement de mon portefeuille!

De plus, il m'a clairement expliqué la différence entre commissions intégrées et honoraires. Pour moi, ça va me coûter plus cher à honoraires puisque je devrai m'ouvrir un compte autogéré, frais que je n'ai pas pour le moment puisque je n'en ai pas besoin.

Donc, de grâce, pourquoi toucher à un modèle qui fonctionne extrêmement bien? Si je veux avoir un portefeuille à honoraires, c'est avec lui que je vais régler ça! Je pense que comme client, nous avons un devoir de nous informer. Ce n'est pas aux autorités de nous dire quoi faire ni comment le faire! À chaque fois que je le rencontre, il me fait signer mes mises à jour, s'assure que tout respecte mes objectifs. Je sais qu'il a également un département de conformité au bureau qui le surveille de très près.

Pensez-vous sincèrement que tout va se régler avec les honoraires? Je pense sérieusement que ça vient mettre en péril des clients comme moi, qui ont réussis à mettre quelques dollars de côté, sans avoir des centaines de milliers de dollars, mais qui avec les années et les rendements obtenus, réussiront à envoyer leurs enfants à l'université et prendront une retraite un peu plus confortable. Pour y arriver, j'ai besoin de mon conseiller. S'il n'est pas capable de gagner sa vie à honoraires, est-ce qu'il va rester comme conseiller? Je ne veux certainement pas devenir une cliente des banques!

Je suis vraiment inquiète de ce qui s'en vient.

Prenez le temps d'écouter les clients puisque c'est nous qui serons les premiers impactés par cette décision, c'est nous qui en ferons les frais…

Julie Roy

Plaidoyer en faveur d'un accès aux conseils financiers indépendants pour TOUS, pas seulement pour les plus nantis

Mémoire présenté aux
Autorités canadiennes en valeurs mobilières

En réponse à la consultation
81-408 sur l'option d'abandonner les commissions intégrées

Par Eric F. Gosselin,
Adm.A. Pl.Fin.

Juin 2017

À Mérédith et Sabrine, mes petits investisseurs, et à leur ami Mathieu qui débute en septembre ses études universitaires en services financiers.

Table des matières

Présentation de l'auteur

L'auteur pratique dans le domaine du conseil financier aux particuliers depuis 1991. Dès l'obtention de son baccalauréat en Sciences Économiques de l'Université de Sherbrooke, il est embauché par la CIBC dans le programme de développement des Directeurs de succursales (BMT, Branch Management Training) et des Directeurs de comptes commerciaux. Après 30 mois, fatigué de l'impératif commercial de vendre uniquement les produits de la banque, il quitte la CIBC pour fonder son cabinet de services financiers indépendant.

Avec une équipe de quatre personnes, il sert aujourd'hui plus de 400 familles qui lui ont confié quelques 115 millions de dollars en placements. Une douzaine de conseillers se sont affiliés à son cabinet au fil des ans, certains ayant depuis pris leur retraite.

Toujours actif dans la communauté, il est occasionnellement demandé comme conférencier, notamment au ***Congrès 2008 de l'assurance et de l'investissement*** de Montréal, pour parler de l'intégrité dans la pratique du conseiller ainsi qu'en octobre 2015, à Dallas, lors d'un rassemblement de conseillers financiers canadiens, pour parler de MRCC2 et de la migration de sa clientèle vers une pratique à honoraires.

Membre de *l'Ordre des administrateurs agréés du Québec* depuis 1994, il y a occupé bénévolement bon nombre de postes, dont celui de président par intérim de l'Ordre en 2008. Il vient de terminer un mandat de président du comité d'inspection professionnelle de cet ordre.

En 2010 il est finaliste pour le prix « Excellence » de la *Chambre de sécurité financière*. En 2014, le *Conseil interprofessionnel du Québec* lui décerne la « Médaille Mérite » pour son implication dans le système professionnel du Québec, une très haute distinction.

Il dessert sa clientèle avec dévotion depuis 1994 auprès de *Services en placements PEAK inc.*, le plus grand courtier indépendant en épargnes collectives au Canada.

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[1] AVIS : ***Les idées avancées dans le présent document, les recommandations et opinions, ne concernent que l'auteur, sans association de quelques manières possibles avec une organisation qui n'est pas signataire du présent document. L'auteur n'est pas lobbyiste et n'agit ni directement ni indirectement pour le compte d'un regroupement quelconque. Les termes « conseiller » et « client » désignent autant un homme ou une femme et sont utilisés dans le but d'alléger le texte.***[1]

Sommaire exécutif

C'est avec un vif intérêt que je vous écris aujourd'hui pour vous apporter des éléments de réflexion sur l'abolition des conflits d'intérêts dans le conseil en épargnes collectives. Je suis extrêmement reconnaissant d'avoir été invité, comme les autres intervenants du marché, à réfléchir sur l'avenir de l'accessibilité au conseil financier indépendant, et de présenter le résultat de cette réflexion aux distingués membres appelés à se pencher sur la problématique. Les conclusions serviront certainement à améliorer l'encadrement législatif et vont véritablement transformer l'avenir du conseil au Canada. Je vous remercie pour cette opportunité.

La société évolue et cela pousse le conseiller à s'adapter, à se réinventer et à améliorer l'offre de services tant au niveau de la qualité que de la diversité. La compétition, désormais apportée par les nouvelles technologies, force à réagir pour que l'investisseur trouve ce dont il a besoin, et ce, à coût raisonnable. Parallèlement, les différents scandales financiers tant à l'étranger qu'au Canada ont marqué l'imaginaire collectif. Conséquence positive s'il en est, ils ont généré une meilleure sensibilisation de l'investisseur face au questionnement qu'il devrait avoir sur son conseiller financier, à ses objectifs, à la nature des investissements et stratégies retenues, ainsi qu'aux coûts reliés à ses choix.

La compétition favorise la réduction des coûts et cette réduction fut observée au courant des dernières années et, de façon plus intense, au courant des derniers mois. Les grands gestionnaires ont par exemple amorcé des processus de réduction de frais de gestion, que ce soit en réduction généralisée ou avec des mécanismes plus ou moins automatiques. Les nouvelles normes de divulgation des informations financières ont commencé à modifier les comportements des gestionnaires, des conseillers et des investisseurs, généralement pour le mieux.

Évidemment, comme dans toute profession, certains intervenants persistent à avoir des comportements jugés répréhensibles, ce qui renforce le besoin de légiférer pour protéger l'investisseur vulnérable. C'est cette infime minorité de mauvais intervenants qui attire l'attention et génère la mauvaise perception que la majorité agit de la sorte. Déjà, en janvier 1995, Gloria Stromberg[2] publiait son rapport qui posa les premiers véritables jalons visant à mieux encadrer la distribution des fonds communs de placement. Articulées autour de deux grands axes, soit « information et connaissances » ainsi qu'« intégrité et équité », ses recommandations ont donné lieu à l'arrivée du règlement 81-105, un premier pas règlementaire dans la bonne direction. Un des nombreux changements qui furent palpables fut l'abolition des « concours de ventes », toujours malheureusement présents du côté des produits d'investissement distribués par les assureurs et dans certains réseaux de distribution privés ou dits exclusifs. Nous sommes maintenant prêts pour une véritable refonte de cet encadrement, qui devrait s'étendre à l'ensemble des intervenants distribuant

[2] Gloria STROMBERG, *Regulatory Strategies for the Mid-'90s, Recommendations for Regulating Investment Funds in Canada*, janvier 1995.

leurs produits financiers, que ce soit par l'entremise d'un réseau privé ou par le réseau des conseillers indépendants. Que l'on prenne le problème par un bout ou l'autre de la lorgnette, la base des comportements répréhensibles réside à mon avis, dans le conflit d'intérêts.

Le rehaussement des obligations des conseillers envers l'investisseur est nécessaire ; l'abolition des conflits d'intérêts et des apparences de conflits d'intérêts est primordiale.

Je présente donc aujourd'hui six recommandations qui visent à éliminer le conflit d'intérêts dans notre industrie, tout en assurant une accessibilité aux services-conseils et en favorisant le renouvellement de la relève chez les conseillers. Chaque recommandation sera élaborée plus en détails dans les pages qui suivent. Ces recommandations visent à offrir une solution aux problèmes soulevés par la consultation actuelle et aux questions proposées. Je répondrai également à certaines questions du document 81-408 intitulé ***« Document de consultation 81-408 des ACVM – Consultation sur l'option d'abandonner les commissions intégrées »*** publié le 10 janvier 2017, qui m'interpellent plus que d'autres et pour lesquelles je crois pouvoir faire avancer la réflexion.

Recommandation No. 1 : *Abolition immédiate des frais de rachat différés (DSC)*. Ce mode de rémunération des conseillers est l'un des éléments responsable de l'augmentation fulgurante des sommes investies dans les fonds communs de placement au courant des 30 dernières années. Il n'y a pas eu que des inconvénients à avoir ce type de rémunération. Les défenseurs diront, avec raison, que l'obligation de garder l'investissement à long terme pour éviter des pénalités de retrait prématuré a permis d'éduquer l'investisseur sur l'importance de conserver un investissement à long terme pour en cueillir les fruits. Pour les petits investisseurs, il a également permis d'accéder à des services financiers personnalisés sans payer directement les coûts reliés à ces services. Conservés à terme, les fonds n'exigent aucune commission à l'investisseur. C'est le conseiller qui, en bout de piste, renonce à une rémunération récurrente annuelle plus importante au profit d'une rémunération immédiate équivalente, une fois les flux actualisés. Les nouveaux investissements faits selon ce modèle représentent désormais un peu moins de 10 % de ce qui est investi. Maintenant que l'investisseur est conscient des choix de placements qui lui sont offerts, ce mode de rémunération peut être aboli.

Recommandation No. 2 : *Maintien des frais de rachat différés réduits (LL) sous certaines balises.* Représentant une évolution relativement récente de la structure de commissionnement de type DSC, ce mode de rémunération permet une rémunération adéquate en fonction du travail exécuté, à coût raisonnable pour le client. Comme pour les DSC, les fonds distribués selon la structure de LL ne génèrent aucune pénalité pour le client, qui conserve son investissement pour une durée de deux ou trois ans, et la rémunération récurrente annuelle du conseiller est diminuée pendant la même période. Conserver ce type de rémunération permet de maintenir une bonne accessibilité aux services-conseils pour le petit investisseur tout en assurant la relève chez les conseillers financiers. Le maintien devrait cependant être fait sous certaines balises, comme l'illégalité de distribution pour les portefeuilles d'une certaine taille ou à certains investisseurs, tels que les personnes âgées qui ont une fenêtre d'investissement potentiellement plus courte.

Recommandation No. 3: *Abolition du conflit d'intérêts par la transformation des commissions de suivi en honoraires de services uniformes.* Un conflit d'intérêts souvent décrié, mais que plusieurs, dont le rédacteur du présent mémoire, considèrent comme étant une apparence de conflit d'intérêts plus qu'un véritable conflit (j'y reviendrai), peut être simplement aboli. La disparition du conflit ne passe pas nécessairement par l'abolition pure et simple de la rémunération. Cet objectif peut être atteint en uniformisant la rémunération d'un type de fonds à l'autre. Cette rémunération est à tort considérée comme une commission, alors que ce n'est pas le cas. C'est une rémunération récurrente qui perdure, tant et aussi longtemps que le client est satisfait des services. Ce n'est pas la résultante d'un processus de vente, c'est celui d'un service continu de qualité. En le remplaçant officiellement par un honoraire uniforme, que l'investisseur ait besoin selon son profil, d'un fonds d'actions, d'un fonds équilibré, ou d'un fonds d'obligations, ce choix n'aura aucune influence sur la rémunération du conseiller qui se retrouve sans conflit d'intérêts à l'intérieur de l'univers de fonds communs de placement.

Recommandation No. 4 : *Augmenter la transparence pour une meilleure prise de décision de l'investisseur.* La mise en place du *Modèle de Relation Client-Conseiller – Phase 2* (MRCC2) est un bon début, mais en matière de transparence, du point de vue de l'investisseur, c'est loin d'être idéal. Comment peut-on prétendre être transparent quand la plupart des frais de gestion payés par l'investisseur ne lui sont pas divulgués ? Pourquoi le commissionnement versé aux courtiers et conseillers est le seul montant qui doit être connu des clients ? Est-ce moins noble que les frais de gestion des gestionnaires et des frais d'exploitation ? Si notre industrie veut cesser de s'attirer les foudres justifiées de certains médias et de certains défenseurs des investisseurs, il est temps que nous appliquions une transparence COMPLÈTE des frais encourus pour assurer la gestion et le conseil et pas seulement d'un seul des intervenants. Afin d'obtenir le coût de gestion, les différents frais et les commissions versées, le client a en ce moment accès à l'information, mais il doit travailler fort et parcourir trois rapports différents. Que ce soit auprès d'une institution de dépôt ou auprès d'un courtier, le client devrait avoir toute cette information regroupée minimalement sur le relevé annuel.

Recommandation No. 5 : *Étendre la transparence des coûts de gestion à l'ensemble des véhicules de placements au Canada.* Il ne devrait pas y avoir de place dans notre industrie pour un conseiller désirant se soustraire de l'obligation de divulgation des coûts de gestion. Se réfugier dans la distribution de produits d'investissements émis par les assureurs, par les banques, par les fonds de travailleurs, par les bourses d'études ou par les associations sociales, ne devrait pas se faire au détriment d'un manque de divulgation à l'investisseur. MRCC2, ou sa version évoluée MRCC3 ou 4, devrait s'étendre à l'ensemble des investissements, contrats d'investissements pour un but spécifique ou général, structure d'investissement, portefeuilles de fonds, gestion groupée, etc. Il n'y a pas de gratuité dans notre domaine et l'illusion de gratuité doit être bannie. L'obligation de divulgation de tous les frais de gestion doit s'étendre à l'ensemble des intervenants, qu'ils soient des institutions de dépôt, des groupes intégrés, des courtiers, des conseillers ou des gestionnaires indépendants. On ne peut pas se permettre d'avoir deux poids, deux mesures, et tous devraient avoir l'obligation de transparence intégrale en ce qui a trait aux coûts de gestion. L'investisseur mérite cette honnêteté.

Recommandation No. 6 : ***<u>Prévoir une période d'implantation raisonnable.</u>*** L'arrivée de MRCC2 est une véritable révolution et nous ne pourrons mesurer véritablement ses effets que dans plusieurs années. Par exemple, de gros joueurs de l'industrie ont annoncé publiquement au courant de la dernière année qu'ils bannissaient les DSC, et d'autres ont pris la même décision sans faire grand bruit. D'autres décisions récemment prises par des grands gestionnaires telles que l'abaissement unilatérale des frais de gestion m'apparaissent également directement liée à l'implantation de MRCC2. À l'exception de ma recommandation No. 1, laissons donc quelques années avant d'initier de nouvelles réformes sans que « la poussière ne soit retombée » après la dernière vague de règlementations. Il m'apparait qu'une période de cinq à sept ans est souhaitable. À ce moment, tous les échéanciers de rachat différés seront terminés, bon nombre des conseillers agissant sous l'ancien modèle auront pris leur retraite et la nouvelle garde, fonctionnant sous un modèle plus moderne, présentera moins de résistance au changement.

Au cours des prochaines pages, je reprends ces recommandations avec une élaboration étendue.

Introduction

Il n'y a malheureusement, à ce jour, aucun système économique fonctionnant parfaitement. Le système capitaliste, loin d'être parfait, est cependant celui qui fonctionne le mieux parmi ce qui a été testé. Pour le conseil financier, plusieurs structures de rémunérations du conseil existent et aucune étude n'a pu démontrer à ce jour qu'une structure plus qu'une autre garantit toute absence de conflits ou apparences de conflits d'intérêts. Faire un choix de structure unique peut donc avoir des effets négatifs importants pour certains investisseurs et, en voulant bien faire, le législateur pourrait bien créer des dommages collatéraux plus importants que la situation imparfaite actuelle. Il est cependant clair pour moi qu'éliminer un choix de rémunération du conseiller ne devrait pas être l'idéal pour l'investisseur. Le choix éclairé facilite la prise de décision. L'absence de choix créé de la frustration et de l'insatisfaction chez le consommateur comme chez l'investisseur.

Certes, il est possible d'ajuster la structure de rémunération des conseillers pour limiter la présence de conflits d'intérêts, et c'est ce que j'entends vous proposer ici.

« Celui qui ne sait pas d'où il vient ne peut savoir où il va.»[3] Cette citation nous invite à nous rappeler qu'auparavant, la gestion de patrimoine était l'affaire des grandes fortunes, les petits et moyens investisseurs n'avaient en aucune manière accès à la gestion professionnelle et active. L'apparition des fonds communs de placement à capital variable a littéralement démocratisé la gestion de patrimoine, permettant l'accès à une répartition d'actifs sophistiquée pour le petit investisseur, et ce, à moindres coûts.

Pour augmenter l'actif sous gestion, certains gestionnaires ont développé leur propre réseau de conseillers pour solliciter les investisseurs. Plusieurs études, notamment la « Mutual Funds Fees Research » du Brondesbury Group[4], ont démontré que cette pratique génère un biais important et, en l'absence d'une rémunération uniforme entre produits dits « propriétaires » et les alternatives, le conflit d'intérêts peut être important. Pour rejoindre les investisseurs, plusieurs autres gestionnaires ont mis en place une structure de commissionnement à l'achat ou au rachat. C'est cette dernière qui apporte le plus de confusion auprès des investisseurs, car elle ne se manifeste qu'en cas de vente avant une certaine période plus ou moins longue. C'est donc parfois avec surprise que les investisseurs constatent sa présence, lorsqu'un décaissement est réalisé, parfois obligatoirement pour faire face à un imprévu.

Démoniser les commissions est facile à faire mais représente un raccourci intellectuel discutable. Sans leur existence, nous sommes en droit de penser que la

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[3] Antonio Gramsci, philosophe italien, (1891-1937)

[4] Edwin WEINSTEIN, Brondesbury Group, *Mutual Fund Fees Research,* (printemps 2015). https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_engwr.pdf

croissance de ce type d'épargnes aurait été passablement moins importante qu'elle n'a été; le petit investisseur, loin d'être habitué à rémunérer pour les services conseils, éprouve moins de réticence à investir lorsque la rémunération du conseiller est prise en charge par la structure financière. Lorsque les prix et conséquences de l'encaissement prématuré d'un investissement sont clairement expliquées, la prise de décision, dès l'investissement initial, est plus facile.

Réponses aux questions de la consultation

Questionnement No 1 - Expérience des investisseurs (questions 15, 17 et 25 du document 81-408): *Quel effet l'abolition des commissions intégrées aurait-il sur l'expérience des investisseurs et les résultats qu'ils obtiennent, plus particulièrement : Quel effet l'option considérée aurait-elle sur le coût et l'étendue des conseils fournis à des segments particuliers d'investisseurs ?*

Pour répondre à cette question, il est essentiel de définir ce qu'est une « commission ». C'est la résultante d'un processus de vente. Elle se matérialise pour le vendeur, une fois la « vente conclue », lorsque le client a accepté les termes du contrat. Cette acceptation survient généralement après qu'il y ait eu présentation des qualités d'un produit ou d'un service, des raisons qui soutiennent la recommandation au client, et après avoir répondu aux questions du client souvent également après avoir présenté une argumentation de vente. La commission est donc le résultat d'un événement ponctuel : la relation entre le vendeur et son client, concernant un produit ou un service.

Pour les services financiers, la rémunération qui est versée au conseiller pour son travail sur une période donnée comme un mois ou une année n'a rien à voir avec une commission. Ce n'est pas le résultat d'un processus de vente, c'est une rémunération présente tant et aussi longtemps que le client est satisfait du travail exécuté. Ce type de rémunération peut être versé directement par le client ou être intégré aux frais de gestion perçus par les gestionnaires. Dans le premier cas, la rémunération est qualifiée d'« honoraires » alors que dans le deuxième cas, cela devient soudainement des « commissions ». D'ailleurs, nous sommes un peu victimes d'une traduction étrange, où l'appellation anglo-saxonne des « *trailing fees* » (frais de suivis) devient en français, des « commissions de suivi ». En anglais, ce sont des frais mais en français, ce sont des commissions. J'ai personnellement toujours décrit ces revenus à mes clients comme étant ma rémunération récurrente pour m'occuper d'eux et je les ai toujours appelés « honoraires de suivi » ce qui correspond plus à ce qu'ils sont réellement. Cette rémunération variera en fonction de la performance du portefeuille : plus celle-ci est bonne, plus la rémunération du conseiller augmente et *a contrario*, elle diminue. Cela aligne les objectifs de l'investisseur et de son conseiller, désirant tous les deux avoir un portefeuille performant.

L'élimination de la rémunération intégrée aurait quel effet sur les coûts et les services offerts à certains investisseurs ? Ce serait particulièrement désastreux pour le petit investisseur qui pourrait se voir refuser l'accès aux services-conseils ou devoir payer un prix disproportionnellement élevé par rapport à un investisseur avec un portefeuille beaucoup plus élevé. C'est d'ailleurs ce qui s'est produit au Royaume-Uni après l'implantation de la *Retail Distribution Review – Phase 1* alors que le nombre de courtiers exigeant un compte d'investissement de plus de £100 000 (175 000 $) a plus que doublé.[5]

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[5] HM Treasury & FCA, *FAMR – Financial Advice Market Review – Final report*, (mars 2016), p.19. https://www.fca.org.uk/publication/corporate/famr-final-report.pdf , (Page consultée le 31 mai 2017)

Dans la situation actuelle, il y a présence d'interfinancement des services par les investisseurs qui disposent d'un portefeuille imposant en faveur d'investisseurs moins fortunés. Cela s'apparente à une subvention pour assurer les services à une clientèle qui autrement, n'aurait pas les moyens de payer le coût réel du conseil financier. J'ai expliqué ce phénomène à mes clients depuis le début de ma pratique et je n'ai jamais reçu de critique, pas une seule fois. Les clients fortunés ont l'habitude de payer des impôts plus importants pour subventionner les services à la population ou de payer pour des services rendus à des membres de la famille qui n'en ont pas les moyens. Le service financier ne fait pas exception. Les conseillers acceptent dans leur clientèle les enfants ou les parents des clients fortunés compte tenu de la rémunération reçue pour la gestion du compte de ces derniers. Dans la collectivité des investisseurs d'un conseiller en particulier, cela assure que les détenteurs de « petits portefeuilles » recevront des services comparables aux investisseurs disposant de « grands portefeuilles ». C'est une forme de « payez au suivant ». La naissance des fonds communs de placement a créé cet interfinancement et a démocratisé la gestion privée autrefois réservée aux grandes fortunes.

L'élimination de la rémunération intégrée élimine l'interfinancement et pourrait donc résulter en une accessibilité réduite aux services professionnels pour les petits investisseurs, qui représentent 67 % des investisseurs canadiens[6]. Dans ma propre pratique, cette proportion est comparable. Le rapport Brondesbury abonde d'ailleurs dans le même sens : « …la fin des commissions présente le risque de créer deux catégories d'investisseurs, soit ceux qui peuvent se payer des services à honoraires, et ceux qui ne peuvent pas. »[7]

Qu'est-ce qu'un « petit portefeuille » ? Tout étant relatif, la réponse variera évidemment en fonction de l'évaluation que l'on fera de son propre portefeuille. Le montant de 100 000 $ est cependant généralement reconnu comme la frontière entre « petit » et « grand » portefeuille. Il est inquiétant de constater que chez certains courtiers appartenant à des banques, les conseillers qui servent leur clientèle dont le portefeuille est inférieur à 100 000 $ se voient pénalisés par la Direction du courtier ; le client paie pour les services mais le conseiller ne reçoit rien. Il est donc normal dans ce contexte que ces conseillers invitent ces clients à quitter sa clientèle. Dans le même groupe, certains courtiers « transfèrent » en succursale bancaire les clients ayant un portefeuille de moins de 250 000 $[8]. Les conseillers en succursale, ne disposant pas des mêmes ressources que leurs collègues œuvrant dans la division courtage, ne peuvent donc pas garantir la même qualité de services. Si l'on prend une facturation répandue de 1 % de l'actif sous gestion, on pourra donc comprendre que la rentabilité du service conseil pour la division de courtage se situe

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[6] Ipsos, *Service Canadian Financial Monitor*, 2012

[7] Jean-François PARENT, « La rémunération à commission crée des problèmes » dans CONSEILLER.CA, *Conseiller*, (25 juin 2015), http://www.conseiller.ca/nouvelles/la-remuneration-a-commission-cree-des-problemes-54198, (Page consultée le 31 mai 2017)

[8] Voir Annexes B et C pour des exemples parmi d'autres, le premier étant une lettre régulière d'avis de transfert, le deuxième étant une lettre recommandée annonçant la liquidation prochaine du compte, avec un impact fiscal (qui n'est pas souligné au client). Évidemment, la raison véritable n'est pas mentionnée au client. L'institution ne lui écrira jamais un commentaire du type « Étant donné que le solde de votre portefeuille est inférieur aux normes de notre entreprise… », il appert toutefois que c'est la raison véritable.

entre 1 000 $ et 2 500 $ par année. Le seuil de rentabilité pour un conseiller n'ayant pas les économies d'échelle du grand courtier doit donc être encore plus élevé. À elle seule, la comptabilité nécessaire pour facturer adéquatement l'investisseur coûte environ 200 $ annuellement par client. Ces coûts sont aujourd'hui assumés par les gestionnaires de portefeuille.

Le paiement pour le coût réel du service financier pour le petit investisseur deviendra donc prohibitif. Ces derniers risquent de devoir se résigner à prendre seuls leurs décisions ou à confier la gestion à une institution financière intégrée qui risque de privilégier les produits « maisons » au détriment des autres choix qui s'offrent présentement aux investisseurs. Cela ouvre par ailleurs la voie vers la tarification annuelle minimum fixe, qui devient disproportionnée dès que le portefeuille est trop « petit ».

L'objectif de vente fixé par l'employeur, un concept qui n'existe pas dans le monde des conseillers indépendants, demeure sans conteste la pire formule qui puisse exister pour mettre un conseiller en position de conflit d'intérêts.

En mars 2017, l'émission « ***Go Public*** » révélait que plus d'un millier d'employés et ex-employés bancaires lui avaient confié par écrit qu'ils subissaient, comme les employés du reportage initial diffusé le 6 mars, des pressions énormes pour vendre des produits de leurs employeurs, que les clients en aient besoin ou non. Certains conseillers ont déclaré qu'ils « …font n'importe quoi pour atteindre les objectifs déraisonnables… »[9], mentir par omission étant une tactique parmi d'autres. C'est une démonstration qu'il pourrait ne pas être dans le meilleur intérêt du petit investisseur de n'avoir autre choix que de confier leur patrimoine à une structure intégrée. Cela m'inquiète au plus haut point pour mes enfants, pour ma mère et pour tous les gens que je connais qui n'ont pas un portefeuille suffisant pour avoir le choix, si l'accès au conseil indépendant se tarit.

L'Institut des Fonds d'Investissement du Canada (IFIC) déclarait dans son communiqué du 30 juin 2016 que « des preuves de plus en plus nombreuses et solides en provenance du Royaume-Uni indiquent que l'abolition des commissions nuit aux investisseurs, car elle restreint l'accès aux conseils et entraîne une hausse des frais ».[10]

Les effets pour les petits investisseurs seraient donc importants, car l'accès aux services-conseils indépendants risque d'être fortement réduit ou les coûts de maintien des services risquent pour leur part, de connaître une augmentation substantielle. C'est un recul historique, un retour vers la gestion privée réservée à l'élite disposant d'importants capitaux.

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[9] Erica JOHNSON, « *'I will do anything I can to make my goal': TD teller says customers pay price for 'unrealistic' sales targets* » dans CBCNEWS, (6 mars 2017) http://www.cbc.ca/news/canada/british-columbia/td-tellers-desperate-to-meet-increasing-sales-goals-1.4006743, (Page consultée le 31 mai 2017)

[10] L'Institut des fonds d'investissement du Canada, « L'IFIC presse les organismes de réglementation à adopter une approche stratégique et fondée sur les faits à l'égard des réformes », (30 juin 2016) https://www.ific.ca/fr/news/ific-urges-regulators-to-adopt-a-strategic-fact-based-approach-to-reforms-french/, (Page consultée le 31 mai 2017)

Questionnement No 2. Risques d'arbitrages réglementaires (question 4.b du Document 81-408) : ***Quel serait le risque que des arbitrages réglementaires soient faits sur le marché dispensé si les commissions intégrées n'étaient abandonnées que pour les produits placés au moyen d'un prospectus ?***

Je suis d'avis que les risques sont très élevés que des conseillers désireux de conserver leurs revenus soient tentés de transférer leur portefeuille de fonds communs de placement dans une catégorie d'investissements où la réglementation est plus faible ou que la rémunération intégrée, directe ou indirecte, soit toujours présente. L'idée ici n'est pas de tenter d'éliminer la rémunération intégrée partout à la fois et de façon simultanée. Je doute qu'il soit possible d'atteindre cet objectif d'un coup. L'élimination de la rémunération intégrée dans les fonds communs de placement peut cependant créer des déplacements d'actifs qui ne sont pas à l'avantage du client.

Ces déplacements pourraient être en faveur des fonds distincts, offerts par les assureurs, où la conformité est minimale, la commission est similaire à l'actuelle rémunération des fonds communs de placement, et où la crainte d'un MRCC3 visant cette catégorie de placement n'est qu'un vague concept. J'ai malheureusement entendu plusieurs de mes collègues m'avouer qu'en réponse à MRCC2, ils travaillaient à convertir les portefeuilles de leur clientèle en fonds distincts, imaginez si les commissions intégrées disparaissent ! Les frais de gestion sont plus élevés pour les fonds distincts étant donné les spécificités du produit. C'est une augmentation d'environ 30 % des coûts payés par les clients. L'abolition de la rémunération intégrée générera une accélération de ce déplacement et la conséquence directe est une hausse des coûts de gestion pour les clients victimes de cet arbitrage réglementaire.

Ce type d'arbitrage pourrait se manifester également en faveur d'autres produits dont une rémunération est incluse à l'achat. La recommandation d'un type de placement pour un client ne devrait en aucune manière être la résultante de la présence ou non de commission. Je suis d'avis que l'abolition des commissions intégrées risque de générer ce genre de comportement de la part d'une certaine tranche de population des conseillers.

Questionnement No. 3 - Compensation de la perte d'un revenu stable pour les courtiers et représentants (question 24 du Document 81-408) : ***Les commissions intégrées, en particulier les commissions de suivis, procurent une source de revenus stables aux courtiers et aux représentants. Les mécanismes de rémunération directe compenseraient-ils la perte de ces revenus et les coûts associés à un tel changement ?***

Le questionnement No.1 met la table pour répondre au présent questionnement. Nous avons vu que certains clients verront une diminution de l'accès aux services ou que le coût de maintien des services s'en trouvera augmenté. Particulièrement pour les conseillers avec une pratique bien établie et importante, les mécanismes de rémunération directe, ou rémunération à honoraires, compenseraient à mon avis, la perte de la rémunération intégrée. Je crois que chaque conseiller réévaluera son modèle d'affaire et la clientèle desservie en appliquant le principe de Pareto[11]. Des choix difficiles devront être faits pour la survie de leur cabinet, telle qu'une réduction de clientèle pour assurer que les revenus de la clientèle fortunée couvrent adéquatement les frais fixes et variables des conseillers. Personnellement, j'ai 61 % de ma clientèle qui n'aurait pas les moyens de payer les coûts véritables des conseils, ce qui pourrait pour eux entrainer un arrêt de service résultant donc en une diminution des coûts d'exploitation de mon cabinet. Les coûts variables nécessaires pour servir la clientèle résiduelle étant forcément plus bas, la rémunération directe nette pourrait compenser et équivaloir les revenus nets actuels.

Cela se fera cependant au détriment des petits investisseurs qui devront quitter la pratique du conseiller.

Je considère avoir une clientèle de bonne taille et j'arriverai donc à modifier mon modèle d'affaire sans problème. Cette modification est d'ailleurs amorcée, car pratiquement toute ma clientèle « fortunée » est désormais sous le modèle à honoraires. Ce n'est malheureusement pas le cas de la plupart de mes collègues dont le portefeuille général moyen, selon plusieurs sources non-officielles, se situerait à environ 12 millions de dollars. Cela peut sonner le glas pour la carrière de ces conseillers et par conséquent, c'est l'ensemble de leurs clients qui devront se trouver un nouveau conseiller. Cela peut s'avérer être une tâche ardue si l'ensemble des conseillers « survivants » sont, durant la même période, dans un processus de « nettoyage » de leur propre clientèle.

D'ailleurs, selon une étude publiée en septembre 2016 par *Natixis Global Asset Management Canada*, au cours des trois prochaines années, 30 % des conseillers ont l'intention de radicalement changer en vendant leur volume d'affaires, en fusionnant avec une autre firme, en quittant le secteur financier entièrement ou en prenant leur retraite. Près d'un tiers (32 %) affirment qu'ils ne prendront plus de petits clients en raison des nouvelles réglementations.[12]

Rappelons que c'est ce qui s'est passé en Angleterre après l'élimination des commissions où ce sont plus de 23 % des conseillers qui auraient abandonné la pratique.[13]

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[11] Le principe de Pareto ([Vilfredo Pareto, (1848 – 1923)] René ROY, « Pareto statisticien : la distribution des revenus », *Revue d'économie politique*, vol. 59, 1949, p. 555-577) est un phénomène empirique constaté dans plusieurs domaines, le nôtre n'y échappant pas : 80 % des clients génèrent 20 % des revenus.
[12] Business Wire, rapportant l'étude de Natixis Global Asset Management Canada, (29 septembre 2016), http://www.businesswire.com/news/home/20160929006170/fr/, (Page consultée le 31 mai 2017)
[13] HM Treasury & FCA, *FAMR – Financial Advice Market Review – Final report*, (mars 2016), p.17-18. https://www.fca.org.uk/publication/corporate/famr-final-report.pdf , (Page consultée le 31 mai 2017) Ce chiffre est probablement inférieur à la réalité car il présente le nombre de conseillers à une date déterminée sans tenir compte de la moyenne des conseillers qui sortent annuellement de la profession et de la moyenne des conseillers qui y font leur entrée. Cela signifie donc que pour la période étudiée, le nombre de conseillers effectuant leur entrée dans la profession n'a pas été suffisant pour freiner la diminution nette du nombre de conseillers. Nous pouvons donc aisément conclure que la proportion des conseillers quittant la profession est bien plus élevée que le 23 % observé.

Questionnement No 4. Carrière des représentants (question 26 du Document 81-408) : ***Quelles répercussions la proposition aura-t-elle sur les représentants et conseillers, en particulier sur ce qui suit : Le cheminement de carrière, le profil type de la personne intéressée par la profession, le recrutement, l'attrait relatif d'une carrière dans les services financiers ? À quels autres modèles de rémunération les représentants débutant dans le métier pourraient-ils avoir recours si les commissions intégrées étaient abandonnées ?***

Je ne crois pas que le profil type de la personne intéressée par la profession varierait. Ce n'est pas le type de rémunération qui nous définit. Je suis d'avis cependant que l'abolition des commissions créera une barrière à l'entrée importante, ce qui diminue passablement l'attrait pour la carrière.

Le modèle actuel permet au nouveau conseiller d'obtenir des mandats importants de conseils, car sa rémunération provient de la structure plutôt que du client directement. Il est peu probable qu'un jeune conseiller (ou nouveau conseiller, sans rapport avec son âge) arrive, dans son début de pratique, à convaincre un investisseur aisé à lui confier sa fortune contre rémunération directe, en dépit du peu de mois d'expérience que le conseiller lui offre. Le modèle actuel permet à ce conseiller d'offrir une gestion active et professionnelle par l'utilisation de fonds communs de placement, sans que son manque d'expérience ne soit un handicap à la performance du portefeuille. Sa rémunération, de la vue de l'investisseur, devient alors secondaire parce qu'elle est intégrée dans les résultats totaux.

Le conseiller débutant pourrait n'avoir d'autre choix que de se tourner vers une rémunération salariale dans une institution financière. La barrière à l'entrée demeurant toujours aussi élevée, le conseiller risque de demeurer à l'emploi de l'institution de façon permanente. Cela risque de créer un manque de relève important chez les conseillers indépendants et leur apporter un stress important et inutile pour les clients.

Questionnement No 5. Recherches de solutions (questions 12, 13 et 18 du Document 81-408) : ***…la proposition d'abandonner les commissions intégrées répondrait-elle aux trois principaux enjeux de protection des investisseurs et d'efficience du marché…? Pour répondre à ces préoccupations, les ACVM pourraient-elles prendre d'autres mesures que l'abandon des commissions intégrées, conjointement ou séparément ?***

Il n'y a pas à ma connaissance de recherches démontrant que la rémunération directement versée au conseiller par l'investisseur rend le conseil exempt de conflit d'intérêts. Il n'y a donc pas d'indication que la simple abolition de la rémunération intégrée viendrait solutionner le problème. La solution est ailleurs.

L'abolition du conflit d'intérêts est un combat noble et je m'inscris sur la liste des combattants depuis le début de ma pratique. J'ai personnellement, pour des raisons financières familiales, réussi à faire passer ma rémunération au second plan, et je comprends que dans l'ensemble de notre industrie, tous n'ont pas cette chance. Il y a cependant des façons autres que l'abolition de la rémunération intégrée pour éliminer le conflit d'intérêts.

Un conflit d'intérêts souvent décrié, mais que plusieurs considèrent comme étant une apparence de conflit d'intérêts plus qu'un conflit véritable, peut être simplement aboli. Il s'agit de la disparité de rémunération de suivi que les gestionnaires versent en fonction de la catégorie de fonds (un fonds d'actions vs un fonds équilibré ou un fonds obligataire). Techniquement, il est donc plus payant pour un conseiller de recommander un fonds d'actions plutôt qu'un fonds équilibré, car sa rémunération s'en trouve augmentée. Cette apparence de conflit d'intérêts qui se transforme en véritable conflit pour certains, peut être facilement éliminée en uniformisant la rémunération d'un type de fonds à l'autre. En remplaçant officiellement les « commissions de suivi » par un « honoraire uniforme de suivi », que l'investisseur ait besoin selon son profil, d'un fonds d'actions, d'un fonds équilibré ou d'un fonds d'obligations, ce choix n'aura aucune influence sur la rémunération du conseiller qui se retrouve sans conflit d'intérêts, à l'intérieur de l'univers des fonds communs de placement.

Je recommande donc d'abolir le conflit d'intérêts généré par la disparité de la rémunération de suivi selon le type de fonds, pour le remplacer par un taux unique et uniforme d'honoraires de suivi.

Je crois cependant que certaines rémunérations intégrées pourraient être mieux réglementées sinon complètement éliminées. C'est le cas notamment des commissions sur rachat différé (DSC)[14]. Ce mode de rémunération des conseillers est l'un des éléments responsables de l'augmentation fulgurante des sommes investies dans les fonds communs de placement au courant des 30 dernières années. Conservés à terme, les fonds achetés sous cette formule n'exigent aucune commission à l'investisseur. C'est le conseiller qui, en bout de piste, renonce à une rémunération récurrente annuelle plus importante au profit d'une rémunération immédiate équivalente, une fois les flux actualisés.

Il n'y a pas eu que des inconvénients à avoir ce type de rémunération. Les défenseurs diront avec raison que l'obligation de garder l'investissement à long terme pour éviter des pénalités de retrait prématuré a permis d'éduquer l'investisseur sur l'importance de conserver un investissement à long terme pour en cueillir les fruits. Il a également permis aux petits investisseurs d'accéder à des services financiers personnalisés sans payer directement les coûts reliés à ces services.

Les différentes études utilisées par les *Autorités canadiennes en valeurs mobilières* (ACVM) tendant à démontrer un manque de concordance entre le prix (via la rémunération intégrée) payé et le service reçu, mais elles ne se penchent généralement que sur l'action de recommandation d'un fonds ou d'un ensemble de fonds alors que le travail du conseiller est bien plus élaboré.

[14] De l'anglais « Differed Sales Charges », on voit également l'acronyme FRD pour « Frais de Rachat différés ».

Selon le sondage de Pollara pour le compte de l'IFIC[15], deux tiers des répondants (65 %) affirment recevoir d'autres services comme des conseils de budget, de planification en vue d'achats ou d'événements importants. C'est même réducteur que de croire qu'il n'y a pas de concordance entre la rémunération du conseiller et les services fournis. La recommandation finale d'investissement est la conclusion d'un processus par lequel le conseiller :

- valide la compréhension de l'investisseur sur les formes d'investissements et le fonctionnement d'un fonds commun de placement;
- mesure le profil de l'investisseur;
- explique les différentes relations que le conseiller a avec les intervenants (courtiers, gestionnaires, etc.), la rémunération qu'il recevra, la façon de porter plainte, etc.;
- conçoit une répartition d'actifs répondant au profil établi;
- effectue des recherches pour sélectionner les gestionnaires les plus performants qui deviennent candidats à la gestion d'une partie ou de l'ensemble du portefeuille du client;
- revoit le client pour lui recommander les différents fonds et lui expliquer les raisons qui ont généré tel ou tel choix;
- rempli, suite à l'obtention de l'accord du client, la documentation entourant la conformité du processus, notamment en complétant une fiche client (un document qui peut facilement compter une demi-douzaine de pages), une ouverture de compte, des formulaires de transfert d'une institution à l'autre, des formulaires d'ordres d'achats et selon les cas, d'autres formulaires;
- s'assure du traitement des documents et de la conformité des investissements par rapport à ce qui a été prévu;
- s'assure que des accès web soient ouverts pour que le client puisse suivre ses placements;
- explique la documentation, les confirmations, les relevés et les autres documents relatifs au portefeuille.

Par ailleurs, l'interfinancement des interventions du conseiller par la distribution de produits d'investissement, permet :

- d'accompagner le client dans l'établissement d'un bilan financier et d'un budget;
- d'établir un diagnostic financier;
- de soulever les incongruences dans la gestion de ses affaires personnelles et d'établir des pistes de solutions;
- d'élaborer un plan d'action avec le client pour optimiser la situation financière, fiscale et légale;
- d'élaborer une planification de la retraite;

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[15] Pollara pour l'IFIC, *La perception des investisseurs canadiens quant aux fonds communs de placement et à l'industrie des fonds communs,* 2013, p.21. https://www.ific.ca/wp-content/uploads/2013/09/IFIC-Pollara-Investor-Survey-2013-FRENCH.pdf/4625/, (Page consultée le 31 mai 2017)

- de répondre aux questions du client face aux préoccupations qu'il peut avoir tout au long de l'année (il m'arrive de conseiller des clients sur le choix de location ou d'achat d'un véhicule);
- d'aider le client à relever certains défis de la vie, comme le financement des études, le mariage, la gestion financière du ménage dans le contexte de revenus fort différents, la prise ou non de la retraite, le divorce, la liquidation successorale d'un proche, etc.;
- d'effectuer un suivi du portefeuille de façon périodique;
- d'interagir avec les différents professionnels autour du client tels que les comptables, les notaires, les avocats, les fiscalistes, les courtiers d'assurances, etc.;
- d'assister le client dans la gestion de son régime complémentaire de pension le cas échéant;
- d'assister le client pour répondre à certaines demandes des autorités fiscales;
- et bien d'autres tâches nécessaires à l'accomplissement du mandat confié par le client.

Évidemment, dans cette liste non-exhaustive, nous pourrions ajouter l'énergie déployée :

- pour maintenir les connaissances du conseiller en assistant à des rencontres de gestionnaires;
- pour assurer une continuité du travail en cas de vacances ou de problèmes (maladie du conseiller, décès de celui-ci, incendie des locaux, etc.);
- pour offrir une équipe administrative de qualité;
- pour offrir un environnement de travail adéquat avec le client;
- pour respecter les obligations de conformité;
- etc.

L'investisseur qui n'a pas besoin de tels accompagnements peut faire ses choix d'investissement seul et procéder auprès de courtiers sans service en achetant des catégories de parts de fonds qui ne comportent pas de rémunération pour le conseil. À ce chapitre, la réglementation devrait être ajustée pour interdire à un courtier à escompte et sans conseil, le droit de distribuer des parts de fonds comportant une rémunération pour le service.

L'interfinancement est donc à deux niveaux dans notre domaine : entre les services offerts et les produits distribués d'une part et entre les investisseurs nantis et les autres. Cloisonner les services avec une rémunération en lien direct, ferait sans l'ombre d'un doute augmenter les coûts des services pour les petits investisseurs. L'investisseur nanti, généralement plus habile à négocier, utilisera de toute manière le poids de son portefeuille pour obtenir les services énumérés plus haut, sans payer à la carte, contrairement au petit investisseur qui n'a pas l'avantage dans la négociation de services. Cela se traduira, uniquement pour le petit investisseur, en une augmentation des frais pour obtenir les services dont il aura besoin.

Pour le petit investisseur, l'investissement dans les fonds communs de placement par l'entremise de parts de type DSC permet d'obtenir tous ces services, lorsque le besoin se manifeste.

À l'heure actuelle, ce mode de rémunération est de façon naturelle, en voie de disparition. Je l'ai personnellement abandonné pour n'utiliser que des parts à frais d'entrée (à frais d'acquisition, FA) dont les commissions sont établies à 0 %. Je ne facture aucune commission d'acquisition et me contente de l'honoraire de suivi pour mes clients, qui ne choisissent pas le mode de rémunération directe. Je ne facture aucune commission pour effectuer des transactions de modification de portefeuille. C'est une pratique largement répandue. D'ailleurs, un sondage non-exhaustif que j'ai mené auprès des différents gestionnaires impliqués dans les portefeuilles de mes clients m'a confirmé que je ne suis pas le seul à avoir pris ce tournant, puisque la proportion des nouveaux investissements dans les parts de type DSC ne représente même pas 10 % des nouveaux investissements en fonds communs de placements.

La plupart des courtiers appartenant à des banques ont interdit à leurs conseillers d'utiliser ce type de parts et des gestionnaires intégrés comme *Groupe Investors* et *SSQ* ont également supprimé ce type de parts, pour le remplacer par des parts versant des commissions au conseiller (comme le DSC régulier), mais avec une pénalité au conseiller si l'investisseur rachète avant l'échéancier établi. Cette dernière variation n'élimine cependant pas le conflit d'intérêts, car le conseiller pourrait être tenté de convaincre l'investisseur de ne pas faire de retrait (malgré une baisse des marchés ou pour rembourser une dette, par exemple), car le premier serait pénalisé.

Certains gestionnaires sans réseau captif de conseillers ont décidé récemment de ne plus offrir l'option DSC sur ses fonds, c'est le cas notamment de *Fonds Dynamique* et d'autres gestionnaires considèrent présentement cette option. Lorsqu'on se rappelle que cela ne représente pas 10 % de leurs nouvelles ventes, on comprend que la résistance au changement n'y est plus.

Les investisseurs sont bien mieux informés qu'il y a une trentaine d'année et sont maintenant plus conscients des choix de placements qui leur sont offert, ce mode de rémunération peut donc être aboli.

Je recommande donc l'abolition de l'émission de nouvelles parts à frais de rachats différés (DSC, FRD), immédiatement et sans qu'une période de transition ne soit établie pour cette abolition.

Une telle période de transition pourrait générer un « effet de course » où les conseillers qui ont déjà une propension à recommander ce type de fonds, pourraient « rouler » leur portefeuille pour générer une commission une dernière fois, et emprisonner leurs clients dans un échéancier de sept ans. Bien qu'on peut s'illusionner à l'effet que ce phénomène ne se produira pas, le risque est à mon avis loin d'être nul.

Les parts avec frais de rachats différés réduits (LL, FRR) représentent une évolution relativement récente de la structure de commissionnement de type DSC. Ce mode de rémunération permet une rémunération adéquate en fonction du travail exécuté, à coût raisonnable pour le client. Comme pour les DSC, les fonds distribués selon la structure de LL ne génèrent aucune pénalité pour le client qui conserve son investissement pour une durée de deux ou trois ans, et la rémunération récurrente annuelle du conseiller est diminuée pendant la même période.

Conserver ce type de rémunération permet de maintenir une bonne accessibilité aux services-conseils pour le petit investisseur et permet d'assurer la relève chez les conseillers financiers. Cela permet également, dans certains cas comme il m'est arrivé en mai dernier, de compenser une cliente pour les frais de liquidation d'un portefeuille d'investissement détenu chez un autre courtier. La cliente avait vu son compte être transféré dans une succursale bancaire parce que son portefeuille était passé sous la barre des 100 000 $.[16] Elle ne désirait pas cette situation qui lui était imposée par la firme de courtage et, en transférant le produit de la liquidation, avait eu à subir près de 2 000 $ de frais de courtage. Le rabais de commission nous permet de compenser les clients aux prises avec une situation semblable.

Évidemment, éliminer les DSC pour ne conserver que les LL représente à première vue une diminution de rémunération pour le conseiller, mais en réalité, il n'en est rien. Le versement d'une commission DSC et de la rémunération de suivi, 50 % inférieure à ce qui est versé pour des parts de type FA, est égale, une fois les flux actualisés, au versement d'une commission LL et de la rémunération de suivi qui double après l'échéancier de 2 ou 3 ans. Les parts de type LL, DSC ou FA sont tous intégrés dans la catégorie « A » des fonds, ce qui signifie que le coût pour le client investissant dans cette catégorie est le même qu'il choisisse un mode ou l'autre de rémunération du conseiller. À l'autre bout de la lorgnette, le conseiller, quel que soit le mode de rémunération intégré, touche en bout de piste le même montant. Il n'y a donc pas de raison de s'accrocher au mode de rémunération DSC, car les alternatives s'équivalent en ce qui a trait à la rémunération du conseiller.

La commission instantanée qui est versée au conseiller, particulièrement à ses débuts dans la pratique, contribue à assurer une relève dans le domaine en le rendant plus attrayant. En débutant dans la profession, le type de commission LL lui permet de vivre adéquatement tout en n'imposant pas au client un temps déraisonnable de détention. Pour le petit client, ce type de rémunération, qu'il n'a pas à verser directement, vient lui garantir un accès aux services connexes décrits plus haut. Au bout d'une période de 2 ou 3 ans, il n'y a plus de frais de rachat pour le client et la rémunération du conseiller revient à la normale.

Le maintien devrait cependant être fait sous certaines balises. Premièrement en uniformisant l'échéancier de rachat à 2 ans, on lance un message aux investisseurs qu'il est toujours préférable de maintenir ses investissements à « long terme ». Nous pourrions cependant limiter le droit d'investissement dans des parts à frais de rachat réduit aux investisseurs de moins de 70 ans, aux investisseurs de plus 30 ans et aux portefeuilles de moins de 100 000 $. Il faut s'assurer de protéger les investisseurs vulnérables qui peuvent

[16] Voir la lettre reproduite à l'Annexe A

avoir besoin de leur capital pour faire face à des besoins inévitables et immédiats, ou pour l'achat de leur première habitation.

Je recommande donc le maintien des frais de rachat différés réduits sous certaines balises, et de réglementer la période de rachat.

Préoccupations, répercussions possibles et conclusion

Si les ACVM décident d'aller de l'avant avec le projet réglementaire sur l'abandon des commissions intégrées, plusieurs préoccupations m'interpellent de manière importante.

Je l'ai mentionné à plusieurs reprises, tout comme plusieurs intervenants à ce jour, l'élimination de la rémunération intégrée risque de limiter l'accès aux services et d'augmenter les coûts pour les petits investisseurs. Déjà en 2013, l'IFIC signalait qu'aux États-Unis, le passage aux frais directs a entraîné une hausse des coûts pour de nombreux investisseurs.[17] Cela peut se traduire par une réduction du taux d'épargne des Canadiens. Déjà qu'avec une contribution annuelle moyenne au REER de moins de 3 000 $, nous ne pouvons croire que nous aurons une population de retraités bien nantis, si le taux d'épargne diminue, nous risquons de faire face collectivement à des défis sociaux importants.

Sous le prétexte d'une plus grande simplicité et d'une impression de gratuité du service, nous pourrions voir les ménages augmenter la concentration de leurs actifs auprès d'institutions de dépôt. D'ailleurs, Yves Bonneau, alors journaliste pour la revue *Conseiller*, déclarait dans son éditorial du 6 octobre 2016[18]: « *Il semble y avoir dans cette vision stratégique de l'encadrement un biais en faveur des grandes sociétés financières dicté par les lobbies, de même qu'un manque de respect pour le professionnalisme des conseillers.* ». C'est un sentiment largement répandu chez les conseillers indépendants. Si tel est le cas, à la lumière du reportage de ***Go Public*** qui a incité le gouvernement canadien à **ouvrir une enquête sur les pratiques commerciales trompeuses présumés des cinq plus grandes banques canadiennes**[19], nous ne pouvons être rassurés sur le sort des petits investisseurs après l'abolition de la rémunération intégrée. Considérant que la concentration des actifs au sein des banques canadiennes serait selon plusieurs à un niveau inégalé au monde, une augmentation de cette concentration ne peut pas être à l'avantage des investisseurs.

[17] Ronald McKENZIE, *« Fonds communs : les investisseurs préfèrent les frais intégrés Conseiller »* , dans CONSEILLER.CA, *Conseiller*, (1er octobre 2013), http://www.conseiller.ca/nouvelles/fonds-communs-les-investisseurs-preferent-les-frais-integres-43258,(Page consultée le 31 mai 2017)

[18] Yves BONNEAU, « *L'héritage des scandales financiers »,* dans CONSEILLER.CA*, Conseiller*, (6 octobre 2016) http://www.conseiller.ca/nouvelles/lheritage-des-scandales-financiers-60106,(Page consultée le 31 mai 2017)

[19] Formulation utilisée par l'agence France-Presse de Montréal pour annoncer la décision du gouvernement d'ouvrir une enquête. http://www.lapresse.ca/le-soleil/affaires/actualite-economique/201703/15/01-5078988-enquete-canadienne-sur-les-pratiques-des-banques.php,(Page consultée le 31 mai 2017) et http://www.journaldemontreal.com/2017/03/15/enquete-du-gouvernement-sur-les-pratiques-des-banques, (Page consultée le 31 mai 2017)

D'ailleurs, en avril dernier, dans le cadre d'une réduction de frais de gestion pour bon nombre de ses fonds communs de placement, la Banque TD en a profité pour dissimuler une augmentation de sa rentabilité en manipulant le ratio de frais de gestion au détriment des conseillers. [20] Sans réglementation sur les frais de gestion, ce genre de comportement préoccupant risque de se répéter.

<u>Je recommande donc d'augmenter la transparence pour une meilleure prise de décision de l'investisseur.</u> La mise en place de MRCC2 est un bon début, mais en matière de transparence, du point de vue de l'investisseur, c'est loin d'être idéal. Comment peut-on prétendre être transparent lorsque la plupart des frais de gestion payés par l'investisseur ne lui sont pas divulgués ? Pourquoi seul le commissionnement versé aux courtiers et conseillers est le montant qui doit être connu des clients ? Est-ce moins noble que les frais de gestion des gestionnaires et des frais d'exploitation ? Si notre industrie veut cesser de s'attirer les foudres justifiées de certains médias et de certains défenseurs des investisseurs, il est impératif que nous appliquions une transparence COMPLÈTE des frais encourus pour assurer la gestion et le conseil, pas seulement d'un seul des intervenants. Présentement, l'information est disponible, mais le client doit travailler fort et parcourir trois rapports différents pour obtenir le coût de gestion, les différents frais et les commissions versées. Que ce soit auprès d'une institution de dépôt ou auprès d'un courtier, le client devrait avoir toute cette information regroupée, minimalement sur son relevé annuel.

Par ailleurs, nous ne devrions pas accepter l'interprétation créative que fait certaines institutions financières. S'il est vrai que dans le total des frais de gestion d'un fonds il y a une partie pour les transactions du gestionnaire, une partie pour rémunérer le gestionnaire et une partie pour le conseiller, je n'arrive pas à croire que l'on accepte que lorsqu'il s'agit d'un fonds commun de placement bancaire, la même logique ne s'applique pas. On parlera alors ici d'une absence de commission en travestissant en « partage de frais de gestion », ce qui est une commission versée à la succursale qui donne le service. Il m'apparaît inacceptable qu'un versement de commission devienne un partage de frais pour une institution de dépôt afin de se soustraire au traitement réglementaire réservé à la rémunération intégrée.

L'abolition de la rémunération intégrée, au lieu de donner naissance à un encadrement de la rémunération du conseiller, ouvrira la porte à une véritable jungle où le client qui mal renseigné, ayant peu de pouvoir de négociation ou négligeant dans son obligation de comparaisons des options, sera face à un coût de gestion total[21] fort variable d'un conseiller à l'autre, pour le même bouquet de services. Nous pourrions par ailleurs assister à l'utilisation de forfaits de services groupés pour lequel le client paiera, sans toutefois tous les utiliser. Cela est comparable aux forfaits déraisonnables des distributeurs de signaux de télévision qui a forcé le CRTC à intervenir et à légiférer sur le service de base et les choix à la carte.

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[20] Didier BERT, « *TD : des gains sur le dos des conseillers ? »,* dans CONSEILLER.CA, *Conseiller*, (25 mai 2017) http://www.conseiller.ca/nouvelles/commissions-la-td-a-t-elle-hausse-sa-part-au-detriment-des-conseillers-62730?utm_source=EmailConseiller&utm_medium=email&utm_campaign=Breaking_News) ,(Page consultée le 31 mai 2017)

[21] Le coût de gestion total est la somme des frais de gestion, d'opérations, d'honoraires versés au conseiller et les taxes applicables.

Pour le conseiller incapable d'adapter sa pratique à cette nouvelle interdiction envisagée, le risque d'arbitrage est important. Nous pourrions observer un confinement des petits investisseurs dans les fonds distincts, car l'iniquité des règlements pourrait faire migrer les recommandations de certains conseillers vers les fonds distincts, ce qui se traduirait par une augmentation des coûts de gestion qui sont plus élevés dans les fonds distincts. ***Je recommande donc d'étendre la transparence des coûts de gestion à l'ensemble des véhicules de placements au Canada.*** Il ne devrait pas y avoir de place dans notre industrie pour un conseiller désireux de se soustraire de l'obligation de divulgation des coûts de gestion. Se réfugier dans la distribution de produits d'investissements émis par les assureurs, les banques, les fonds de travailleurs, les bourses d'études ou les associations sociales ne devrait pas se faire au détriment d'un manque de divulgation à l'investisseur. MRCC2, ou sa version évoluée MRCC3 ou 4, devrait s'étendre à l'ensemble des investissements, de contrats d'investissements pour un but spécifique ou général, de structure d'investissement, de portefeuilles de fonds, de gestion groupée, etc. On ne peut pas se permettre d'avoir deux poids, deux mesures, et tous devraient avoir l'obligation de transparence intégrale à ce qui a trait aux coûts de gestion. L'investisseur mérite cette honnêteté.

Le droit au libre choix

Nous vivons dans une société où le droit au libre choix est une valeur fondamentale. C'est le principe même de la démocratie, et la population chérit ce droit pour plusieurs services, que ce soit pour la santé, la scolarité de ses enfants, les politiciens qui la gouvernent et évidemment, la foule de fournisseurs de services, dont les institutions financières et les conseillers.

Plusieurs choisiront de confier leur avenir financier au soin des institutions de dépôt, nous l'avons vu par les études présentées dans le document de consultation 81-408, et un nombre en croissance d'investisseurs, choisissent les conseillers opérant à l'extérieur d'une structure intégrée.[22]

Je suis d'avis qu'on ne peut enlever ce droit aux investisseurs, particulièrement pour les moins nantis. L'abolition de la rémunération intégrée pourrait avoir comme conséquence, la disparition de ce choix. Les conseillers « survivants » pourraient augmenter la quantité d'actifs nécessaires pour pouvoir travailler avec les clients, ce qui laisserait certains investisseurs à l'écart, sans autre choix que de se réfugier auprès d'une institution de dépôt.

Présentement, le choix existe pour la rémunération du conseiller : une rémunération de suivi intégrée ou un paiement direct. J'ai personnellement une pratique à rémunération hybride, où une partie repose sur une rémunération directe et une partie sur une rémunération intégrée. D'ailleurs, la population est partagée sur la rémunération préférée,

[22] Investor Économics Household Balance Sheet 2016

si on se fie au sondage de Pollara conduit en 2013[23], qui a entre autre révélé que la majorité des Canadiens préfèrent les commissions aux honoraires. Ainsi, 51 % des épargnants préfèrent les frais intégrés aux placements, alors que 41 % préfèrent une rémunération directe. Je ne peux envisager comment la disparition de ce droit de choisir peut être perçue par le législateur comme une bonne chose.

Mis à part mes recommandations d'élimination des nouvelles parts souscrites sous le modèle DSC et le nivellement des honoraires de suivi intégrés aux frais de gestion, je suis d'avis que nous devrions laisser l'implantation de MRCC2 faire son œuvre avant de lancer une nouvelle vague de règlementations. L'arrivée de MRCC2 est une véritable révolution et nous ne pourrons mesurer véritablement ses effets que dans plusieurs années. Par exemple, de gros joueurs de l'industrie ont annoncé publiquement, au courant de la dernière année, qu'ils bannissaient les DSC, tandis que d'autres ont pris la même décision sans faire grand bruit. D'autres décisions récemment prises par des grands gestionnaires telles que l'abaissement unilatérale des frais de gestion m'apparaissent également directement liée à l'implantation de MRCC2. MRCC2 génère par ailleurs, une recherche d'information de la part des investisseurs, une guerre de prix des gestionnaires et un comportement plus sain des conseillers. Les impacts sont déjà palpables et nous ne pourrons voir avant plusieurs années l'étendue complète des effets générés, bons ou mauvais.

Je recommande donc d'attendre quelques années avant d'initier de nouvelles réformes sans que « la poussière ne soit retombée » après la dernière vague de règlementations. Il m'apparait qu'une période de cinq à sept ans serait souhaitable. À ce moment, tous les échéanciers de rachat différés seront terminés ; bon nombre des conseillers agissant sous l'ancien modèle auront pris leur retraite et la nouvelle garde, fonctionnant sous un modèle plus moderne, présentera moins de résistance au changement.

Si l'option d'abandon des commissions intégrées est retenue, je suis d'avis que nous pourrions dès maintenant éliminer les nouveaux DSC, conserver les LL sous certaines balises et possiblement avec pénalités au conseiller plutôt qu'au client en cas de rachat prématuré, tout en limitant l'interdiction aux nouveaux investissements. Les comptes actuels continueraient à comporter une rémunération intégrée alors que les nouveaux investissements pourraient s'effectuer sous le mode de rémunération directe. Ainsi, à l'intérieur d'une génération, nous aurons fait une transition en douceur, pour le bien des investisseurs et de la collectivité.

Comme le risque zéro, l'absence totale de conflits d'intérêts en matière de conseils financiers est une utopie. Au mieux, nous pouvons et devons être conscients de la présence du conflit d'intérêts, le déclarer au client et limiter les actions y menant. Augmentons les responsabilités des conseillers en la matière et légiférons pour qu'agir dans le meilleur intérêt du client ne soit pas qu'un simple concept philosophique et déontologique, mais bien une obligation légale. Obligeons tous les intervenants à déclarer l'ensemble des situations où il y a ne serait-ce qu'une apparence de conflit d'intérêts.

[23] Pollara pour l'IFIC, *La perception des investisseurs canadiens quant aux fonds communs de placement et à l'industrie des fonds communs,* 2013, p.33. https://www.ific.ca/wp-content/uploads/2013/09/IFIC-Pollara-Investor-Survey-2013-FRENCH.pdf/4625/, (Page consultée le 31 mai 2017)

Je l'ai recommandé plus haut, en nivelant les honoraires de suivi intégrés, nous éliminons presque totalement le conflit d'intérêts dans l'univers des fonds communs de placement.

Lorsque bien expliqués, les frais de gestion intégrés sont facilement acceptés par les investisseurs, petits et grands.[24]Une plus grande transparence, étendue à l'ensemble des intervenants, favorisera une meilleure littératie financière tel qu'il est souhaité par les gouvernements.

N'annihilons pas l'évolution réalisée par le petit investisseur au courant du dernier siècle, ne lui enlevons pas le droit de choisir avec qui il fait affaire et comment il le rémunère. Protégeons-le contre les comportements répréhensibles commis par les individus et par les entreprises. Informons-le adéquatement et totalement, en toute transparence.

L'abolition pure et simple du financement de ses services financiers par une rémunération intégrée aux frais de gestion lui enlèvera ses choix, le limitera dans ses actions et n'éliminera pas le conflit d'intérêts dont il peut être victime.

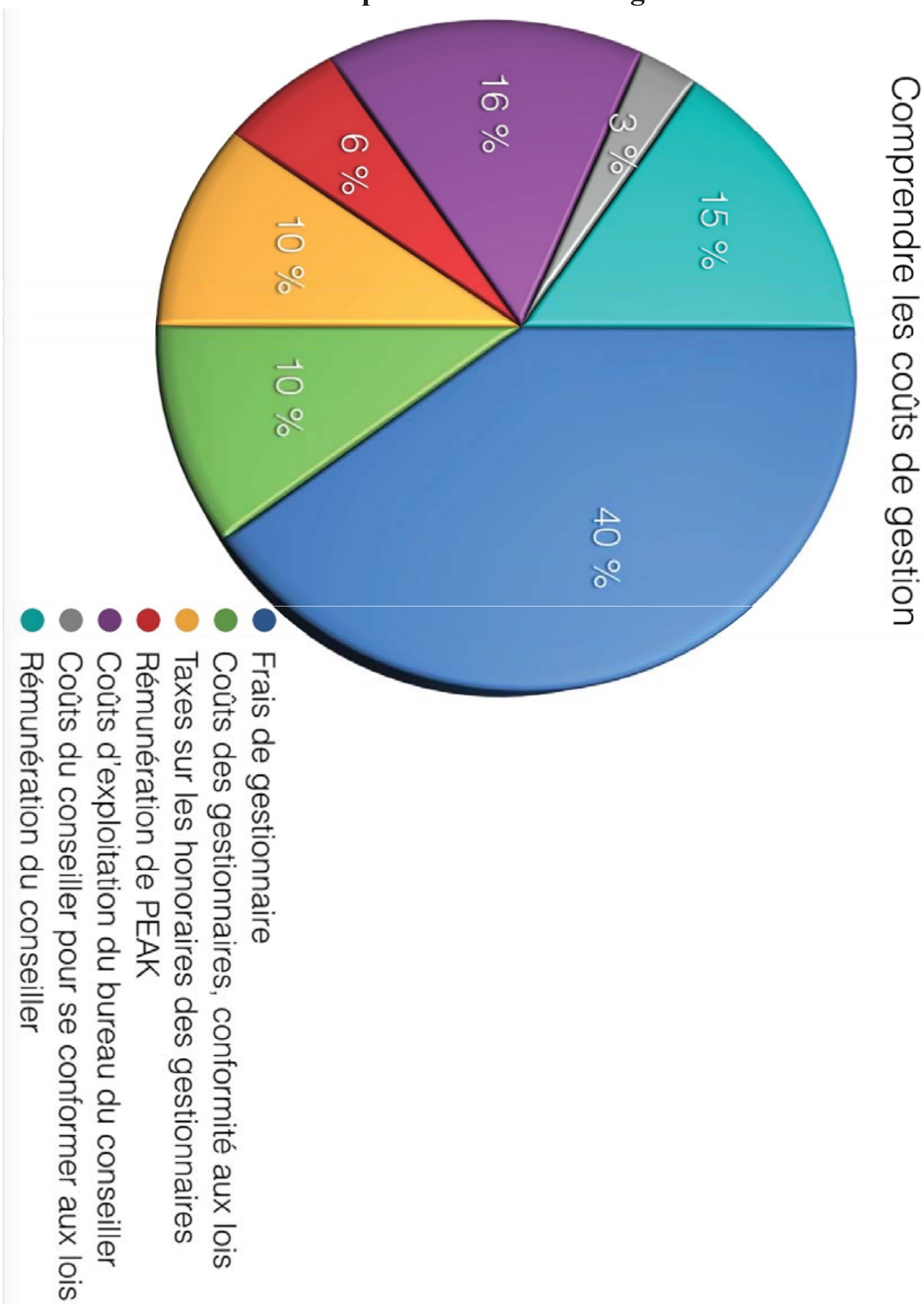
Nous sommes des professionnels responsables, nous avons entre autres la responsabilité de rendre accessible les services-conseils financiers à TOUS, pas seulement aux plus nantis de la société.

Eric F. Gosselin, Adm.A. Pl.Fin.
Administrateur agréé
Représentant en épargnes collectives inscrit auprès de Services en placement PEAK inc.
Conseiller en sécurité financière inscrit auprès de Services Financiers Eric F Gosselin inc.
Planificateur financier
Fils et père de petits investisseurs.

[24] Voir Annexe A

Annexe A

Comprendre les coûts de gestion



[25]

[25] Eric F. Gosselin, 2014

Annexe B

Lettre de transfert en succursale d'un compte devenu trop « petit » pour le courtier

Scotia Wealth Management™

ScotiaMcLeod®,
a division of Scotia Capital Inc.
95 St. Clair Avenue West
Suite 1400
Toronto, ON, M4V 1N6

Mai 23, 2017

[redacted]

Cher Ca[redacted]
Numéro de compte: **69[redacted]**

Nous souhaitons vous informer que nous avons confié votre compte aux bons soins d'une équipe dévouée de la succursale nationale qui continuera à répondre à vos besoins de placement.

Octave Tetiali, Nathaniel Brown et **Marie Noel**, votre nouvelle équipe de conseillers, sont impatients de vous servir. Ils communiqueront avec vous pour revoir vos objectifs de placement, votre tolérance au risque et discuter de votre portefeuille. Ils pourront alors vérifier que vos placements s'harmonisent avec vos objectifs financiers.

Soyez assuré(e) qu'aucune autre modification n'a été apportée à votre compte, à l'exception du changement de votre équipe de conseillers. Je vous invite à communiquer avec moi si vous avez des questions ou des inquiétudes concernant votre portefeuille, ou encore, si vous avez des transactions à effectuer, des changements d'adresse ou tout autre élément à nous signaler avant que nous prenions contact avec vous. Vous pouvez nous joindre au **1-877-388-6330.**

Vous êtes un client important pour nous. Nous sommes heureux de vous être utile et de continuer à vous aider à atteindre vos objectifs financiers.

Veuillez agréer, Madame / Monsieur, nos sincères salutations.

Sincerely,

Aaron Stoker
Branch Manager
National Branch
Aaron.Stoker@scotiawealth.com

Annexe C

Lettre de liquidation d'un compte devenu trop « petit » pour poursuivre les services

BLC
SERVICES FINANCIERS

Montréal, 16 mai 2017 **ACTION IMMÉDIATE REQUISE**

[redacted]

Objet : Fermeture de votre compte BLC Services financiers inc. - N°018[redacted]

Monsieur,

En juillet et septembre dernier, vous avez reçu deux lettres vous informant de changements importants concernant votre compte BLC Services financiers inc. (BLCSF). Le type de compte que vous détenez n'est plus disponible chez BLCSF puisqu'il ne vous permet pas de tirer profit de services complets en matière d'investissement. Dans les précédentes lettres, nous vous avons proposé de transférer votre compte vers notre fournisseur de services B2B Banque Services financiers inc. (B2BBSFI), à qui nous avons confié l'administration de l'ensemble de nos comptes d'investissement en novembre dernier.

Comme nous n'avons pas reçu de réponse de votre part, nous comprenons que cette option ne vous convient pas. Afin de régulariser la situation, nous vous demandons de bien vouloir signer le formulaire joint à la présente lettre afin de retirer les fonds que vous détenez dans ce compte et de procéder à la fermeture de ce dernier. Un chèque sera ensuite envoyé à l'adresse demandée.

Afin de nous permettre de traiter vos instructions, vous devez faire certifier votre signature par votre institution financière ou un commissaire à l'assermentation et nous retourner le formulaire dans l'enveloppe préaffranchie ci-jointe. Veuillez prendre note qu'il est de votre responsabilité de vous informer de l'impact fiscal de vos transactions.

Nous vous remercions de votre confiance et vous prions d'agréer, Monsieur, nos plus cordiales salutations.

La Direction de BLC Services financiers inc.

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Attention:
British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

June 6, 2017

I consider myself one of the good guys. As per page 95 of the CSA consultation paper, I am making this submission on my own behalf. This September I will have been working for a mutual fund dealer for exactly 20 years. I also have been licensed to do life and disability insurance for most of that time. I graduated from the University of Alberta with a B.Comm in finance prior to financial advising. When I started, my wife, who is a medical doctor, and I decided I would work at home. We knew this would mean less income for us but since I have been able to be there for our daughters since birth, it has been worth it. Presently, I drive our daughters to gymnastics and dance, two of my many many obligations to them.

This letter will explain how I have run my financial advising practice and to give you several alternatives to banning embedded commissions, which I consider an unnecessary action that will hurt the small investor. I find the CSA consultation paper deficient in many ways which I will explain in the context of your main issues regarding embedded compensation. I will also suggest several regulations that will ensure investor interests are aligned with adviser and fund manager interests.

Issue 1 of CSA consultation paper - Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.

I find the exact opposite in my practice. Since day one, I have always explained to each investor most of the information contained in the fund facts documents. I would sit with them and go through a prospectus (remember those) detailing how much I was paid, how DSC fees work, etc. Since I competed in the Olympics for curling, much of my client base comes from the curling community. I didn't want anyone to say I didn't disclose information about fees etc. I was very careful about this because a bad reputation would spread like wildfire in the curling network. I have always told my clients I will only deal with mutual funds and mutual fund companies that pay me exactly the same way and the vast majority do, so I have many options. When I buy a DSC fund, I have told clients I will only pick companies that pay 4.9% like Fidelity or 5% like

C.I. I have told them for every $1,000 invested this gives me $49 or $50. The difference is not enough to make me choose Fidelity over C.I. or vise versa or over anyone else. This means I will choose what is best for investors. This has given me an idea for a good regulation that will protect investors in this regard. Make the maximum DSC paid 5%. This way mutual fund companies can compete by reducing DSC but not increasing it. This will work for all forms of DSC. Another good regulation regarding DSC would be to put a maximum investment amount per household that can go into DSC. I have told my clients that once they invest $100,000, I will put all future purchases into FEL at no-load. This should be easy to maintain for compliance with our technology in databases. This is what makes it worthwhile to take the small investor. Also, I will only choose mutual fund companies that have a 6 or 7 year redemption fee schedule and the redemption fee has to be in line with the general practice in the industry. This leads to another good regulation. Since plenty of mutual fund companies have operated just fine on a 6 year schedule, make the maximum DSC schedule 6 years at the general market rate (to be determined) for redemption fees. You can find good average values for other load types, low load, etc. DSCs are far from perfect but at least an investor can get some money quickly in an emergency. Regulations such as these will only allow mutual fund companies to compete on performance which it should. Regulations SHOULD be there to take other incentives out of the hands of mutual fund companies to give to advisers. The focus on performance simply will align the goals of the mutual fund company, the adviser, and obviously, the investor.

One more thing: DSCs allow investors to put more into RRSPs which the small investor has trouble maximizing. I would rather put $10,000 in my RRSP and get a tax deduction on that amount rather than put $10,000 less my account fee in. RRSPs are not generally considered emergency money and therefore the DSC schedule is likely to get to 0% before the money is withdrawn especially after the majority of the portfolio is load free. That money gets withdrawn first.

This brings us to trailing commissions. When I started, the vast majority of trails, DSC and FEL, were about 0.5%. Of course that has changed to DSC at 0.5% and FEL to 1%. I have told my clients that I will only deal with mutual funds and fund companies that give a 1% trailer on FEL and 0.5% trailer on DSC. Again, a good regulation would be to make these amounts the maximum a mutual fund can pay so the mutual fund companies can compete on paying less but not more. One more note: I have told my clients that money market funds can pay less on the trailers and no DSC in some cases and these funds are generally seen as a short term investment with capital preservation so if they need this I can provide it. Other than the money market fund, I have told my clients from day one that no matter which mutual fund company I pick, fund company A, B. or C, I do not get paid any differently, I also do not get paid any differently no matter what risk level I pick. Therefore my only goal is to pick funds that will maximize client return for their individual risk level. If you use my suggested regulations, all advisers under this compensation model will act in this fashion. Fund managers will have no alternative but to make fund performance their top priority and advisers will migrate to the funds with proven fund managers.

One quick bit on the 10% free rule. I do this every year for my clients so they can have more load-free money in an emergency. The 10% free should not be a use it or lose it proposition but after 3 years you should have approximately 30% of your money available to you at no load.

This leads me to a discussion on mutual fund MERs. Being one of the good guys, I carry around the fund facts for the Brickburn Income Growth Class Fund. Its MER, as of April 30, 2014, is a whopping 6.11%. Wow!!! I show this to my clients because it lists my trailer fee as 1%. Again, I tell my clients I will only deal with funds that pay me the same trailer of 1%. Obviously, I would never pick this fund for a client. I tell them I look for funds that get as close as possible to a 2% MER and rarely go over a 2.5% MER, some managed ETF funds I buy are less than 2%. I am being the paid the same so why wouldn't I shop around for a lower MER? I want to keep my clients so I will do anything to increase the probability of good performance. There are plenty of excellent fund managers at this level so there is no need to go for a higher MER IF FUND FEES ARE TAKEN OUT OF THE ADVISER'S HANDS. The only thing that shocks me about Brickburn is they don't increase trails to advisers in an attempt to have advisers put their interests above the clients. With a MER over 6% they certainly should be able to afford that. If you put fees in adviser hands I think there will be more unethical adviser activity. Again, no matter which adviser compensation model you choose, there will be a small percentage of unethical advisers and clients will be taken advantage of. The best way to guard against this is the current MER with 1% trailer model and not allowing ANY additional fees (other than a small self direct fee) if someone purchases a mutual fund. This should be another regulation and will be the easiest way to seek out and remove the unethical advisers while putting client interests in line with ethical adviser interests. By the way, if MERs are generally in a 2% to 3% range, it is not from collusion or a lack of competition. There are many many mutual fund companies with thousands of funds. With low cost alternatives readily available, this is where fair competition puts MERs.

One extra thing to note about MERs. I have noticed that mutual funds, particularly at the banks, are generally at very similar levels to some funds I choose, many at around 2.5%. They are NOT paying trailers to anyone for these over the counter funds. Will removing trailers lower Bank MERs? That is doubtful. Perhaps a regulation that trailers can only be paid to advisers is in order. If a client purchases a fund, that I could provide, from a bank's discount brokerage, there isn't any advice given, why should the trailer be paid to the bank?

In conclusion, regarding issue 1 of the CSA consultation paper, this compensation model with the extra regulations I have suggested WILL align the interests of clients, advisers, and fund managers making portfolio performance everyone's primary concern.

Issue 2 of CSA consultation paper - Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.

My clients are fully aware of how MER's work. I tell them if they got 10% in a mutual fund and the fund's MER is 2.5% then the fund manager got 12.5% return on the fund of which 1% goes to my mutual fund dealer and after they take out my overhead, I get the remainder. Also, again, from issue 1, I tell them if I get a DSC and what the DSC schedule is. Again, these get paid to my mutual fund dealer and after my overhead, the remainder comes to me. After the disclosure on the amount paid to my mutual fund dealer, I don't see how you can make investors any MORE aware of dealer compensation. After this knowledge, with the numerous other investment types such as ETFs, robo advisers, fee for service advisers, etc, etc, we have to ask ourselves why do investors stay with an adviser that has embedded commissions? ETFs like Bank of Montreal's S&P/TSX ETF has a 0.05% MER, practically free. ETF mutual funds have been around for over 20 years and ETFs are constantly advertised in the media so is it possible that investors haven't heard of them? The answer is of course no and, in the information age, anyone looking for understanding of compensation models can readily find it. Before I started working for a mutual fund dealer over 20 years ago, Altimara Investments, a mutual fund company, had a S&P index mutual fund with a 0.5% MER, very low. All the Banks have ETF mutual funds with very low MERs that you can buy over the counter so again, why would clients stay with an adviser that has embedded fees? The answer is simple, investors go where they think they will get the most return. In the information age with all the media advertising about alternatives, I refuse to believe they are unaware of the alternatives to embedded commissions and I refuse to believe they do not care enough about their savings to at least look into this issue.

In conclusion, regarding issue 2 of the CSA consultation paper, embedded commissions do NOT limit investor awareness, understanding and control of dealer compensation costs.

Issue 3 of CSA consultation paper - Embedded commissions paid generally do not align with the services provided to investors.

In my practice, I have clients that call me very often to very rarely. I call them all periodically but I obviously cannot force them to call me back. The clients that call me often get very good value for their embedded commissions. The clients that call me rarely have the right to call me as often as they want. They choose not to. So, why don't they leave and go to a compensation model that would benefit them? As stated in issue 2, I refuse to believe they are unaware of the compensation alternatives. In my opinion, they must believe I will get the maximum return for their portfolio and they must be satisfied with their portfolio knowledge or they would call me. Otherwise, why would they stay? Why wouldn't they pick up the phone and call me? Again, I refuse to believe they simply don't care enough about their investments to bother to pick up the phone. Canada is a free country, they CHOOSE not to call me back. If they believe they are getting the most return for their portfolio from me should the CSA force them to go to an alternative compensation model? Does the CSA believe investors lack the intelligence to move on their own and therefore have to force them to change? Again, in the information age, with all the alternatives available, the answer is obviously no.

In conclusion, regarding issue 3 of CSA consultation paper - Embedded commissions paid generally DO align with the services provided to investors.

On page 5 and again toward the end of the consultation paper the CSA stresses "We emphasize that we have not made a decision to discontinue embedded commissions." There are a few reasons why I feel like the decision to ban embedded commissions has already been made and we are simply going through the motions of consultation. On page 6 of the consultation paper, the CSA claim that they consider Canada to be a different market and "the potential impacts from similar reforms in Canada might not be the same." That certainly seems like a stretch. How can you prove that? "Might" not be the same? That sounds like lawyer speak to me. Change the regulation and HOPE for the best? Are statements in the consultation paper, like on page 98, "can lead to under performance" and on page 101 "may negatively affect investors" the type of language to support this argument? Also, I didn't see any references to studies that say, in the U.K., the small investor has been hurt other than on page 141 of the paper where it says there are "Higher advice costs for some". How many is some? Again, very vague. As we all know, there will be studies that agree with this conclusion and studies that disagree with this conclusion. The CSA has chosen to quote studies that support banning embedded commissions. Has the decision already been made? If so, this displays a liberal elite, nanny state attitude at the CSA. This is the way I view FAIR Canada. They seem to think they are protecting people who can't protect themselves. Again, as I have said previously, it assumes investors do not have the intelligence to make their own decisions so the nanny state must regulate on their behalf. As an investor, I find this assumption insulting. As previously stated, with alternative compensation models readily available during the information age, it simply doesn't stand.

One more note: I talked to another adviser that said if his wealthier clients want cuts to their fees he will increase fees to his less wealthy clients. He refuses to take a pay cut. This seems like one unintended consequence of banning embedded compensation. The small investor will end up paying more and if they can't afford it, they will be on their own. Wealthy people will always pay fees, lots of them, and there will always be unethical advisers that figure out how to work around the rules no matter which compensation structure you choose. Further to that, in the consultation paper, page 120, it says "Fee-based option not a true choice for everyone". As an adviser, if the ban does come into effect, I will be forced to stop working in this industry because I will not believe the CSA cares about the small investor or small adviser and are only interested in regulation for the sake of regulation. You will have lost one of the good guys. The CSA is supposed to make decisions on behalf of all its stakeholders, including investors and advisers. If not, then who are they working for? Bans lead to unintended consequences. Proper regulation of all the current forms of compensation is the correct way forward.

Thank you for your consideration.

Sincerely,
Dan.

Dan Petryk
Financial Advisor
Global Maxfin Investments Inc.

The Moral Case
(and thus practical case)
For Embedded Compensation In Mutual Funds

One individual's response to CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

David McGruer
Ottawa
June 2017

The contents and opinions expressed in this submission are my own. In no way should they be construed to be those of any individuals, businesses, associations or organizations I am affiliated with. Any inconsistencies or errors are mine and mine alone. I'm just a guy writing this without compensation and without the hundreds of millions of annual budgets spent by regulators. I write in the faint but still real hope that one day such arguments will no longer be needed because a society based on reason will have developed.

Along the way the reader will find several short comments that are in bold face with a line above and below. These are not excerpts from the text but rather are side commentary on the subject being discussed, designed to prompt further thought outside the main line of thinking. I hope they are not too distracting and that readers find them interesting and valuable. I have bold faced some other portions that I believe will help readers identify key statements and refer back to them more readily.

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Introduction

After reading CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions I felt dismayed at the great harm that would be inflicted upon Canadians if this initiative was implemented and disappointed that securities regulators, who are charged above all with *protecting* Canadian investors, would be the ones *infringing their rights*, in direct opposition to the fundamental mandate given to them by the elected representatives of the people.

I expect the CSA will receive other professional-quality submissions (Advocis, IFIC, fund companies, etc.) that address the numerous questions posed in the Consultation in great detail and demonstrate how factual technical, economic and practical information contradicts the default position the CSA has taken in proposing a ban on embedded compensation. With their far greater resources, I cannot duplicate the quality of their work and instead have chosen to focus on the most important area of discussion - the area avoided at all costs by the CSA and unfortunately by almost all submission writers - the subject of morality.

I intend to demonstrate the morality of embedded compensation in mutual funds by critiquing the CSA Consultation Paper from five critical perspectives.

1. I will examine the CSA's assumptions about what is the proper standard of the good. On this it is very important to be very clear and explicit.
2. I will consider whether the CSA places ethical issues in their full context in order to gain a full understanding of the meaning and impacts of a ban on embedded commissions. I will carefully look at a few of the the clear positives and supposed negatives of embedded commissions.
3. I will discuss how information provided by experts should be used properly. I will examine both content and method of research reports that have been used to justify the CSA position on embedded compensation.
4. I will examine a few of the fallacies used to make the case the CSA seems determined to support.
5. I will summarize the big picture.

1 - What is our standard of the good?

Is the very popular use of embedded compensation in mutual funds and other investment products a fundamentally moral choice or an immoral choice? To answer this question, we need to be clear on our standard of value—our metric of good and bad—in investment regulatory issues. I find that the CSA position that embedded compensation in mutual funds should be banned is fundamentally a moral argument and one that is wholly incorrect. This response will demonstrate why this is so and provide a fully moral alternative position the CSA should take on this question and all similar ones.

The CSA paper refers to embedded compensation as "a compensation model with inherent conflicts of interest", with the emphasis on conflict of interest clearly indicating the CSA sees this as a moral/ethical problem. The online legal dictionary defines a conflict of interest as "*the situation in which a public official or fiduciary who, contrary to the obligation and absolute duty to act for the benefit of the public or a designated individual, exploits the relationship for personal benefit, typically pecuniary.*" http://legal-dictionary.thefreedictionary.com

The key terms used in this definition are "*act for the benefit of*" and "*exploits..for personal benefit*." I believe it is safe to assume that a financial advisor's highest purpose is to act for the benefit of the client. As the CIRANO study ("*advised savers received net median returns that were about 3% points higher than non-advised participants*") and others demonstrate, advised clients are currently far, far better off in the long run than non-advised clients, so it is clear advisors are already broadly acting for the benefit of clients and the benefit is large and robust. The question prompted by the CSA paper then might be whether the advisor is acting in the interest of the client while exploiting the relationship at the same time? For "exploit" to be applicable, we need to look at what this term means, and Wikipedia says it is "*to take advantage of something (a person, situation, etc.) for one's own end, especially unethically or unjustifiably*." The word exploit would thus not apply to situations where there is an economic exchange of value for mutual benefit where the terms of the exchange are clear to both participants. Such exchanges are by definition just, not unjust, and win-win. Under a political system that properly protects individual rights (the moral meaning of justice) almost all economic activity is of this type since fraud is illegal and is prosecuted and punished.

An advisor's value proposition

Now let's examine the moral position of a financial advisor who offers the following value proposition to prospective clients.

- The advisor's functions are (a) setting and quantifying a goal, creating a plan, which, at historical returns, would realize the goal, and funding the plan with an appropriate portfolio (about twenty percent of his value proposition); and (b), behavioural coaching at times of pronounced emotional stress, when the client is at greatest risk of making The Big Mistake of turning a temporary decline into an investment loss by selling investments during a decline (about eighty percent of his value proposition).

- The advisor does not charge for selection and timing because he cannot deliver these consistently - no one can - and because relative investment performance is totally irrelevant to long term, real life financial outcomes. Above all, *"outperformance" is not a financial goal*.

- The **advisor's fee is approximately one percent per year of assets under administration**. This covers the costs of the services provided to the advisor by the investment dealer, the costs of running the physical office location and - most importantly - the personal advice you receive from the advisor. This fee may be embedded in investment products like mutual funds or charged separately to the client's account, but the advisor finds the embedded option far more economical and believes it also fosters better client behaviours.

In this example the advisor is making a clear value proposal to the client and stating a clear amount of compensation, with alternative mechanisms for that compensation, one of which is embedded and the other billed to the client account. Note in this case that the management fee of a mutual fund the advisor uses is public and always has been, is disclosed through multiple clear sources, the client knows exactly how he pays the advisor and has agreed to it regardless of the mechanism chosen. The advisor may well wish to use the embedded mechanism for its vastly superior economy and lower cost to the client, ease of use, resulting cleaner client statements, client behavioural benefits and other reasons - see more on this below. The client may disagree with either the amount or method of compensation and thus no exchange takes place and the client seeks another advisor to agree with his terms. Unless both client and advisor agree, no transaction takes place and both the client and the advisor's right to choose has been respected. As I said, this is the very definition of a win-win free market transaction.

Government-run schools have done a remarkably successful job of graduating financial illiterates who are uniquely un-prepared for the real world. What percentage of high school grads who get their first job are required to complete an income tax return without the the least clue about the nature, structure and reasoning behind the income tax system? Do they know anything about mortgages and debt, life and disability insurance, economics, finance, education funding, budgeting, investments, retirement planning, powers of attorney and estate planning? Into this breach steps the financial advisor, charged with overcoming the abject failure of the educational system to prepare students for real-world financial issues.

Now back to morality. Under a political system that protects the rights of its citizens, the economic exchange illustrated above is perfectly moral because it is voluntary - it is freely chosen by both parties involved. Now imagine a third party comes along, sees this arrangement, then states that the arrangement may produce sub-optimal results, there may be a conflict of interest and such an exchange of values should be banned by law. Whose opinion will determine what is optimal and whether there may be a conflict of interests? The two people actually involved in the agreement or someone who is unknown to those people and they will never even meet? Who will decide to forbid the two parties from coming to an agreement and by what means will the ban be enforced? What threats will be used to discourage such trades, what police force will take action against those who might agree with each other and trade anyways and what punishments will be forced upon those who dare to make such an agreement?

This is all to highlight the title of this section - the standard of the good when it comes to a compensation mechanism. Is the moral standard a) whatever a third party such as an agency of the government arbitrarily says it is; or b) what freely acting parties agree is a mutually beneficial transaction? I believe **the proper moral standard is the one that leads to maximum human flourishing, meaning it allows for the maximum use of individual reason, decision-making and choice in economic activity**. This does not mean that every choice will be optimal according to someone's scale, it means that it allows for maximum options to be available and the most opportunity for people to think and choose in the absence of coercion.

The vague, morally-charged statements like "embedded compensation is an outdated model" or "Canadian mutual fund fees are the highest in the world" are an attempt to put something over on you. Check their premises.

Free to choose

A system that uses force to limit or even impose a total ban on free choice to trade is by definition immoral, unethical and should be condemned by all members of a civilized society. Presently, about 85% of mutual fund assets are in funds using the embedded compensation model, making this **the most popular form of advisor compensation ever devised**, by far and the only form of compensation that provides affordable, accessible financial advice to middle and low income Canadians on a large scale. So why do those who pretend to speak for these Canadians hold a position so completely opposite to the self-evident preference of those same Canadians? Further, in The Gamma Factor and the Value of Financial Advice by Claude Montmarquette and Nathalie Viennot-Briot the researchers found that more than 85% of households with a financial advisor chose their advisor and were not approached by one. Here I must again emphasize the crucial element of individual consumer choice - from among the wide range of compensation models available on the market, the vast majority of consumers have chosen advisors using embedded compensation. Ask yourself - does anyone have the moral right to forbid the free choice of consumers and the advisors who serve them? Does a group of people have this right? A large group? A majority of voting citizens? Their government officials? I don't think so.

The 5% per year embedded service fee!

Advancing a proposition to its extreme logical conclusion is often helpful in illustrating its correctness. Let's take the example of embedded compensation to an extreme: imagine a mutual fund company set up funds that allowed the advisor to select any amount of service fee the advisor desired, and an advisor set up a business and offered his services onto the market for 5% of assets under management per year - a 5% embedded service fee!. The advisor will certainly have to try to make a case to prospective clients that his advice is worth the 5% but since a free market is a competitive one, it is highly likely all clients would choose from one of the many advisors willing to work for less than 5% per year - heck, the client can find an online discount brokerage to buy EFTs that have almost zero compensation in their structure. It is only by allowing for all such business models to be offered on the marketplace that clients can sift through the options and choose the model that meets their preference. Notice that there are zero, and never have been, any mutual fund companies that allow such an option within their funds. Why? Because the fund companies rationally understand that competitive pressures make this a non-viable choice in the eyes of consumers and that the value of their reputation would be severely harmed, if not destroyed if they did so. Thus, creating such a model would be irrational and non-economic. Preferred models come to dominate the market and other advisors see this and adapt accordingly. **This is exactly how markets work and how the price signal works to make markets the most moral and most efficient mechanism for value creation possible: competition to find clients who agree with the advisor drive pricing to optimal levels**. By optimal I don't mean zero or

5% or any specific number, I mean the levels chosen and ever-changing by freely acting people in their roles and consumers and producers of advice.

The fully moral system of financial advice

So what is the full moral system I promised to disclose at the start of this section? It is one where people who make it their business to assess investment and business practice standards evaluate investment products and financial advisors and stake their reputation, and thus business success, on the accuracy of their judgement. It is also one where the government vigorously prosecutes and punishes fraud in its various forms. For example, if a professional association grants a designation to an advisor and the advisor is found to be not living up to the standard, then the designation may be revoked and the advisor's reputation and business impaired. Such an association may have insurance that compensates clients in case of the illegal or incompetent work of a member advisor. An advisor may have insurance that protects clients in case of certain negative occurrences. Government has an objective and robust court system that investigates claims of fraud so clients know the legal system backs them and is reliable. This system would have presently unknown but no doubt numerous options provided to consumers. Above all, buyers of advice would be fully free to choose among the variety of business models offered by freely acting advisors and fund companies would be free to design whatever products are chosen by consumers and their advisors. **Everyone's rights would be protected and none would be violated, especially by agencies of the state that are charged with protecting them**.

2 - What is the full and proper context?

The option for embedded compensation is of tremendous value in increasing both the supply and demand for financial advice and thus for the creation of life-enhancing wealth in our society. The possibility of a minor potential conflict of interest is a small side effect in the production of this great good. The CSA paper only lightly acknowledges the great social value of financial advice but places great emphasis on the small potential side effect. This is like proposing to ban vaccines because studies prove there are some side effects that are in truth very minor for the vast majority of people while ignoring the fantastic value in enhancing the flourishing of human life.

First, consider the fact that comprehensive, well designed, carefully reported and groundbreaking studies such as The Gamma Factor and the Value of Financial Advice by Claude Montmarquette and Nathalie Viennot-Briot are given only brief attention in the CSA discussion paper. This study, as illustrated in Figure 1 on the next page, shows that:

> In 2014, the impact of having a financial advisor took effect as soon as four years: for comparable households, the one with a financial advisor gains 69% more value for its investment assets. The additional value reaches 290% for a household with an advisor for 15 years or more (3.9 times the value of assets of the equivalent non-advised household).

INCLUDES COMMENT LETTERS

This is an enormous creation of value! *After* the fees paid to advisors and for whatever products were used, the long-term advised client has about *quadruple* the financial assets! Imagine the wealth of a country where everyone had a financial advisor - the wealth of the society, the advances in science, medicine, the arts, technology and culture that would be possible. It would be like advancing the progress of the society by decades, with benefits for all the members of society, especially those least able to care for themselves.

What is the equivalent gain in the rate of return for advised investors?

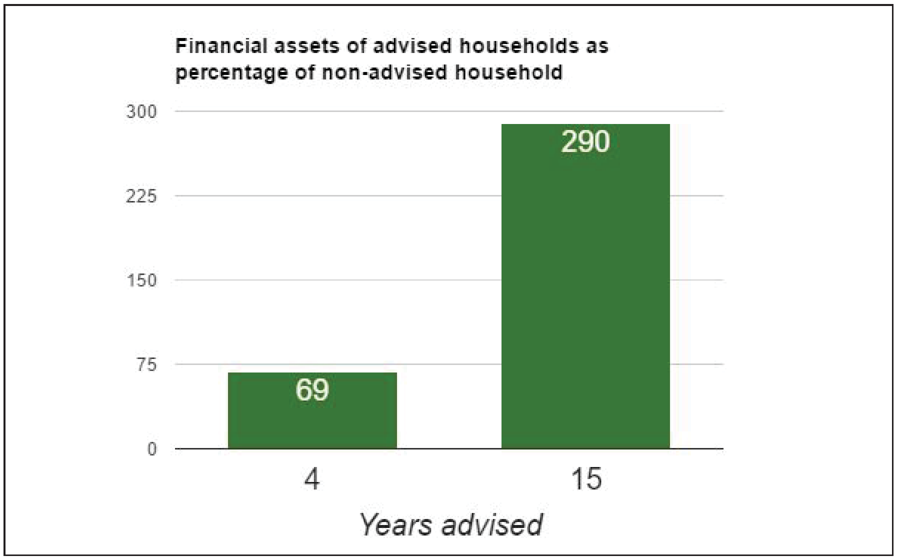
Although the authors of the study refer to other research showing an equivalent of 3% or more and do not show us a similar calculation based on their own data, it is possible to do this using the formula for the future value of money. Montmarquette & Viennot-Briot identified that after 15 years the advised households have accumulated 3.9 times the financial assets compared to non-advised households. Table 1 below shows how I have done this calculation and it finds the rate of return equivalent for advice to be 9.5%.

Table 1. Long term value of advice calculation		
Present Value	PV	100
Future Value	FV	390
Number of time periods	n	15
Rate of return	i	9.5%
FV=PV(1+i)^n		
i=((FV/PV)^1/n) -1		

Anyone who says "mutual fund service fees reduce client returns" is also saying "financial advice is a pure negative value for clients."

While one can argue the significance and method of doing such a calculation, I use it simply as one way of demonstrating that the value of financial advice is large- and again, note that this is calculated <u>after</u> all mutual fund fees and advisory fees have been deducted, so it is a net gain to the client. **I have long believed that my clients' gains from my advice are multiples of what they pay me and that I could never charge them anywhere near as much as the value I create**, and this study confirms my belief with careful measurements.

Figure 1. The financial assets of advised households versus non-advised households.



Source: The Gamma Factor and the Value of Financial Advice by Claude Montmarquette and Nathalie Viennot-Briot, 2016

The true public good

You see, just as energy is the industry that powers all other industries and civilization, finance is the sector that manages the allocation of capital to the best people and the best ideas that provide the very foundation of modern human life. Just as energy is the equivalent of calories in the human body and the power grid is like the blood vessels in our bodies, finance is the equivalent of the neural network that controls circulation. Good financial management makes all other human values more possible or even enables their creation in the first place. **The provision of good financial advice is of immeasurable value to society**. How do you measure the difference between a society that has vaccines and laser surgery and one that does not, one that has electronic communications and one that does not, one that has powerful machines to do work for us and one that does not. All of these and everything else is facilitated by finance - it is the communications and directions that connect the impossibly complex network of supply and demand for everything we produce and consume.

The fact is that financial advisors don't take inexpensive products and make them expensive, they take financially uneducated and emotion-driven prospective clients and turn them into better stewards of wealth who are better protected from financial disasters.

Consider the potential damage to society if the rights of citizens are violated by banning the embedded compensation option for financial products. Never mind the fact that the ban is immoral as shown above, what about the economic damage and the wealth destroyed or never created because the supply of financial advice was reduced and/or the demand for such advice was reduced. In fact, because multiple options are available for compensating advisors right now, we know that banning one type of compensation can only lead to a **decrease in demand for advice**, since it is impossible that every single consumer who preferred embedded compensation before will switch over to un-bundled compensation. And what of the supply of advice? For many reasons, under a system of reduced choice there will be fewer advisors who will target a smaller number of wealthier clients, so the **supply of advice will decline**. What of the price of advice? When the most popular and economical form of compensation is banned, do you think the price of advice will go up or down? Right… **the price of advice** will go up..

Why don't regulators leap for joy to learn that advised investors have long term financial security that is hundreds of percent higher than those without advice and then do everything in their power to see that as many advisors as possible enter the business and as many investors as possible understand the tremendous value of advice? Maybe it's that doing so would mean their present budgets of hundreds of millions of dollars per year are poorly spent.

36,000 extra annual transactions per advisor

While there are similar concrete examples that can be used for several other harmful effects a ban on embedded compensation would have, I will leave that to others (and I refer the reader to the the excellent paper "A major setback for retirement savings: changing how financial advisers are compensated could hurt less-than-wealthy investors most" by Pierre Lortie, 2016) and use only one to illustrate the point clearly. Imagine, if you can, that you are a financial advisor with two hundred households in your practice (not at all unusual) and they have 1,000 accounts in total. For an account where there is a direct advisory fee charged to the account, there is a transaction for this fee shown on the client statement, thus in your practice there would be 1,000 additional transactions per month or 12,000 transaction per year. As they say in the infomercials… but wait! There's more! There is another line on the statements to show the HST on the fee! Thus, your practice now has 24,000 additional transactions per year. But hold on, wait for it… there's still more! How is the fee to be paid? There must be cash in the account to pay for it, so there could be another transaction to sell a tiny portion of an investment to pay for the fee and tax - that's up to 36,000 transactions per year!! Starting to get the picture?

The actual financial advice reality: abundant, affordable, accessible advice with embedded compensation enables both client and advisor to focus more time on improving lives instead of administering payments and taxes.

Oh, and the average household would then have up to 5 x 12 x 3 = 180 transactions per year on their statements just to administer the payment for advice and the associated HST. Do you think this might cloud their ability to interpret the much smaller number of transactions that were actually recommended by their advisor? Do you think the client might perceive that with such a high number of fee and tax transactions there should be consequently more investment transactions, even though once an asset mix and a portfolio are in place, research (see the work of Barber and Odean among others) clearly indicates that nothing is virtually always the *right* thing to do? But nothing is also the absolutely *hardest* thing to do and without a caring, empathetic and tough-loving advisor to keep clients from doing something, the plan is highly likely to be blown up. Do you think an extra 36,000 transactions on statements will occur and that the cost of these transaction is nil? **Will costs to the advisor, the dealer and the client go up or down with 36,000 more transactions per year?**

Now how does this compare to the embedded compensation via a mutual fund service fee? In this case the mutual fund company calculates the total assets per advisor at the fund company and sends one payment to the dealer per month, or twelve per year. Let's see… 12 vs 36,000, which is more economical, easier to administer, less expensive for the client, leaves statements looking cleaner as they show transactions related to recommendations instead of administration, easily enables clients to see bottom line results after the fund company, dealer and advisor have all been paid? Could it be that the compensation model requiring 12,000 times more transactions to administer is a bit less rational in most cases?

Embedded mutual fund service fees may cause a fund to underperform a similar one that has no such fees, res ipsa loquitur, but we know for certain the clients who pay those fees are far, far better off for having the advice paid for by those fees.

But never mind rationality, practicality and economics **- what about the specific morality of embedded service fees?** The CSA claims their existence creates an intractable, irreducible conflict of interest. Is this true? Do studies really show this? Can they? The last section will examine this more closely.

3 - How should expert information be used?

While the CSA paper makes reference to a number of academic studies, two of them are given special prominence and appear to have been assigned much higher meaning than the rest: the studies known in the industry as the Cumming Report and the Brondesbury Report, which were in fact commissioned and whose parameters were specified and limited by the CSA. I will examine these in their proper context to illustrate the proper role of expert academic research in the process of formulating public policy. Before doing so, it must be stressed that the CSA specifically **prohibited the authors of both studies from considering the value of advice in their report**, thus zooming in on the potential consequences of small potential side-effect factors while deliberately avoiding any focus on the consideration of the greatest factor of all in the determinants of client success: the presence of advice.

Instead of comparing the current embedded fee environment to the one where consumer choices are eliminated and costs are higher, anti-fee proponents compare it to a non-existent fee-free utopia where clients act the same with or without caring advice.

The Brondesbury Report

The Brondesbury Report conducted no new research and was only a literature review of one area of research. The authors provided clearly conflicting conclusions. On one hand they say "evidence on the impact of compensation **is** conclusive enough to justify the development of new compensation policies" while on the other hand they state:

- While removing commission lowers product cost, advisory fees may rise as a means of paying for the cost of service. There may also be new or increased administrative fees, higher costs on margin accounts and lower payments on cash balances.
- There is **no** conclusive evidence that investors will have greater after-fee investment returns with asset-based compensation instead of commission.

I find that when I read the Brondesbury report there is an attempt to insert an unwarranted conclusion that compensation policies should be changed, despite much stronger statements that any such change is likely to cause both expected and yet unknown harms. It is as if the authors wrestled with the visible evidence that advice is of tremendous value, that freedom of choice is important, that a ban on one type of compensation might well cause great harm, yet inserted a conclusion they thought was what the CSA wanted to hear and was paying for. In the CSA Consultation I find insufficient attention is paid to the harms stated in Brondesbury and undue strength is attributed to the apparent mandate to interfere with existing free market mechanisms.

The Cumming Report

The Cumming Report was different than Brondesbury in that its task was to conduct original research using a large database of Canadian mutual fund transactions over 2003-2014. Specifically, it was to "examine the relationship between risk-adjusted performance ("alpha") and future fund flows ("flow-performance slope"), and fund flows that are obtained regardless of past alpha ("flow-performance intercept"), and consider whether or not flow-performance intercept and slope are influenced by the fund fee structure."

To highlight my key criticism of how the some research such as the Cumming Report is being wrongly interpreted and misused, consider its oft-referenced conclusion: "Trailer fees increase new flows regardless of past performance. Generally, the greater the trailer fee, the greater the level of net flows that has no relationship to past performance. For example, a 1.5% trailer fee increases the average monthly flows by 0.3% of AUM each month regardless of past performance." Okay, so on the face of it this seems conclusive and seems to cry out for a ban on service fees, but is this a fair interpretation of the data and is the full context examined? Not at all. Even if the interpretation was correct it does not justify a ban on embedded compensation, as I will show later.

Consider just two aspects of the brief quote provided. First, it states that monthly flows are 0.3% of AUM higher in a fund that pays a 1.5% service fee. Okay, but **how significant is this**? We are talking about 3.6% per year of increased flow, so it would take twenty years for the fund to double its size when compared to if it paid an average service fee instead of an elevated one. Twenty years - during which much would change in the fund, the fund company, the advisor, the dealer and the marketplace. It is extremely unlikely the elevated service fee would persist very long because market competition would be very likely to deal with it with no regulatory intervention.

Where are the high-service fee funds?

How can I justify this last statement? That leads me to the second aspect - the 1.5% service fee that is given as the example. Where are these funds that pay a service fee of 1.5% vs the industry standard 1% for equity funds? How big are these higher-fee funds and what percentage of the industry assets do they represent? I understand the number of funds paying a service fee over 1% is 10% of the number of funds in Canada, but obviously many or most of these pay less than 1.5% plus they are likely not large funds in terms of assets, so funds that pay 1.5% likely represent much less than 10% of industry assets. It is speculation on my part, but **I'd bet that less than 1% of fund industry assets pay 1.5% or more in service fees**. I have been an advisor since 1993 and I am not aware of nor have I used any large funds that pay over 1%, but I have seen a few small funds that paid 1.25%. If I saw a fund with otherwise highly desirable characteristics and did pay 1.5% I would recommend to the fund company to reduce the service fee to be in line with the competition if they hope to attract my business, because I don't want to be associated with a high compensation fund in order to protect the value of my reputation.

Connecting this with the finding from Cummings, and **we have a very small fraction of funds paying above average service fees and attracting a slightly higher inflow of assets**. In 2014 Investor Economics reported that "over the last three years, two out of the three years higher trail products have actually been in net outflows and last year for 2013 they were in net inflows, but as it turns out the funds that had the higher trails that did see the inflows also happened to be the better performing products." I conclude that overall, the issue of high service fee funds is a statistically small one and is certainly no justification for a nation-wide violation of rights likely to cause large scale and lasting financial damage to the country.

A more comprehensive study of the determinants of fund flows

Another Canadian study released in 2015 "Analysis of Factors Influencing Sales, Retention and Redemptions of Mutual Fund Units" conducted by Investor Economics examined mutual fund flows in their full context, not eliminating all other factors and focusing on one, but instead looking at all potential factors and isolating the most important ones. The study states:

> Our analysis has revealed that no single factor can satisfactorily explain the volume of mutual fund sales and redemptions into a specific fund at a given point of time. Rather, mutual fund flow activity reflects the interplay of a large number of factors. While no factor in isolation offers sufficient predictive value in terms of individual fund flows, three factors have been identified as significantly relevant to advancing the understanding of the volumes and the directionality of mutual fund sales and redemptions.

1. Macro-economic and demographic factors comprise a powerful backdrop to fund flow activity and can overpower all other factors.
2. Individual fund investment return characteristics, expressed both in absolute and relative terms, represent the single most valuable predictor of sales and redemptions at the individual fund level.
3. Preferred access to distribution, either via direct affiliation or strategic alliance.

The researchers went on to examine the influence of advisor compensation on fund flows and found "**The statistical relationship between trailer levels and net flow volumes is not significant**." Further, they "The importance advisors and clients assign to the funds' investment returns, however, supersedes the importance of the level of compensation in the sales process." Acknowledging the shifting preferences of consumers and advisors over time, they go on to conclude "Meanwhile, the shift to unbundled fee-based practice models and the diminishing reliance on the upfront sales commission payouts associated with deferred sales charge load sales in the intermediated advice channels, have continued to lessen the impact of embedded advisor compensation on fund flow activity."

It is the contrast between the Cumming Report and this last report by Investor Economics that is at the heart of my point about the proper use of expert research information. In order to properly use the results of academic research, one must be able to identify the knowledge foundations of the study (that is to say we must examine its underlying assumptions), its research methodology, the statistical analyses performed, the representation and significance of these statistics and the limits to the conclusions one may draw from them before even beginning to use them to form public policy. The CSA commissioned the Cumming Report and asked for a highly specific and delimited result, which they received. However, when a statistically significant result can be found it is not scientifically nor morally sufficient to proceed as if this is equivalent to an assessment of the magnitude and importance of the result.

I drank radioactive Fukushima orange juice

As one extreme illustration of this principle, the reader may recall the earthquake, tsunami and subsequent Fukushima nuclear reactor breach in 2011. Because radiation leaked into the Pacific Ocean, it was spread by currents across to the west coast of North and South America. Thus it is possible that the orange juice I drank at breakfast today that contains California oranges contains one or more radioactive atoms from Fukushima. With sensitive modern instruments we might measure this and declare outrage, however we would be ignoring the significance and magnitude of the measured fact. The full context would include considerations such as a) humans have evolved in a low radiation environment and appear to flourish in such an environment; and b) organic Canadian maple syrup may be more radioactive than the California orange juice that had us outraged.

Expert research information may provide us with factual measurements, but the value we assign to the facts is moral in nature and must be placed in the full context of human life and with the understanding that our goal is to maximize human flourishing.

4. More to think about

To fully understand the errors in thinking within the CSA discussion paper would take much more space, but I don't want to end without examining a few of the fallacious thinking methods employed in the paper.

The abuse-use fallacy

The first fallacy could be called the abuse-use fallacy and refers to the incorrect linking of something that exists that *could* be abused or *could* create a severe conflict of interest such as embedded compensation, and then drawing the conclusion that therefore it ought to be banned under threat of legal punishments such as seizure, fines, loss of livelihood or even prison. Seizure and prison (violence against the individual) is always the threat behind the surface threats, otherwise when an individual refuses to comply, the lawmaker has no power. Even if we were to stipulate that in some cases some advisors choose to recommend products merely because of higher embedded compensation, it is irrational to say that because something can be abused that it ought not to be used at all. The use-abuse fallacy can be used to attack anything you don't like: you can say that because some people drink too much that all alcohol should be banned or that because some people die in car accidents that cars should be banned. Individual cases of abuse do not prove something should be banned, it proves it should not be abused.

We live in a country where the government agencies are focused on making financial advice expensive and inaccessible to a large portion of the population.

The false-attribution fallacy

The second fallacy worth examining is the false-attribution fallacy, which usually follows a simple three part formula. First a story is told where an investor has lodged a complaint based on a claim such as he didn't get his money's worth from an investment that had embedded compensation, or he didn't know about the embedded compensation. The most dramatic case is one where the investor lost money on the investment while the advisor was being paid a service fee even as the investment declined in value. The horror! The blame is then laid on the existence of embedded compensation without exploring other alternative explanations such as the responsibility of the consumer to make rational and reasonable inquiries about the investment, the fact that just about any mutual fund will recover from every decline and go on to new highs if allowed time, or the possibility that the investor acted emotionally and sold the investment at a bad time despite the advisor's best recommendation. The truth is that every form of compensation can be abused yet this is no justification for a legal ban on all of them.

The no-threshold fallacy

Finally, consider the no-threshold fallacy which uses the fact that because a large amount of something can be a problem that any amount of the thing is bad, thus it ought to be banned under threat of legal force. Refer back to my example of the radiation from Fukushima as one example. Think about what regulators would have to complain about if embedded compensation was 25% lower than the average of today - would this be low enough for the CSA to conclude that it was not dangerous, unethical and thus ought to be banned? What if it was 50% lower? 75% lower? You can see that there is no objective threshold at which it can be morally justified to ban embedded compensation since there is an infinitely fine spectrum of possible compensation levels. All that could be done to establish a cutoff point is to make an arbitrary decision based on whim and emotion, not reasoning and based on correct morality.

The false-attribution fallacy and the no-threshold fallacy for a particularly dangerous combination in the hands of regulators. Because there will always be stories of investors who lost money on investments that had embedded compensation, regulators use these as evidence to support a complete ban on all investment products that have embedded compensation. All too often, there is a failure of regulators or politicians to use human flourishing and the social conditions required for it as the standard of the good.

The liberated human mind, not the behaviour coercing bureaucrat, is the root of progress.

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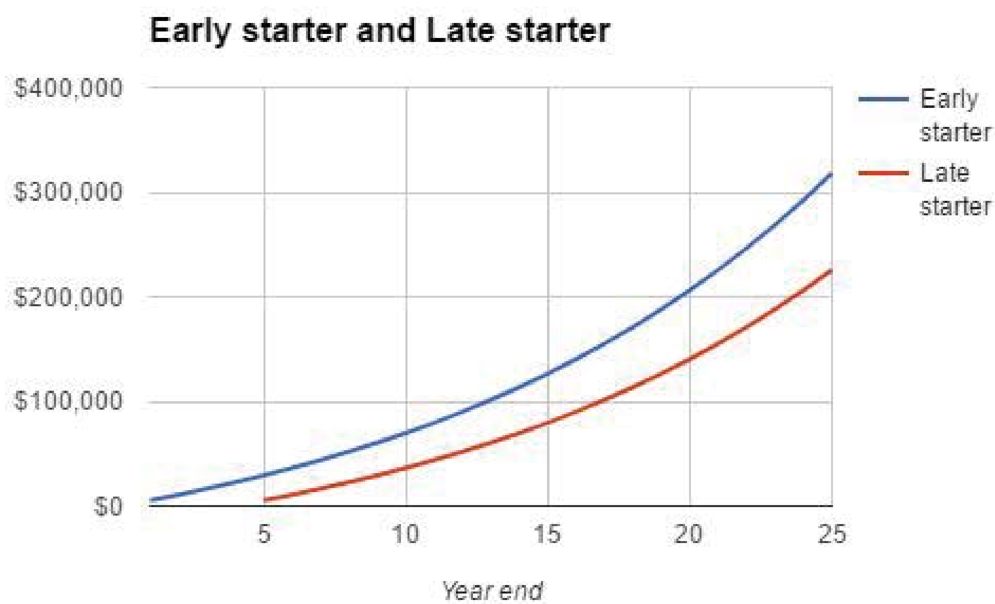
5 - The Big Picture

I hope the reader can now see that the CSA proposal to ban embedded compensation in mutual funds and other investment products:

1. fails to properly place compensation in its full context;
2. uses an incorrect standard of value, preventing the possibility of a conflict of interest, instead of that proper for a society dedicated to human flourishing;
3. makes incorrect use of expert research data that even deliberately avoids considering a full analysis and minimizes contradictory evidence;
4. uses several logical fallacies to make the case for a ban on embedded compensation seem strong or even irresistible when in fact there is no moral or practical justification at all for such a massive violation of the rights of investors, advisors, investment dealers and mutual fund companies.

That which is not seen

The harm that could be inflicted on Canadians by a ban on embedded compensation would be widespread and severe, reducing the future wealth of the country and holding back all forms of progress. If a ban is implemented, Canadians will never be able to measure the wealth that was never created, the financial security that was impaired, the higher taxes required to sustain social programs, the health, education, and cultural benefits that never accrued. Just as investment returns compound on an exponential curve (see Figure 2 below) and the person who starts earlier shifts the curve upwards, so do regulatory actions that inhibit investors and advisors from making arrangements that are freely chosen and mutually beneficial create a society with lower demand for advice and a lower supply of advice, retarding the wealth curve of the whole society.



The moral high ground

Financial advisors, investment dealers and mutual fund companies should proudly stand up and proclaim their pride in the good they do, the value they create and the consumer relationships they have established. They need to realize that they occupy the moral high ground and state it clearly in their communications. I do not mean to imply that all advisors operate perfect practices - no such thing exists, or that all mutual fund companies and their products are excellent - this is an impossible standard in the most fiercely competitive market in existence. Rather, I assert that given the relatively free market that existed in the past, advisors and mutual fund companies accomplished incredible good and formed millions of voluntary arrangements with investors. Recent years have seen radical increases in regulation, rising compliance costs and the threat of much more of these.

Let it be said far and wide: in a market where government and its agencies protect individual rights, embedded compensation in mutual funds is a profoundly moral, extraordinarily economical and wildly popular form of financial advisor compensation that has led to unbelievably successful advisor-client results as measured by the accumulation of financial assets by advised investors.

The last word

If the advocates of banning embedded compensation in mutual funds had forced this on the industry 30 years ago, they would have prevented the creation of hundreds of billions of dollars of wealth in Canada and permanently damaged the lives of millions and millions of Canadians, yet we would have never known of this loss because the gains were never given a chance to accrue.

Hello. I am writing on behalf of myself and my husband to voice our concerns regarding the option of discontinuing embedded commissions for financial advisors. As self employed artists, we have come to terms with knowing that we will have less disposable income than if we had chosen to work in other fields. We are happy to sacrifice some of life's luxuries to be able to do the work we love and feel called to do. A big part of or success in being able to live debt-free on our relatively small incomes is due to the advice and guidance we have received from our Financial Advisors. We have been learning a great deal about financial responsibility and planning for our future from our advisors and it is they who have encouraged us to write to you.

Today, Canadians have a choice in how they pay for financial advice, whether through upfront fees or through embedded commissions based on the products they buy and the size of their investments. This is beneficial to lower-income households like mine, because it means that our Financial Advisors can make their living on commissions, particularly from larger clients, while still taking on small clients like us, who they make very little from on commissions, but have a huge passion to help and teach. However, proposed government changes may alter that.

Canadian regulators who oversee the sale of mutual funds are now proposing to ban embedded commissions for financial advisors, meaning that all clients would be forced to pay fees directly. These changes don’t favour those who need professional advice most: Financially vulnerable Canadians who have less money to invest, whether seniors on a fixed-income or young people and artists like my husband and I who are just starting to save for retirement. We would not be able to go to a financial advisor if we were forced to pay direct fees of $100 to $300 per hour. And yet, the proposed changes mean financial advisors will lose the ability to decide how their clients may pay them and will not be able to keep their costs the same. Vulnerable Canadians may lose access to affordable, professional financial advice.

It is not only wealthy Canadians who should have access to financial advisors. All Canadians – regardless of their income or where they live – should have access to trustworthy financial advice.

I believe that Canadians like me should continue to have a choice in how they pay for financial advice – whether through commissions or upfront fees.

These proposed changes mean that:

- I may lose access to affordable financial advice;
- My financial advisor may not be able to keep their costs the same;
- Professional standards in the industry may not be maintained;
- Canadians will have little choice about who helps them manage their finances into the future.

I think the best way to maintain standards and keep fair access to advice is through the professionalization of the industry. Instead of limiting access to financial advisors, professionalization will make the industry stronger and protect the interests of Canadians.

Financial advisors are part of our community, and the advice they provide not only creates wealth, but also makes me feel more secure.

Thank you for taking the time to read this letter and consider our viewpoint on this issue.

Anonymous

Via email

June 7th, 2017

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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Response and Comment to CSA Consultation Paper 81-408 Consultation on the Option of
Discontinuing Embedded Commissions

Class A mutual fund shares have embedded remuneration/commissions called trailers. Regulators have the surprising notion that embedded due to its very nature - is bad. I believe this view to be incorrect.

Associating embedded remuneration automatically with price gouging or skewing is not a correct concept - not even close. As a deposit broker, I get paid a GIC commission and because all the commissions are the same there is no skewing. Extending this concept to the fund industry should not be difficult as I know it works 100% and is proven.

Many believe that "pay direct" by the investor is the one and only solution. They are calling upon the industry to find ways to mitigate the damage (to investors) caused by going to a single-choice "pay direct" model.

I think we should pause here and reflect just a bit. **Regulation should never be designed to hurt investors and asking the industry to find ways to mitigate the damage to investors is just not the right thing to do.**

Rather than ban embedded, regulators should be embracing the concept albeit in a slightly different manner.

My proposal:

FE, DSC and LL mutual fund classes of shares would be eliminated. Let the investor choose whether they want a *negotiated* embedded AUM fee/commission or a *negotiated* un-embedded AUM fee.

Almost all advisors will agree that after almost thirty years, trailer commissions have converged to become AUM fees - specifically for advice and service rather than for distribution. The front-end loads of yesteryear –of up to 9% are now set at 0% as almost all **advisors in Canada have completely eliminated their own front-end load commissions. In effect, advisers have skewed their own commissions to zero.**

According to current statements, the industry is being accused of the pervasive skewing of sales. According to the dictionary definition of pervasive, pervasive means widespread. With close to 30 years experience, I know one thing for sure – skewing is not pervasive –not widespread and I believe –is exceedingly rare.

Embedded remuneration (trailers) is set by the manufacturer of the product –not by the securities firms (excluding proprietary products) or their financial advisers. There have been accusations that sales will tend towards where compensation is the highest. Although this behavior describes the capital economy perfectly, regulators perceive it is a grave problem. Some studies conclude that skewing to higher compensation investment products (impacting sales) is pervasive however these studies did not divulge exactly how much skewing is going on or the degree of skewing. Advisers acknowledge that skewing probably exists somewhere but only as rare outliers.

Cummings is essentially correct – money will flow to where compensation is highest which will be to fee-based accounts that have no caps, are open-ended, not regulated to any degree and remuneration is controlled by the dealer's pay grid.

It is clear that the traditional transactional business for the purchase of securities is dying. Stock trading commissions for the average investor have plummeted over the decades and are just a few dollars per trade or are even free. Average trailers and commissions to advisers have been dropping along with mutual fund MERs. Front-end loads have all but disappeared. Trailers for money market funds have ceased to exist. Competitive pressures to reduce costs are everywhere.

The belief that banning embedded will result in immediate savings does not make sense. At best, separating out the commission from the product should only be a wash. It is similar to arguing whether the HST should be built into the product price or charged separately at the cash register. Either way –the price of the product to the consumer turns out to be exactly the same except I believe it won't be the same. Fee-based compensation could be higher than embedded based compensation for many investors.

The best mechanism to lower costs is through competitive pressures in the marketplace rather than through regulatory mandates.

The regulators appear to have come to the conclusion that anything embedded is bad but regulators have never regulated open-ended fees and appear reluctant to do so. Unfortunately, industry commentators **perceive trailers as evil incarnate and must be stamped out of existence – at all costs and at any cost.**

There is no logic to assume or believe that embedded is the cause of all evil. The regulators made sure that all fees and commissions be made 100% transparent and they have made it happen. Whether a disclosed commission is embedded or not is not relevant in an embedded society where all products and services have embedded costs.

However, what if we do stamp trailers out? And what should replace them?

How might this be done?

Eliminate commissions and trailers entirely. No front-end loads, no DSC fees, no low-loads.

Trailers have an inherent perceived flaw from a regulatory viewpoint. They are set by the fund company and the interactions are between the fund company, the advisor and the firms that the advisors work for. According to the paper, there is a potential for a conflict of interest as a higher trailer might potentially tempt an advisor to steer sales in that direction. How do we deal with the temptation of higher remuneration with a financial institution offering "too high" of a trailer or avoid the temptation to charge "too high" of a fee in a fee-based account?

Rather than let the industry or regulators set commissions and fees, why not **give the investor full control of what they are paying for their investment products and services.**

In the model I am proposing, **trailers cease to exist and would be completely replaced by embedded AUM fees (or commissions)** except there is an important difference. The AUM fee/commission is *negotiated* between the adviser and the investor. In other words, **embedded fixed trailers are replaced by embedded**

negotiable commissions. This would negate the need for an exclusive “pay direct” model.

This will also greatly reduce the large numbers of the “alphabet soup” of multiple classes of mutual funds.

If advisor embedded compensation is negotiated one-on-one with the investor in the same fashion as with fee-based accounts, then there can no longer be any skewing. It is eliminated instantly.

Embedded negotiable AUM fees (to replace trailers) can have a very significant advantage over traditional fee-based accounts. It may be possible that each embedded mutual fund AUM fee can be negotiated individually. **This is a very important and key difference. For example, moving a fixed income mutual fund with a fixed trailer of 0.50% to a fee-based plan will increase investor costs dramatically**. The investor moves from paying a 0.50% annual (trailer) to a lofty 1.0% to 1.5% annual fee (or more) in a fee-based account. **Fee-based plans charge a fee on all holdings in the account**. **All fee-based plans have an inherent conflict of interest to potentially tempt advisers to replace low commissions (fixed trailers) with much higher fees.**

In my proposed embedded negotiable AUM account, ***the investor will have the ability to negotiate the AUM fee/commission on each holding.***

“Pay direct” fee-based accounts would continue to exist as they always have and fees remain negotiable as they always been. Fee -based accounts can also incorporate other negotiable fee structures other than just negotiable AUM fees – flat fee retainers or retainer fees based on tiered AUM, for instance. Or as an alternative, all AUM tiers, minimum account size and AUM fee schedules could be eliminated. The marketplace is proving that it can be extremely competitive without the need to regulate remuneration.

To eliminate “skewing” either make remuneration the same everywhere or make it different for each transaction (make it negotiable).

If embedded commissions are eliminated entirely, there will be mass disruption in the industry as such a regulatory ruling will effectively kill client-held accounts.

There will be massive inflows to set up nominee accounts and investors will be forced to pay expensive annual trustee fees. For small accounts it makes no economic sense to pay a $125 annual trustee fee (plus HST) plus some Dealers charge additional fees for additional registered plans. Full transfer-out fees ($250 + HST) are also notoriously expensive as well.

As a result, **regulators will likely lose future regulatory control over fees. It would be very difficult for any regulator to regulate open-ended fees or to regulate advisor pay grids.** Investor advocates should pay attention that **replacing lower embedded fixed commissions with higher fees may not be the result they really wanted or in the best interest of all investors.** And soon, we will be having conversations about the inherent conflicts of interest that potentially, all fee-based plans have. It is perhaps naive to assume that fee-based "pay direct" plans will eliminate all conflicts of interest. **Fee- based will never eliminate conflicts of interest- they merely create *different* conflicts of interest.**

Moving from client held accounts to nominee fee-based structures could result in increased costs to investors as fees for fee-based accounts could be higher than fixed trailers –especially for small or average investors.

Unfortunately**, investors will pay the price with increased fees and less access to advice** as the industry is forced to go "upscale". When we see terms like "mitigating damage" you can be assured they are referring to small or average investors as collateral damage. **Surely this is not in the best interest of the average investor.**

Based on the paper's comments, I think it is outside the scope and mandate of any regulator to suggest that the industry reduce profit margins or tout specific investments. **Those investment and risk decisions must always be made by the individual investor depending on their personal circumstances. In all cases, the regulatory role should be seen as having a neutral stance –neither favouring one investment product over another or one industry over another.**

Proof of harm

Not much has been written about the *psychology of money* with respect to issuing a new bill or fee to an investor or what an investor actually prefers. The tendency in the investment business is for advisers, advocates, regulators and industry participants are to tell investors what their preferences should be. Perhaps we should be asking investors what *they* prefer.

So how will investors react to being forced to give up their all-in-one embedded pricing and be handed a new bill for service and advice?

I contacted one of the world's best known behavioral economists (**Dan Ariely of "Predictably Irrational" fame**) and asked him ***what the specific impacts on investors would be if investors in Canada were billed separately for their investments*.**

Dr. Ariely explained to me that if a client who has $1 million dollars invested in a savings account, for example, and pays 1% asset under management a year usually doesn't express any concerns***. However, Dr. Ariely argues that if a client had to directly pay $10,000 a year, they probably wouldn't do it. The reason is that people may not seek advice if they have to pay for it directly.***

Therefore, according to Dr. Ariely, ***if Canada bans embedded commissions and starts to bill investors directly, investors may refuse to pay, and if they do they will be upset*. *Investors may not seek advice, may stop investing or may not be put in the correct investments.***

Dr. Ariely's research suggests that forcing investors from embedded pricing to separate billing of fees could have dire consequences.

A single choice fee-based model is not a panacea –not even close. Fee-based plans have been around a long time and have had a relatively long track record. Have they caused advisors to massively pursue the cheapest investments possible? Or convert en-masse from active management to passive ? Advisers transferred their existing Class A shares to Class F and recommended the same investments from the same fund companies. If the embedded model is banned, advisers would be mandated to move the same funds from one account to another - with any additional financial costs borne by the investor. I see financial benefits to advisers but I am not seeing benefits to investors who have to pay more in a fee-based account for the exact same investments. For many investors, they are economically better off in less expensive Class A embedded mutual funds.

Considering financial advisers front-line role with investors, I am greatly disappointed that advisers are largely uninvited to participate in the regulation of their own industry. Advisers are not present in many (if any) regulatory committee role and it seems we have very little input in the regulatory process. That omission, I feel, is a shame.

Conclusion & Recommendations

I would recommend that **both models be retained** with some changes to all-in pricing models. Whether a fee (or commission) is built-in or not, mathematically – it comes out the same but many investors like and prefer all-in pricing. Regulators may **consider making all compensation negotiable**, **embedded or not.**

FE, DSC and LL mutual fund classes of shares could be eliminated along with all trailers. Let the investor choose whether they want a *negotiated embedded* AUM fee/commission or a *negotiated un-embedded* AUM fee.

Financial advisers can bring a lot to the table. Financial advisers should play a greater role in the regulatory process and work towards better regulation of the investment industry.

Respectfully,

Glenn Szlagowski
Financial Adviser
Assante Financial Management Ltd.

June 7, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
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Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408
Consultation on the Option of Discontinuing Embedded Commissions (Consultation Paper)

Dear Sir or Madam:

Thank you for the opportunity to comment on the CSA Consultation Paper 81-408. I found the document to be a very interesting read that presented a comprehensive and balanced overview of the current state of the industry and some of the challenges we are facing. I thank you for producing this consultation paper and for the opportunity to provide comments.

As an advisor, I felt it important to provide my perspective on actions that should be taken to improve the industry in a manner that will help Canadians achieve a more secure financial future. It is a privilege to work in this industry, and I am very passionate about educating the public and enhancing the experience of every Canadian consumer.

Please note that all comments are only mine and do not in any way reflect those of the dealer I work with or other advisors that I am associated with.

My Story

I would like to begin my comments by telling you my story, and why I believe my perspective is unique. I began my professional career as an Occupational Therapist and worked in that field for 5 years, starting in the late 1990s. Once I'd accumulated some money and paid off my student loans, I became interested in investing and sought out a financial advisor to help me. I found the process to be challenging and frustrating in the sense that the industry was very confusing for me as a consumer. (I believe this issue still exists today some 20 years later.) I then decided to pursue investing on my own and began to read countless books. During this time, I quickly made thousands of dollars in stocks like Nortel, Ballard Power, and some e-commerce companies (that no longer exist). However, I lost it just as fast—probably faster.

But the process of investing intrigued me, and I decided to go back to school to change careers and was fortunate to be accepted to the MBA program at Columbia University in New York. After graduating from Columbia University in 2004, I also completed the CFA designation. For the next few years, I worked on the institutional side of the industry at firms such as BNP Paribas and Alberta Investment Management (AIMCo).

I began working with individual investors in Canada during 2009, because I wanted to share my experience and apply my knowledge to enhance the financial outcomes of Canadian families. I believe I am one of the few financial advisors in Canada who has seen the industry from the lens of both the institutional and retail investing worlds.

To me, being an advisor means truly providing a holistic wealth management experience. It's about making sure that every client has all the rooms of their financial house in order (investing, insurance, retirement planning, estate and legacy planning, etc.). It's about being a behavioural coach to clients to make sure they are saving enough for retirement and sticking to their investment plan, rather than making emotional decisions at inopportune times. It's about making sure that families are adequately insured in the event something catastrophic were to happen. It's about making sure that both members of a couple are adequately informed of their financial situation. It's about speaking to the client's accountant and lawyer to make sure all the client's professionals are on the same page so the client achieves the best outcome. It's about helping clients to understand and mitigate (to the extent possible) their financial risk. It's about helping retirees design tax efficient income streams. It's about helping clients with tax effective estate planning. It's so much more than solely focusing on investing. With respect to the debate between active and passive investing, I would like to add that while fees are important, in my opinion there is room for both passive and active strategies within a properly constructed portfolio.

As was the case 20 years ago, when I first sought out a financial advisor, I believe the industry is very confusing for the average Canadian consumer to navigate. Differences in qualifications, licensing, compensation structures, investment philosophy, services provided, and level of true independence are only some of the issues. I have been so frustrated with this over the years, that I decided to write a book for Canadian consumers. In March 2017, I released *Your Money's Worth - The Essential Guide to Financial Advice for Canadians*. It is my hope that this book will help Canadians navigate our industry and find the advice they need.

Embedded Commissions

In my humble opinion, consumers should have a choice in how they pay fees. Ideally, all consumers would be able to choose whether they pay fees directly or via embedded commissions. In fact, I have had many clients over the years mention that they prefer to pay costs using the embedded commissions model. Consumers should also understand that dealers have costs for the services provided to advisors, and collect a portion of the embedded commissions, or other fees charged to clients.

While I agree with much of your report with respect to the challenges of embedded commissions, I strongly feel that choice is important and that banning embedded commissions is not the silver bullet to solve the industry's challenges. To be clear, a ban on embedded commissions would have very limited impact on my practice as the vast majority of the clients I work with are on a fee-based platform.

One of the central concepts that both regulators and consumers should understand is that the work of financial advisors extends far beyond managing investment portfolios or selecting specific investment products. For me, the role of a financial advisor is about providing holistic financial advice and direction, in addition to making investment recommendations. While fees are important, the value of good advice can often save the client multiples of what they pay in fees (such as via tax efficient retirement planning, in-kind charitable giving, maximizing estate value, etc.). Moreover, the value of advice can be lumpy and should not necessarily be measured solely on investment returns. For example, what is the value of making sure that a young family is adequately insured and has updated estate documents? I very strongly believe in the value of advice, and without their advisors, many Canadian households would not be where they are financially today.

Whenever I see the image of financial advisors being broadly painted in a negative light, I am disappointed. I can tell you that I take my role as an advisor with a heavy sense of responsibility. Indeed, it is a privilege to work in this industry and help Canadians reach their financial goals and objectives. As in any occupation, there are always "bad apples." However, I can tell you that in general, the advisors in Canada that I have come across are hard-working decent people who care about their clients and do their best to help them achieve their goals and objectives. While we have all heard about the many Canadians who have unfortunately had negative experiences with their advisors, the countless stories of extremely positive outcomes (of people who would not have achieved their financial goals and objectives without their advisor) are generally untold - this is unfortunate indeed.

I believe a key issue was very clearly explained on page 122 of the consultation paper - service standards. I quote: “However, there is currently no securities regulation that prescribes, or guidance that articulates, the specific services that an advisor is expected to provide in exchange for ongoing trailing commissions. Under NI 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103), dealers/representatives are required to provide certain services at the time of the trade (e.g. suitability, know-your-client), but no requirement to provide ongoing advice focused on the client's portfolio." All financial advisors are not created equivalent and there can be an immense variation in the level of service provided by different advisors. To me, this is at the heart of the issue.

Suggestions to Improve the Industry

1. Introduce a **service contract** to the advisor and client relationship whereby every client would receive the following on at least an annual basis - investment review, insurance review, estate planning checklist discussion (to remind the client to ensure basic estate planning documents are completed) and retirement projections.

2. The advisory industry should move to a stronger and common educational standard that is required to become an advisor.

3. Implement new guidelines for use of titles by advisors to ease consumer confusion.

4. Ensure that there are no incentives for advisors to recommend proprietary products. Mandate all firms to have an "open product shelf."

5. Implement a form of "best interest" standard that is commercially viable to administer without causing unintended consequences.

6. Work with insurance regulators to ensure a level "playing field" for all advisors, and eliminate opportunities for "regulatory arbitrage."

7. Consider implementing an active share threshold (for example, 60%) for mutual funds to be classified as active (and charge associated investment management fees). For example, below this active share threshold percentage, fees charged by the investment manager would need to more closely match index funds. I acknowledge that sector concentration of the Canadian market would pose a challenge to fund managers in this regard.

8. Immediately terminate embedded commissions charged in the discount channel where advice is not provided.

9. Consider adding practicing financial advisors to your respective organizations to provide input. Working together, advisors and regulators can improve the industry for the benefit of all Canadians.

10 Work with the provincial and territorial governments to make a financial education course **mandatory** at the high school or post-secondary levels. This course should cover basic concepts including budgeting, investing, insurance, and estate planning. Over the years, I have known of many Canadians who made unfortunate mistakes that were entirely preventable with the right knowledge.

Conclusion

In summary, I believe that banning embedded commissions is not a silver bullet for the challenges faced by the financial advisory industry in Canada. Consumers should have choice in how fees are paid.

Good advice is more important today than ever before because we are living in unprecedented economic times. Advisors can deliver significant value in many areas in addition to investments. The heart of the issue is service delivery standards in these areas. I urge the CSA to strongly consider some of the suggestions made in this letter.

It is a privilege and honour for me to work in this industry, and I (like so many of my colleagues) take it very seriously. I thank you for this opportunity and sincerely hope that my comments will add to the conversation.

I would like to conclude by mentioning that consumers themselves must also take responsibility for their financial future. I will end with words from Glorianne Stromberg. In her 1998 report, Investment Funds in Canada and Consumer Protection: Strategies for the Millennium, Stromberg concluded by stating that the well-being of consumers and investors cannot rest alone on governments and regulators, and that investors “have to do their part. They have to help themselves. They cannot abdicate their responsibility to act prudently and with full knowledge of the facts.”

Sincerely,

Shamez Kassam, MBA, CFA
Author: Your Money’s Worth – The Essential Guide to Financial Advice for Canadians

June 7, 2017

Dear Board of the Canadian Securities Administrators,

I am writing to challenge the CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* which suggests that embedded commissions incent financial advisors in negative ways.

While I can see that embedded commissions appear to provide a misdirected incentive to people who aren't financial advisors or registered investment advisers, as a financial advisor I know first-hand that they allow me to provide the best service possible to my clients. Embedded commissions allow me to work with young people starting out in life, people who don't have a lot of money, and people who want to trust their financial advisor before they start working with them. The reason these people can afford to work with me is because my fee for working for them is paid out of the trailer on their investments, their mortgage, and a commission on the insurance products they choose to purchase -- not out of their pocket.

Following are some examples of when paying out of pocket holds people back from using a service:

1. Approximately 50% of Canadians don't have a will. http://www.advisor.ca/tax/estate-planning/48-of-canadians-have-no-will-survey-230734
Middle class Canadians (or "every day Canadians") think that having a will done by a lawyer is too expensive (despite it being the cheapest legal procedure they will pay for) and that belief holds them back from approaching lawyers to assist with their wills. Many of them choose holographic wills or will kits instead which could be done incorrectly and assets are distributed according to their wishes. Others don't get wills at all, leaving their families to divide up their assets after death.

2. Canadians with group dental benefits are more likely to go to the dentist than Canadians who have to pay for dental care out-of-pocket. http://www.hc-sc.gc.ca/hl-vs/pubs/oral-bucco/fact-fiche-oral-bucco-stat-eng.php

3. Most Canadians do not pay to get their income taxes done because they don't want to pay out-of-pocket. Those who do pay to have their taxes done either have complex income taxes and/or will be getting a refund.

4. When access to health care in Canada is compared to access to health care in the United States, more middle-class and lower-income Canadians have access than in the United States because they don't have to pay out-of-pocket. Because of this, Canadians have a longer life expectancy than Americans and Canadians with chronic health conditions (such as cystic fibrosis) have a significantly longer life expectancy than Americans with chronic health conditions.

5. Many Canadian women choose to dye their own hair instead of paying a hair stylist for it because of the out of pocket cost.

6. Many Canadians choose to do free exercise (such as running, riding their bike, walking, YouTube exercise videos) instead of joining a gym, exercise classes or hiring a personal trainer because they don't want to pay out of pocket. Even people who do pay to exercise still do some form of free or low cost exercise.

7. People with access to state-run elementary and post-secondary education programs are more likely to go to school than people who pay out of pocket.

Currently, all Canadians have an option to pay an hourly rate out of pocket to their financial advisor or registered investment adviser, yet most people choose not to pay their financial advisor or registered investment adviser that way. Paying an out of pocket fee-for-service can benefit some people such as some high net worth clients, but it doesn’t benefit most people. Canadians who can't afford to pay out of pocket, but still need advice, can afford to pay for the advice they receive through embedded commissions.

Recently I’ve been working with several 15 year olds to 25 year olds who have saved some money -- between $3,000 to $15,000. To them, that's a large sum of money, and all of them worked hard for it. All of them want to do the right thing with it, but they aren't sure what that is. With each of them, I spent 1.5 - 3 hours discussing how investing works before they decided to invest their money. I did it because I know that if I spend time with them when they are young, they will start proper saving and investing habits early and I will have a client for life. If they take my advice at their age, they will become wealthy and I will get paid for years to come.

If each of those young people had to pay me per hour to listen to me talk about investing, how much would they have been willing to spend? Trust is built by spending time together getting to know each other, how many of these young people would have paid me per hour to sit and talk about life? To ask questions about how the stock market works and if they should choose an RRSP or a TFSA or both?

The most crucial financial discussion I had in my lifetime occurred when I was 14 years old and my mom’s financial advisor came to our house, sold Mom some life insurance and showed me why I should invest $50/month in the stock market. I’ve invested in the stock market ever since and watched my savings grow through ups and downs. But I never would have paid him an hourly fee to listen to him.

Several years ago, a client of our office was tragically killed in an unexpected and sudden boating accident. This client started his life -- and his relationship with our office -- with nothing. When he became a client of our office, he was in his early 20s, newly married with a young child, a big mortgage and a dream of taking over his parents’ farm. He took advice from our office and purchased life insurance and set up RRSPs for him and his wife. He didn’t pay us an hourly rate for that advice (he couldn’t have afforded it with so many obligations) and he knew we were paid by commission from his investments and for selling him life insurance.

When members of our office heard that he passed away on a Friday evening, one of our staff went to the office the following Saturday morning and started the process of filing his life insurance claim and notifying the investment companies holding his RRSPs and other investments of his passing. We did this because the survivors needed money fast and there were lots of forms to prepare. Survivors of a deceased loved one are under pressure to make some major decisions, and often are too overwhelmed to complete the paperwork. Our office spent more than 50 hours over the next month or so helping settle the estate. His survivors didn’t pay us out of pocket for our time.

We didn't charge an hourly fee when his widow cried in our office. We didn't charge when his two kids phoned us periodically to ask what to do with their inheritance, or stopped by over lunch to talk about what they were going through. We didn't charge when we ran into them at the local gym and local grocery store and they asked questions about income taxes and how investing works.

Seven years after his death, his family is doing well. The other day, his widow came into our office to invest a settlement her family received for his death. The sum of settlement is well into the millions. She listened to our advice and did what we suggested. She didn't ask how much we were paid, although we've told her in the past how our pay is calculated (as we do with all of our clients). The embedded commission on this money is significant, yes. However, she knows we need to get paid. She knows we've invested many, many hours in her family when she had nothing to pay us. She trusts us because she's been working with our office for almost 20 years.

Can you imagine having to decide what to do with the multi-million dollar settlement you received from your husband's tragic death by taking advice from someone that you pay an hourly rate to and therefore don't spend time getting to know? An hourly fee-for-service incents the advisor to drag out the process of giving advice, and incents the client to limit the time they spend listening to the advice. That creates a lot of pressure for the client, and may mean a lot of questions remain unanswered.

Embedded commissions actually work in our clients' favour – it puts the pressure on us, not them, to answer all of their questions and to thoroughly explain our solutions, because we don't get paid until they invest their money through our office. Until they make the decision to invest with us, they can spend as much time as they want talking to us. Financial advisors and registered investment advisers have no choice but to take the time to answer their questions, because if we don't our clients will find someone who *will* take the time – even after knowing each other for years.

All Canadians with a consistent income, no matter how modest, have the ability to save enough money to retire sometime in their 60s to the lifestyle they've become accustomed to if they listen to our advice. To achieve retirement, you have to start setting money aside at a young age, and you have to invest in equities that provide a good return. You also have to decide if RRSPs or TFSAs or both are right for you. You have to understand how they fit with LIRAs and RESPs and what happens to all of those savings vehicles if you die or get divorced or lose your job.

A good adviser also needs to not let you give in to your fears. There's lots of misinformation and scare tactics out there about investing. The media is full of them. So is the local coffee shop. Your neighbour, the accountant at your gym, and the realtor who got rich in real estate all have investment tips for you. Their tips are compelling, but none of the people giving those tips are trained in how investing in the stock market works.

Our clients know they can phone us anytime they have questions about something they saw on the news. They know they can walk into our office anytime (often without an appointment) and ask how their investments are doing and how current oil prices or Trump's presidency are impacting their hard earned savings. They can email us or text us whenever they have a concern. They can ask questions for clarification. And if they don't understand something, they can ask again.

We listen, we respond, we provide relevant resources all without an out-of-pocket fee. And we repeat, if necessary.

I pay a fee-for-service to my mechanic. I just spent $1100 for new calipers and brake pads to be installed in my car. The fee *didn't* include the mechanic's time explaining what was wrong with my car and what my options were. It included the parts and the time working on my vehicle. My mechanic took the time to explain to me what was wrong and what my options were because if he didn't, he knew I'd get my car serviced somewhere else – and he also knew I wouldn't pay him to tell me what's wrong with my car.

I also pay a fee-for-service to my tax preparer. I spend $80/hour. This fee *doesn't* include advice, either. It includes the time it takes for my tax preparer to file my taxes. He might have suggestions for how much I should set aside for income taxes next year and that I can reduce my income tax bill by investing in RRSPs, but he won't help me pick my investments and savings vehicles, or complete the paperwork to set them up.

I also pay a fee-for-service to my bank. I pay $14.99/month in bank account fees. This fee *doesn't* include advice on whether I should get a savings account or a TFSA or a chequing account. I have to decide that myself.

I pay a fee-for-service to my gym of approximately $400/year. This fee gives me full 24 hour access to gym equipment and exercise classes, but it *doesn't* include advice. I could pay an hourly fee to a personal trainer for advice, but like most people I don't, because I don't want to pay for it. I'd rather take the chance that I'm using the equipment incorrectly and injury myself (because it won't happen to me) than pay for it. Besides, I can Google how to use the equipment (even though I don't Google it because it's too much work).

One reason the CSA suggests embedded commissions aren't good is because the CSA thinks that financial advisors and registered investment advisers are paid more of a commission for certain investments than we are for other investments. In the words of the CSA, embedded commissions can

> *"Incent dealers and their representatives to sell funds that compensate them the best or focus on only those funds that include an embedded commission rather than recommend a more suitable investment product; specifically, they can encourage a push for higher commission generating funds, such as higher-risk actively managed funds, which can impair investor outcomes"*

This is only partly true.

All carriers pay us the same embedded commission for the same type of investment, so the commission we make isn't an incentive to choose one carrier over another, or even one fund manager over another. They have to pay us the same, or else all of us advisers would work with only the investment company that pays us the most.

Across all investment carriers, advisers are paid more to invest people's money in equities, real estate and balanced funds than we are paid to invest our client's money in bonds. But shouldn't we be? A financial advisor's job is to help people grow their net worth. Bonds don't keep up with inflation, and when outside of registered investments, are the least tax-efficient investments there are. Only equities surpass inflation, and are also more tax efficient than bonds (when non-registered) because they are taxed as capital gains and dividends. We should be encouraging our clients to invest in equities because that's where the long-term growth is.

Investing in equities is more work for my staff and I than investing in bonds, GICs and savings accounts. Our office has more compliance to do and we spend more time training our clients discussing how their investments work than we would if they were invested in bonds, GICs and savings accounts. We need to stay abreast of current news events and understand the impact of economic and political changes on the stock market so we can answer their questions. We need to be there for our clients when they have concerns about the market. None of that work needs to be done when people invest in bonds, GICs and savings accounts.

The CSA report also claims that embedded commissions can:

> *"Incent investment fund managers to rely more on payments to dealers than on the generation of performance to gather and preserve assets under management; this incentive can in turn lead to underperformance and drive up retail prices for investment products due to a competition between investment fund managers to offer attractive commissions to secure distribution."*

Embedded commissions don't incent fund managers to rely more on payments to dealers than on the generation of performance. This is because the embedded commission is paid on the amount of money in the fund which can only grow two ways: with increased returns and with people putting money into the fund. If the fund isn't managed well, the fund won't produce increased returns, and if the fund doesn't produce increased returns, people won't want to invest in it.

The CSA also claims that embedded commissions "inhibit the ability of investors to assess and manage the impact of dealer compensation costs on their investment returns". This doesn't need to be. If investment returns reported on a client statement show the returns *after* all fees are paid (the net return), then the client knows their returns. As long as the client gets the expected return, does it matter what the compensation is? A client is getting better value investing in a mutual fund earning 7% with a 2.5% MER than a GIC earning 2.5% recommended by an advisor he paid a $150 hourly fee to.

Another of CSA's concerns is that embedded commissions might "cause investors to pay (indirectly through fund management fees) dealer compensation that may not reflect the level of advice and service they may actually receive; the cost of the advice and service provided may exceed its benefit to investors".

It's true that the amount of advice received by clients might not perfectly reflect the amount they pay in embedded fees, but that's how it needs to be. Some clients need a lot of advice – such as the widow mentioned above, and my mom who found herself to be a single parent in her late 30s with no knowledge of how investing and insurance works, and the 18 year olds starting out in life. All of these clients get the advice they need because they don't worry about paying for advice out of pocket.

If embedded commissions are no longer an options for adviser compensation, clients won't get the advice they need because they won't pay their financial advisor a fee for service. We will see people's net worth decline in the coming decades. As people's net worth decline, they will become a liability to the government. Most people invest for retirement, and without enough retirement savings, they will be more reliant on programs like the Guaranteed Income Supplement, Old Age Security and Canada Pension Plan. This will cost tax payers billions of dollars in the future.

Finally, I must mention that I notice there are no financial advisors sitting on the Canadian Securities Administrators Board. As such, none of the CSA board members have any working knowledge of what registered investment advisers do on a day-to-day basis. Have you considered having at least one financial advisor or registered investment adviser on your board? It doesn't seem possible to me that you can make sound decisions about how I work with my clients without having done it yourself.

I did some research on the make-up of regulatory bodies in other industries. Physician in Saskatchewan answer to the Saskatchewan Medical Association (SMA), which has a board of directors and a representative assembly. The SMA requires that half of all people sitting on the board, the representative assembly and their committees be physicians. Shouldn't the CSA be held to similar standards? (For more information on requirements for being on the SMA board, RA or a committee, go here: http://www.sma.sk.ca/kaizen/content/files/Physician%20Health%20Program.pdf)

I trust that you will consider my words in making your final decision about removing embedded commissions as an option for payment. At this point, consumers can pay a fee for service if they want to, and they can also pay embedded commissions. Removing embedded commissions as an option will limit choice for consumers and will have a negative impact on their wealth in the years to come.

Sincerely,

Shannen Fisher, B.A. (Econ), CFP, CEA
Certified Financial Planner, Certified Executor Advisor and
Financial Advisor

June 8, 2017

To:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Dear Sirs/Madam:

I am writing in response to the request for comments on the Canadian Securities Administrators Consultation paper 81-408 released on or about the 10th of January, 2017.

Who am I?

I am an enigma in the industry. I have been licensed to sell mutual funds for over 35 years in Alberta and have been operating my own mutual fund dealer since 1996. My understanding is that there are few mutual fund dealers operating in Canada who's head office jurisdiction is in Alberta. Primarily though, I am an investor using my own capital as my primary source of income. For example, I was the largest public shareholder in Companies such as Executive Inn Group which went private in 2007, H. Paulin and Company in 2013 and Morgan Financial in 1996. I currently own in excess of 10% of the voting shares of a public company GVIC Communications Corp. I have also been active legally by dissenting shares in Morgan Financial, Municipal Bankers Corp. and Dundee Realty when they went private respectively. RBC was able to enter the insurance industry by taking over Westbury Canadian from under Morgan Financial without any fair value calculation to protect the shareholders and Dundee was taken private below the independent "fair value" calculated amount. So I do what I can to protect my interests when I feel I have been wronged.

Mutual Funds are a Great Product

Looking back over my career I find mutual funds to be a great product to use in advancing an individual's savings over time. If you can compound your money at 5% per year over a long period of time on your savings you will do well. Do it yourself investing in stock and bond securities when done right can advance your savings at a much faster pace but the individual has to be diligent and do their own research. Or simply investing in a good performing closed ended fund can do well for investors with lower fees; or obviously just investing with Berkshire Hathaway or Fairfax Financial has made many investors quite well off. I have found setting up regular savings of even small amounts can lead to much larger amounts over time and this has been relatively easy to do with mutual funds for amounts as low as $25 or $50 per month. Similar to what Investors Group has been preaching since the beginning of time.

A Little History

I cannot compete against the position taken by the Canadian Securities Administrators (CSA) since I do not have the time nor the energy to answer their questions in the format put forth in their paper 81-408. But what I can do is share my experience over time in the industry as a client, salesman, investor and MFDA licensed dealer.

I attended my first investment presentation in 1981 when the Dow was less than 1,000 points at the time. I was enthralled. I personally purchased a term certificate paying 20% along with a portion of my investments going into an equity mutual fund after paying the 9% upfront fee in September of 1981. I ended up leaving the Chartered Accounting firm I was articling with in 1982 and embarking on a "career" marketing primarily term certificates, term deposits and mutual funds. We had a branch right next to the Royal Bank and as rates declined mutual funds became more and more popular with investors willing to pay up to 9% on the front end for equity funds and 5% on bond funds even though RBC was offering mutual funds without these front end loads. No matter what is believed, investing is an emotional decision not a logical one.

In 1987 with the stock market collapse I was witness to my office manager being "strangled" in front of everyone by a small female client whom he had continued to leverage as the markets were moving higher. The manager was fine but shaken. I have taken a "no strangulation" policy within my firm where the use of leverage is not only frowned upon but forbidden entirely. I was also caught up in the dealer firm I was with filing for bankruptcy protection in 1987 and from that day on have never sold a term certificate nor term deposit. The mutual fund investors were unscathed as they "owned" the funds. I was able to join an independent dealer and carried on with the remaining clients I had.

DSC Funds

Mackenzie brought out the Industrial Horizon fund in 1987 which was the first fund available in Canada to be sold on a deferred sales charge (DSC) basis. It was a sister fund to the highly popular Industrial Growth fund. I think assets quickly hit $1 billion leaving the Industrial Growth Fund which had a 20 year history in its wake. I found the independent firm I was with conflicting as they heavily promoted the use of the DSC sales structure. For example at a conference in 1990 I would quickly get surrounded by salespeople with calculators espousing the financial virtues of transferring my client's assets to DSC funds from the front end version I was using. I wasn't buying it. DSC funds are never in a client's best interest. No client in their right mind would choose a DSC fund over a no front end load equivalent. I recently asked one of my "senior" representatives why they did not use DSC funds anymore. His answer was brisk and sharp – he just knew it was not right. If the regulator continues to let mutual funds sold on a DSC basis exist then they are doing a disservice to Canadians. Mutual funds are primarily sold not bought so this puts the onus in the regulators hands to make the right decision.

Lowering Fees

With front end fees at zero advisors still need to be compensated for selling mutual funds and also holding on to client's assets through turbulent times. When trailer fees first came out I was relieved that I could focus more on my existing clients than having to spend time gathering new clients. In 1993 my firm even placed advertisements in the Financial Post advertising the no front end load sales model which was hugely successful. One of my representatives was even "interviewed" by Barry Critchley. Of course we try to find the best mutual funds for our clients as we always risk clients redeeming primarily due to poor performance. As a dealer and investor I am also aware how higher fees directly affect the returns my clients achieve. Do I believe fees are too high? You bet. Thankfully most manufacturers are lowering their management expenses on larger accounts. I also believe representatives should lower their fees but my understanding is that it is dealers themselves that are balking at this. They need to make a spread on their sales. My firm is not like this as I charge representatives a flat fee irrespective of their assets under management. I believe a reasonable charge would be a service fee of .50 % on equity funds and .25% on balanced and bond type funds. The higher fee is necessary on equity funds because it is much more difficult to hold a client in these funds when turbulence hits.

CSA's position:

Mark Armstrong, supra note 184. At page 6, Armstrong states: "Although the direct effect of a price cap is to reduce prices, the indirect effect of reduced search lessens each firm's demand elasticity so much that prices on average go up. This formalizes a claim sometimes made informally, which is that imposing price controls on an oligopoly market could raise equilibrium prices. One intuition for such a claim is that a price cap acts as a focal point for tacit collusion."

This is ridiculous. One of the easiest ways to ascertain when someone does not know what they are talking about is when they try to talk "over your head". Anyone speaking like this in front of me I would immediately dismiss as an insult to my intelligence.

Robo Advisors

To actually believe active management does not outperform passive is only a current "sales pitch". It soon will pass. While my chances at doing better than the average person at tennis who only wins 50% of his matches depends on the day and my opponent, there will be obvious winners and losers amongst money managers as well. Of course the higher the fees the more difficult it would be to perform well. Back when you could list all mutual funds available in Canada on a single piece of paper, four mutual funds stood out: the Cundill Fund, the Industrial Growth Fund, the AGF Special Fund and the Templeton Growth Fund. Of course these funds were relatively small but each fund averaged roughly 10% per year between 1974 and 1984 when the markets were basically flat.

CSA's view:

…embedded commissions can incent dealers and their representatives to sell funds that compensate them the best or focus on only those funds that include an embedded commission rather than recommend a more suitable investment product; specifically, they can encourage a push for higher commission generating funds, such as higher-risk actively managed funds, which can impair investor outcomes.

If the regulator sees a world where passive investing will outperform active then I will definitely become a dinosaur in the industry. As stated previously, mutual funds are primarily sold not bought. Clients will and do prefer to pay a sales fee imbedded or otherwise to get advice. If I was to sell only passive low commission funds for free I would quickly look for other employment and the industry would also have difficulty retaining any quality salespeople.

My Fear of Unembedding Trailer Fees

I absolutely hate bank charges. The same $19 a month shows up on my statement every month unless I maintain a certain balance in my account. My fear is that if clients are charged monthly service fees outside of the fund they will be constantly reminded of the fees they are paying. When times are good there should be no problems but when the market fall which they will do then this charge might be enough to make the client redeem. As everyone knows, these redemptions primarily occur at the bottom of the market not the top. This would be a disservice to them.

Language is an Issue

While a fully informed client is preferred, the regulator must understand that investing in itself is a language that is not easily understood by the public, advisors, nor some manufacturers. I was at a recent investment conference in Banff hosted by the Franklin Templeton Group of funds. While I was interested in some speakers I had a difficult time understanding the alpha, beta and gamma that the fund manager was talking about as crucial for their fund to do well. He might as well have been speaking Spanish. I was more interested in seeing if one of my holdings, Ithaca Energy would do a compulsory buyout of the remaining shareholders. If I was right, the shares I could buy at $1.55 would be bought out soon at $1.95 based on Ithaca taking up 92% of the outstanding shares already.

Now I bring this up because this is relatively simple for me because I know the language and have been involved in a number of takeover deals in the past. I would say this fund manager is actually clueless on managing his fund which I would never recommend to any client. But the advisors in the room do not know this. At another conference put on by Mackenzie on the 24th of May I attended a presentation by their lead fixed income manager who did not even mention the yields on the bonds within his fund. To say that the emperor has no clothes on would be an understatement. At least he had on a good suit.

Investing is never easy but it is made all the more difficult by the fact that new funds are increasingly brought out as new funds without a track record are more exciting than older funds. And poorer performing fund tend to perform better than current 5 star funds due to a “reversion to the mean” but everyone goes off a fund’s current track record for comfort.

Direct Sales of Funds

If the regulator believes investors are better off with a direct sales model where the client buys directly from the manufacturer and more “aligned” I doubt this is the case. As an advisor and dealer I want the clients in funds that perform the best along with a high degree of security. That way my client is happier and will keep his investments with me, maybe invest more and likely will be a good source for referrals. Doing the opposite just means I am shooting myself in the foot eventually and risk losing the client forever.

Altamira went direct a number of years ago and gathered many assets due to their star manager Frank Mersch. Dare to say, the experience was likely not that good for clients who are attracted to better performing funds even though they rarely see the future risk they are assuming with the outperformance. Altamira, alas, had to sell themselves off while they still had some assets as redemptions became rampant. I would say the experience will be similar to any other firms that plan to or are currently selling direct now.

My Recommendation

Funds sold on a DSC basis are a bain of the industry. Getting rid of this sales practice would go a long way in lowering the administrative costs of dealers and manufacturers and obviously clients would be better off not being trapped in a product. If a client holds a front end fund today he or she is always free to move it should they believe the performance of the fund is lacking, or move the fund to another representative or dealer if they feel their account is not getting serviced properly.

Lowering trailer fees by having them negotiated between the representative and client should do away with conflicts and also improve the transparency of these fees/charges. I do not see much difference between having the fund companies charge trailer fees on a regular basis by selling client fund units and charging these amounts internally. I just do not think it is in the client's best interest to keep reminding them of the fees especially when the markets drop. Mutual funds are a great product and I have seen many financial "successes" over the past 35 years that may not have been possible had the client been given more incentive to redeem at the wrong time in the market cycle.

Dan Good

President

D.W. Good Investment Co. Ltd.

June 08, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Re: **CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS**

I am an investor. A significant portion of my portfolio is invested in mutual funds. I am compelled to provide feedback on the above consultation paper. As I am not a fund manager, dealer or advisor I cannot respond to many of the questions in the consultation paper. However, I offer my overall perspective on some of the key matters being raised in the consultation paper. My points of interest are:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.
2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.
3. Embedded commissions paid generally do not align with the services provided to investors.
4. The requiring of disclosure of the actual dollar amount of fees paid and returns foregone. The CSA chose not to proceed with this option as it does not anticipate that it will have any measurable effect in addressing any of the other investor protection and market efficiency issues identified by the CSA.

I offer the following perspective on the above four points.

Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.

This matter has been of concern to me, and other investors I have spoken to. This is an obvious conflict of interest that has the potential for increasing the value of returns foregone due to investments in underperforming funds offering higher commissions to dealers and advisors. The elimination of embedded commissions including such incentives as ongoing trailing commissions and upfront sales commissions would be beneficial in ensuring dealers and advisors remain focused on providing services that benefit investors.

NOTE: Although not discussed in the consultation paper, there is the matter of fees being based as a percentage of the value of the investment in a fund. It is unclear to me how a fund manager can justify an increase in dollar value of fees based solely on the value of the investment. A doubling of the value of my investment in a fund does not double the cost of managing that investment.

Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.

The myriad options of embedded commissions are overwhelming for the lay person investor. Even with ongoing interaction with investment advisors, it is difficult to comprehend what fees are being paid and for what purpose. The introduction of clear and simple fees for service would offer the average investor the opportunity to make informed decisions on investment options. Fee based series of mutual funds provide a methodology for compensating dealers and advisors. The amount paid should be based on what level of service the dealers and advisors provide to investors.

Embedded commissions paid generally do not align with the services provided to investors.

Presently, the services provided by my investment advisor are superior to past experiences. However, this is mainly due to the character of my investment advisor and not a reflection of the embedded commission structure presently in place. My experience with past advisors certainly suggested that their services did not align with the embedded commissions they received. Analysis of past performance of my portfolio and a straightforward review with a knowledgeable and principled investment advisor identified obvious shortcomings in service delivery. The elimination of embedded commissions could provide an opportunity for improved service delivery based on clear and simple fees.

The requiring of disclosure of the actual dollar amount of fees paid and returns foregone.

The CSA has chosen to not pursue this option. It is puzzling to me why that position has been taken. Although explained in the consultation paper, it does seem to me that the reasons for not pursuing this option are somewhat weak. The reasons include such matters as limited benefit to investors and potential significant costs for implementation.

It is my opinion that there is significant benefit to investors. Namely, knowing exactly how much of my money is being used to manage and administer the fund. Not an MER that I use to attempt at calculating an estimate of fees paid to a fund manager. It is unreasonable to expect an investor to have to perform some form of calculation to determine an estimate of fees paid. Full disclosure, as now required of dealers and advisors, is fundamental in building trust from investors.

To exacerbate the matter, the media has been inundated with advertising from regulators encouraging investors to ensure they know the fees they are paying. The ads are structured in such a manner as to indicate that full disclosure is now required. However, it is not – only the dealers and advisors portions are being disclosed. Not the fund managers. This is confusing in the least and deceitful at its worst.

Further, it is my view that the cost for implementation may be overstated. At present, it is my understanding that the fund managers have the information for each investor in any fund. That is, the fund manager knows how many units I hold in a fund. Additionally, in general the fund managers calculate their fees daily and collect those fees monthly. Although not trivial, I do not believe the cost for manipulation of this data to report individual investors' fees is prohibitively expensive.

Lastly, fund managers should be held to the same standards as dealers and advisors. There is no place for regulatory oversight that establishes a higher standard of disclosure for one portion of the investment industry and not the other. Full disclosure should be just that. It is the only manner in which the average investor can maintain a sense of control on investment decisions impacting portfolio performance.

Sincerely,

Robert Bernard

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Toronto, Ontario Canada M5J 2M3

Private Bank

June 8, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Re: *CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions*

Dear Sirs/Mesdames:

Citibank Canada Investment Funds Limited ("**CCIFL**") appreciates the opportunity to provide comments to the Canadian Securities Administrators (the "**CSA**") on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (the "**Consultation Paper**").

About Citibank Canada Investment Funds Limited

CCIFL is a wholly-owned subsidiary of Citibank Canada, a Canadian chartered bank, which is in turn an indirect subsidiary of Citigroup, Inc. CCIFL is a registered portfolio manager and exempt market dealer in eight of the provinces of Canada, and a registered mutual fund dealer in Ontario and British Columbia. CCIFL sells securities of pooled investment funds to institutional and high net worth individual clients of Citibank Canada on a private placement basis and through accounts managed by CCIFL under the terms of an investment management agreement.

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Private Bank

__Comments on the Consultation Paper__

CCIFL recognizes the potential investor protection and market efficiency issues arising from the prevailing practice of remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions, paid by investment fund managers ("**embedded commissions**") and supports the consideration of different compensation models. However, CCIFL submits that the potential option of discontinuing embedded commissions and transitioning to direct pay arrangements should not apply: (i) to investment funds sold in the exempt market under the accredited investor exemption set out in section 2.3 of National Instrument 45-106 *Prospectus Exemptions* (the "**Accredited Investor Exemption**"); (ii) in particular, to investment funds that are sold under the Accredited Investor Exemption to the category of investors defined as "permitted clients" in section 1.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") ("**Permitted Clients**"); and (iii) above all, to exempt foreign investment funds sold to Permitted Clients.

The focus of the discussion in the Consultation Paper is on "mutual funds that are reporting issuers and members of the organization of such mutual funds". CCIFL supports the consideration of alternative fee arrangements for mutual funds that are Canadian reporting issuers. All such funds are subject to the same regulations, and, therefore, a change in compensation arrangements will apply to all issuers equally and would be unlikely to have an adverse effect on competition, investor access to these mutual funds or to investment advice from dealers of these mutual funds. However, the Consultation Paper also states (*emphasis added*):

> Recognizing that the fee structure of various types of investment funds and structured notes commonly includes embedded commissions, and with the aim of promoting a level playing field amongst comparable investment products and limiting opportunities for regulatory arbitrage, we currently anticipate that any regulatory proposal to discontinue embedded commissions would affect:
>
> - an "investment fund", as defined under securities legislation and
> - structured notes,
>
> whether sold under a prospectus *__or in the exempt market under a prospectus exemption.__*

__Accredited Investor Exemption__

CCIFL submits that any discontinuation of embedded commissions should not apply to investment funds sold in the exempt market under the Accredited Investor Exemption. The Accredited Investor Exemption only allows sales to sophisticated, typically institutional, investors with sufficient financial knowledge and investment experience to understand and take on the risks associated with certain investment offerings. These investors have access to complex and higher-risk investments that are not available to a typical retail investor. As such, CCIFL believes that the objectives of promoting a level playing field amongst comparable investment products and limiting opportunities for regulatory arbitrage would not be undermined by permitting embedded commissions for investment funds sold in the exempt market

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Exempt Foreign Investment Funds

CCIFL submits that any discontinuation of embedded commissions should, above all, not apply to foreign investment funds that are sold to Permitted Clients in the exempt market. Foreign investment funds that are not Canadian reporting issuers are not subject to Canadian regulations and may be permitted to continue embedded commissions pursuant to regulations in their home jurisdiction. The discontinuation of embedded commissions will prevent sophisticated Canadian investors who fall into the category of Permitted Clients from investing in such foreign investment funds, limiting their available foreign investment options.

It is desirable for Permitted Clients in Canada to have cost-effective access to global investment products, thereby necessitating effective access to the brokers and dealers entitled to trade and provide advice in respect of such investment products. These brokers and dealers may be regulated in foreign jurisdictions, many of which permit embedded commissions as a form of compensation. By discontinuing embedded commissions on investment funds sold to Permitted Clients under the Accredited Investor Exemption, the CSA will effectively preclude access to certain foreign investment products and to the advice of brokers and dealers entitled to trade such investment products.

The CSA has recognized that over the years there has been an increasing interest in, and opportunities for, investment in foreign securities by sophisticated Canadian investors. For example, with the implementation of NI 31-103 in 2009, a structure was put in place for facilitating access by sophisticated clients to trading of foreign securities through foreign dealers that satisfy the international dealer registration exemption in section 8.18 of NI 31-103. CCIFL submits that discontinuing embedded commissions on foreign investment funds would limit the investment products available to Permitted Clients in Canada and may prevent such Permitted Clients from accessing the expertise of foreign dealers of such investment funds.

CCIFL submits that certain benefits of embedded commissions, such as access to advice of foreign dealers and heightened competition for foreign investment funds, may outweigh the issues or harms of embedded commissions in these particular circumstances.

* * * * * * * * *

CCIFL appreciates the opportunity to submit these comments to the CSA on the Consultation Paper. If CSA staff has any questions concerning the matters discussed in this letter, please contact Robert McGuire, Chief Executive Officer, at (416) 947-4147 or robertj.mcguire@citi.com.

Yours sincerely,

Robert J. McGuire
Chief Executive Officer

Investia Services Financiers Inc.

Québec, 8 juin 2017

Monsieur/Madame

Nous sortons d'une rencontre avec notre conseillère financière, que nous avons depuis 20 ans, nous sommes très satisfaits de son excellent travail qui nous permet de maximiser nos placements année après année.

Nous sommes totalement en désaccord à tout changement de rémunération de notre conseillère, car les petits investisseurs comme nous, sommes très privilégiés de garder un service aussi professionnel dans les conditions actuelles.

Francois Prémont

Nicole Gravel

June 8, 2017

CSA PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

The Secretary
Ontario Securities Commission
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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Thank you for providing me with the opportunity to offer my thoughts on Consultation Paper 81-408. This is quite possibly the most important piece of regulatory reform that the Canadian Financial Services industry has ever faced. It is obviously important that stakeholders work hard to 'get it right' and to consider the range of possible outcomes when weighing alternatives.

I'd like to begin my comments with a pre-emptive observation about the terminology that is used in this paper and in other papers that are similar in tone and substance. This is in regard to the loose application of the term "unintended consequences" – at least in regard to the entities that offer their comments. Specifically, I believe more explicit clarity ought to be provided regarding the true intent of possible consequences. As such, I'd recommend simply using the less-judgmental term 'consequences'. In short, what matters about public policy changes are the consequences of actions taken – whether they were intended or not. For example, there might be a broad agreement that certain reforms might reasonably result in a reduction in the number of advisors offering financial advice. Some commentators might think this is a potentially positive likely outcome, while some stakeholders might see it as being a potentially negative outcome. What matters here is the outcome itself, not the terminology of how that outcome is to be positioned (whether the outcome is intended or not is largely and inherently a value-judgement). Stated differently, the same facts / consequences could be characterized differently depending on who is making the submission. Some might say that an outcome is positive (i.e. an "intended outcome"), while others might say (for example, decline in the number of advisors) is likely to be negative (i.e. an "unintended outcome"). My simple point is that the word "unintended" can be manipulated. It is often used as a synonym for words like "unfortunate" or "unpopular" when in actual fact, unintended consequences are simply those that people might not reasonably foresee.

By way of clarification, I believe the potential reduction in the number of advisors is both likely and positive. To me, it is neither here nor there whether that potential outcome was intended or not. It simply is. Furthermore, I believe it is an outcome that most reasonable people who understand the situation would reasonably foresee. As such, it would be disingenuous, in my opinion, to portray the consequence as "unintended". The term "unintended" implies that you didn't see the consequence coming – irrespective of whether that consequence is positive or negative. That's simply not the way many commentators use the term.

***

Please note that while I work as a portfolio manager at an IIROC member firm, I am nonetheless functioning as an independent contractor and the views expressed in this document are strictly my own. None of the comments that follow should be misconstrued as representing my place of employment. I will allow those people to speak for themselves just as I am speaking for myself.

For greater detail, I ask that the people reading this submission refer to my book <u>The Professional Financial Advisor IV</u> for more detail – especially chapters 4, 5 and 10 through 15. I provided copies of my book to both Dennis Yanchus and Chantal Mainville of the OSC in late 2016.

***

Rather than go into an inordinate amount of detail at the outset, I feel it would be best for me to answer the specific questions that are posed throughout the body of the consultation paper and to offer a summary and final overview once I have done so.

Therefore, my answers to your specific questions are as follows:

1. Yes. I feel the issues are essentially self-evident.
2. While not noted expressly in the introductory section, a key problem is the competitiveness of other products and investment alternatives. Stated differently, the opening section seems to deal with how embedded compensation can skew recommendations relative to competing products that pay lower commissions. However, there are a number of competing options (ETFs come to mind) which are often superior, cheaper, more transparent (regarding underlying holdings) and more tax effective (due to generally lower turnover) which are not expressly referenced at all. To my mind, the bigger problem is one of recommending the best products available; not merely the best products from among those that might pay an embedded

commission. My experience is that for many (mostly MFDA) advisors, the surest way to find your way off the product shelf is to have a product that does not offer embedded commissions. If one takes the view that mutual funds, in particular, are sold; not bought, then it should logically follow that registrants will likely prefer those products that are 'easy to sell'. In short, the 'other harms' that you ask about include foregone opportunities to substitute superior products into clients' portfolios in lieu of those that pay embedded commissions.

3. The short answer is 'no'. The longer answer is that concepts like 'access to advice' are red herrings. Changing how one pays for advice has zero economic impact on how much one pays.
4. The short answer is 'yes'. Normally, answering 'yes' would involve a non-response to corollaries a and b, however, I feel I need to respond at any rate. I have nothing to add re: a, but I do believe that, further to b, there is a real risk of regulatory arbitrage if embedded compensation is discontinued for some products and not others. Ironically, you have asked for empirically evidence in this paper. However, the nature of this question means that people will be required to offer their best guesses in light of the obvious lack of clear evidence regarding potential outcomes. I have heard a considerable amount of anecdotal evidence (some of which may have come to light after this discussion paper went to press) that many dual licensed registrants (both insurance and funds) were moving their practices toward segregated funds precisely because they did not want to be held to the standards set out in CRM II. If that trend is even modestly apparent due to CRM II, it would likely be highly apparent if embedded compensation was discontinued for mutual funds, but not segregated funds.
5. The simple answer is 'no'. This sort of policy would work best in a world where there is a level playing field and all participants (including discount brokerages) charged separately for the advice they give…. or are prohibited from charging in those instances where they expressly offer no advice whatsoever.
6. In my view, all manner of embedded compensation ought to be discontinued as per my previous response. There should be no exceptions. Embedded compensation should be discontinued across the board.
7. Yes, I agree. It simply maximizes transparency, minimizes bias and goes much further in exploding the (still prevalent after CRM II) myth that financial advice is "free".
8. Other compensations need not be under consideration for discontinuation at this time. As has been noted by the Brondesbury and Cumming Reports, embedded compensation compromises recommendations and creates an environment that can fairly be described as having advisor bias. Although I have personally not seen any research regarding advisor bias being caused (or even exacerbated) by the types of compensation noted in the original question, I do not believe it would be particularly material even if it did exist. Furthermore, some elements (small token gifts) will be difficult to monitor and might be open to interpretation if enforcement was attempted). If a limit is $100 and a company gives an advisor a golf shirt that cost $50 to manufacture, but that retails for $120, was the limit exceeded? Better to stick with the major concerns rather than getting involved in minutiae. The possible exception here is underwriting commissions. At present, some firms allow advisors to double dip – either by buying new issues directly into fee-based accounts or by buying them in commission-based accounts and then transferring them into fee-based alternatives. To my mind, the surest way to end this abusive practice – which is clearly contrary to the spirit of the regulations even if it is not always clearly contrary to the letter – would be to remove all embedded compensation from new issues.

9. In my opinion and further to the answers given to question #8 above, the answer is 'no'.
10. I have very limited experience regarding the questions asked in this section and, as such, I will refrain from commenting.
11. The idea of simplified payment remittances lies at the heart of making embedded compensation disappear, in my opinion. Too often, stakeholders come forward with the ridiculous positon that paying separately would cause clients to leave their advisors and create an "advice gap". This is total rubbish. Assuming all else to be equal, the amount being paid would be unchanged whether the payment is made via the payment of trailing commissions, the payment of direct and separately charged fees or the liquidation of pre-existing holdings to pay the fees. The quantum of payment does not change simply because the method of collection and remittance changes. The explanation that I like to use is that one dollar does not cost more than four quarters. The extent to which people refuse to pay for separate, transparent and duly itemized fees seems to be dependent on the extent to which they understand how and how much people pre-existing payment methods cost. Correlation is not causation. Certain groups would have people believe that charging separately makes advice less attainable. In fact, it simply makes the cost of advice more transparent. People refuses to pay not because they cannot do so (indeed, the cost of advice is unchanged), but because they are now being shown (in many instances for the first time) in a clear, unambiguous way just how much financial advice costs. The industry says it favours disclosure and transparency, but that is not strictly true. My experience is that certain stakeholders make disclosures only to the extent that they meet their (modest) regulatory obligations. In so doing, they are obviously not gaining an informed consent from their clients, because those same clients often refuse to pay when they are made to understand that financial advice is not "free". Facilitating payment (for instance, by redeeming units of mutual funds) would mean that those people who do not wish to pay separately could be accommodated seamlessly.
12. Categorically yes.
13. There needs to be a CRM III sort of disclosure that begins either prior to or concurrent with the ending of embedded compensation whereby consumers are told explicitly (in yearend dollar terms) how much their investment products cost. $100,000 in a front end equity fund with a 2.4% MER currently notes that compensation to the advisor and firm is (typically) $1,000 annually. It does NOT note that there is an additional $1,400 product cost being borne by the investor. In short, the quantum of product cost and the importance of product cost are not salient considerations for most retail investors. They ought to be. Making the information transparent is akin to making it salient. The entire challenge is to help investors make informed decisions. As such, the principle of informed consent needs to be championed and all means available to apply the concept should be utilized.
14. The answer to the conflicts of interest question depend on how the transition takes place. The devil is in the details, as they say. For instance, if an advisor could make more money using one format over another (if there is a period when both are at least somewhat available), one ought to expect the system that pays the advisor more to be the system that is recommended – all else being equal. Assuming all inherent conflicts can be eliminated (or at least honourably controlled for), I would not anticipate any problems.

15. In my opinion, the answers are/ outcomes will be as follows:
    - The will indeed be a greater alignment of services, products and overall advice.
    - The change will likely provide a moderate boost to the adoption of online services. The ramifications are likely too difficult to predict given the lack of statistically significant evidence on the subject. However, recent studies (Dalbar QAIB and the recent report from Morningstar Inc. of Chicago have found that mutual fund performance experienced by average Canadian fund investors is often worse than that of the funds they hold). As such, online and "robo" offerings may well gain increased acceptance as people come to understand the importance of managing both product and advisory costs and investor behavior as primary determinants of investment outcomes.
    - Discretionary is likely to increase as well. As a portfolio manager, I can tell you that my decision to offer discretionary series was driven by a different consideration – the desire to be held to a fiduciary standard. I made the decision to offer fee-based advice more than 15 years ago. Offering discretion is a logical extension of that earlier decision, which was nonetheless motivated by the principles set out in your paper: transparency, lower product cost and the breaking of the link between products recommended based primarily on preferred advisory business models.
    - Discount brokers are also likely to grow as a result of this change, but my suspicion is that the difference here will be relatively modest. The only real reason why people might switch to a discount broker as a result of the changes in 81-408 being enacted is that it might be cheaper to buy mutual funds by advoiding otherwise embedded trailing commissions. Anyone who is inclined to use a discount broker, but not mutual funds would likely be unaffected.
    - The cost of advice will be more granular as a result of unbundling. Specifically, small investors will likely end up paying moderately more for advice (but will likely be able to save a greater amount in lower product costs). Larger accounts (for instance, those over somewhere between $500,000 and $1,000,000) will likely pay the same or less for qualified advice. I would not expect a change in compensation methodology to lead to a material change in the services being offered. People generally do what they like and / or are comfortable doing – irrespective of how they are paid to do it.
16. In general, I would not expect broker/ dealers to offer different payments based on the segmentation of clients (for instance based on age, income, gender, profession, etc.). The primary means of segmentation will likely continue to be investable household assets, with a sliding scale being offered to offer competitive pricing for more desirable affluent households.
17. This proposal will absolutely, positively NOT result in an "advice gap". Changing how one pays does absolutely nothing to change how much one pays (*ceteris paribus*). A dollar does not cost more than four quarters. In particular:
    - Smaller investors are the ones least likely to pay – but only because they still do not (by and large –even after the reporting being done in CRM II) understand how and how much their advisor (and advisory firm) are being paid. Those who "refuse" to pay are largely oblivious to the **fact** that they have been paying for advice (often at similar or identical dollar amounts) all along.
    - I agree with the definition, but do not believe it will be manifested in the way that those who have expressed a concern about it would have people believe.

- There should be absolutely no distinction between face to face advice and 'robo' advice. This is especially true since there is no evidence (that I have seen, at any rate) that demonstrates the superiority of one format over another. Presumably, the distinction would be made on the premise that one kind (humans would always have the public believe they are better than pre-programmed algorithmic robots). Increasingly and in virtually all walks of life, artificial intelligence is disintermediating and disrupting pre-established business models. The onus is on those who claim the disruption is harmful to demonstrate that claim. To date, I have seen no such evidence.
- The things that would be most affected are mutual funds offered through discount brokerages and mutual funds offered to low-end (under $100,000 in household assets) families. Discount brokerages will be more compelling for DIY mutual fund investors. Many of the advisors serving small accounts insist that they add value through constructive behavior modification (i.e. encouraging higher savings rates). While possibly true, it might be equally true that 'robo' advisors are even more valuable (i.e. encourage the exact same behavior to the same extent, but at a lower cost). Again, I believe it is too early to say one way of another, but to suggest that the human approach is self-evidently superior is silly. Humans are the 'devil we know'. Presently, we simply do not know how effect 'robo' advisors might be in helping people to deal with their heuristic shortcomings. Time will tell.
- I do not believe the interplay between this initiatives or others will make for a material change (either better or worse) in the advice gap because I simply do not believe that there will be an advice gap.
- There is no need to mitigate things that do not exist. What are we doing to protect ourselves from a Martian attack?
- The short answer is 'no'. If anything, the expansion of online advice will serve to further democratize access to advice because the cost of advice with product implementation through 'robo' advisors will be the cheapest delivery mechanism available. Remember this: price is what you pay; value is what you get. In order to offer even comparable value, humans need to offer better advice, because the cost of 'robo' advice is lower than the cost of human advice. To my mind, 'robo' advisors represent an exciting and positive alternative for households with less than $100,000 in investable assets.
- I do not believe an advice gap will develop, but I fail to see how the concentration of advice offered by a particular channel (for instance, banks) would have an impact if it did develop.

18. Directionally, the industry would continue to transition toward unbundled formats at any rate. The issue here, however, is one of magnitude, not direction. Moving from 10% to 20% unbundled or from 20% to 25% is all fine and well, but if the pre-eminent problem is one of advisor bias, then that directional movement to (say) 25% unbundled would still leave 75% of the advisor population subject to bias-laden advice as a result of the harmful effects of embedded compensation. This matter is too important to leave to self-selection. Do police forces simply "encourage" people to refrain from drinking and driving without providing sanctions for those who fail to comply? Moral suasion is not nearly a powerful enough lever to cause such a necessary and fundamental shift to take place. Stronger measures are clearly in order.
19. Accepting that the depiction is necessarily general in nature, I believe the depiction set out in Figure 8 are reasonable. I would expect the industry to continue to evolve and migrate toward

higher end services and fees structures with algorithmic alternatives taking up the slack for the low end advisors and the clients they serve.

20. The only obstacles that exist are those that are implicitly imposed by dealers themselves. For instance, many vertically-integrated MFDA firms have been slow to offer true fee-based platforms. If they did, advisors might use them. But if advisors used them (i.e. substituted high-cost products for low-cost products in favour of their clients), it would hurt their employers. Employers call high-cost products “high-margin” products. To the extent that employers can delay the adoption of technologies and trading platforms that might be in their clients’ best interests, they effectively maintain the status quo. Since most advisors at MFDA firms are more loyal to their employers (who defend their mutually-beneficial compensation models), only a modest number of would –be early adopters press for change. These people are quickly and easily marginalized as “troublemakers” when the prospect of real change is put on the agenda.
21. For purposes of this discussion:
    - I absolutely believe that industry consolidation will continue – and likely accelerate.
    - Consolidation is likely a positive development since it will leave only the largest, most well-capitalized firms standing. This, in turn, should provide greater stability and possibly even more compelling economies of scale for those people who would use these services (i.e. ordinary investors).
22. The challenges are likely to be as follows:
    - Independent dealers – operational and compliance-based in nature
    - Independent fund manufacturers – nothing but pain. They will lose market share and will have lower margins on the assets they retain
    - Integrated financial service providers – will likely fall somewhere between the two groups above depending primarily on whether they are more like the first group or the second
    - Mutual fund dealers – see Independent Fund Manufacturers
    - IIROC dealers – largely impervious. These firms have already gone through the necessary changes. They will sit back and watch the disruption that is about to hit the low (and perhaps even middle) segments of the market.
    - Online/discount brokers – will lose (most of) the cash cow of mutual fund trailing commissions, but otherwise be unaffected.

    - Regulatory arbitrage is likely to occur in the first few years. The extent to which it occurs depends primarily on relative timing. If there’s a sense that there will be a long (say - 4+ year) lag between eliminating embedded in mutual funds and eliminating embedded in segregated funds, many near-retirement advisors (in particular) will simply make a modest change to their product mix in order to avoid having to make a more drastic change to their business model.
    - Dually-licensed registrants might be the most inclined to engage in product arbitrage. The major impact for them would be to have to re-paper their clients using insurance application forms. I have little insight to the other parts of this question.
23. I am unaware of any back-office limitations, but would caution you that some people (read: me) suspect that many firms opposed to this potential change will make excuses and suggest that technological and / or operational change will be too difficult to implement. The challenge, of course, is that claims of this sort are difficult to reliably confirm or refute (which, of course, is

precisely why they are made in the first place). The need for controls and oversight would simply change. Going forward, the need would be to ensure that clients were not being overcharged in some manner. At no point would any reputable person recommend not providing meaningful oversight with so much money at stake.

24. The short answer to your question is "of course". Once again, four quarters is neither less than nor more than one dollar. Changing how one pays ought to have no impact whatsoever on how much one pays. To the extent that it does (or to the extent that people allege that it does or that it has in the past), the reasons are pretty much entirely rooted in the parties not understanding how (and how much) they were paying in the first place. No rational person would be opposed paying the same amount in a different format.
25. Some ultra-progressive advisors (not entire firms) might move to a mixed model with a base retainer fee and an asset based fee on top. It guarantees a minimum annual income and often has specific (often annual) deliverables attached to the offering. This would likely round to zero as a percentage of the advisor population, however.
26. To my mind, the impact on representatives will be as follows:
    - career path – the industry will be more professional in the future. Much like young dentists entering the business, there would likely be an increased opportunity to buy a practice and to pay the retiring advisor out of the cash flow of that practice over a number of years
    - attractiveness of the job – massively positive. This is one of the very best career options available. It should do a better job than ever of attracting the best and the brightest.
    - typical profile of individuals attracted to the career – commensurate with a new doctor or accountant or engineer
    - recruitment – turning many good people away because there are only so many new spots / retiring advisors to go around
    - relative attractiveness of careers in competing financial service business lines – the top of the pyramid
27. My sense is that the mitigation measures being contemplated would do a good job of ensuring that access, choice and a level playing field are maintained for clients in all circumstances.
28. There are no other measures that I can think of that might help.
29. At the beginning of this document, prior to answering the specific questions, I made the point that "unintended consequences" is a bit of a loaded term since it's applicability depends primarily on what one's intent was in the first place. My example (again) is in regard to the population of advisors. I believe we have too many. As such, I believe that a reduction in the advisor population would be an extremely positive development for consumers – especially small consumers. As such, a reduction in the number of advisors would, to me, be both expected and intended. Most of all, it would be welcomed. Other stakeholders would likely point to a similar fact pattern and allege that these consequences would be a bad thing. In short, "unintended consequences" has become code for "bad thing". I simply disagree with this usage. The adjective is redundant and value-laden. These future outcomes should simply be called "consequences". The same goes for the word "choice". More choice is not necessarily better choice. Adding an inferior choice to a pre-existing menu that was entirely adequate is of not utility (and likely has a clear disutility) to those doing the choosing. With that out of the way, my view is that all consequences would be of the minor variety and could be dealt with relatively easily and purposefully.
30. My views are as follows:

a) Using a 1% trailing commission as a baseline, I will use my own fee schedule as a guide regarding the cross-subsidization of clients. My fees are 1.4% on the first $250,000; 0.8% on additional assets up to $1,500,000 and 0.5% on assets above $1,500,000. Accordingly, my fees are:

$250,000 – 1.4%; $500,000 – 1.1%; $750,000 – 1.0% (the point of indifference); $1,000,000 – 0.95%; $1,500,000 – 0.9%; $2,000,000 – 0.8%. Anyone who has an average client with less than $750,000 in investable assets would actually increase their revenue. This is also good news for the profitability of broker-dealers.

b) The short answer is "yes". Although my personal break-even point is $750,000, I also pass along product savings of about 1% relative to other market participants (MFDA registrants in particular). My experience is that clients with $500,000 to invest would gladly pay an advisor 10 bps more if that advisor had the decency to use product that cost the client 100 bps less. That's still a net saving of 90 bps ($4,500 annually on a $500,000 account) to the client family.

c) I'm unsure of what is being asked about eliminating a cross-subsidy. Nonetheless, I believe it might be useful to provide mandatory information to all clients with over $500,000 in mutual funds that they could realize substantial savings if they were to switch to a direct pay method and to using other products (e.g. ETFs and individual securities) as compared to their current product mix.

31. The industry could engage in a period of hyper-disclosure with a clear two page document given to all clients with embedded compensation that offers a clear, concise explanation of the change that can be easily understood (and not manipulated by unscrupulous people who continue to insist that advice is - and always was - free). This could be similar to the Client Relationship Disclosure documentation that became mandatory after the introduction of CRM I. Written client disclosure verifying that the documentation has been received would ensure that facts could not be misrepresented.
32. Transition options depend very much on the individual practice. It would be extremely difficult, in my opinion, for anyone to offer general advice on the topic of transitions, since various advisors will be at varying stages of readiness and so their clients will have different (both in identity and in magnitude) challenges in adjusting to the new order. Flexibility is paramount. My view is that an appropriate transition period would involve a clear deadline set out in 2017 with clear intermediate steps along the way. For instance, it could be announced that embedded compensation would end on December 31, 2020. It could be further announced that until that date, all funds sold with a back end load would need to have their penalty period expire on or before that date. A fund sold in 2018 might only have a 2-year DSC penalty and a fund sold in 2019 might only have a one year penalty. Funds sold in 2020 might carry a trailing commission, but would no longer be able to have a DSC of any kind. Finally, if technology allows the industry to reliably identify funds with embedded compensation (i.e. via discreet fund codes), then there could be a period where embedded funds and unbundled funds co-existed in client accounts, provided that there was a reliable way to avoid double-dipping (i.e. to ensure that only F Class funds attracted an advisory fee).
33. My dream would be to have all embedded compensation gone from Canada as we begin 2021. It is, to me, the first reasonable opportunity to do away with embedded commissions.
34. No caps should be placed on embedded commissions other than the elimination timeframes I noted above.
35. I believe the steps under consideration are sufficient.
36. There are no other alternatives that I can think of.

Thank you for your time and consideration. The exercise is a useful one and I'm sure you will be receiving a number of thoughtful responses to this important matter. Even though I strongly support the general thrust of this paper, I cannot help but wonder why it has taken so long for us to come this far. I was involved in the Fair Dealing Model Consultations over a decade ago.

Given my tenure on this file, you might imagine that there are some things that I find disheartening about the exercise. The consultation paper asks that commenters not re-hash previously-made arguments, but rather answer the pointed questions that the paper asks using demonstrable facts. The question that this begs is: “where was the insistence that people use only factual information previously”? There was a clear sense that embedded compensation causes advisor bias that came out of the Fair Dealing Model final report. In spite of this, the CSA only commissioned research that empirically demonstrated advisor bias recently- with two groundbreaking reports being released in 2015. My question to the CSA, therefore, is: “if you honestly wanted evidence of advisor bias, why did it wait you a decade to commission research to determine whether or not embedded compensation caused bias”? Dithering is not a course of action that can be reputably followed by anyone who purports to take purposeful action. If your house was burning, how long would you wait before you called the fire department? If your child was missing, how long would you wait until you called the police?

In spite of my obvious frustration, all will be forgiven if the people at the CSA can act purposefully rather than merely consult symbolically. The time has come to act. For the love of all that is decent in this world, please put an end to embedded compensation at the very first practical opportunity.

Sincerely,

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CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS
http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf

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Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Your consultation paper is thorough, lengthy and complex. Much thought and work obviously went into it and for this you should be commended. Most small investors though, do not even know about your deliberations. Real effort must be extended to actually reach out and hear the voice of the public.

Time after time these consultations are put forward and you are flooded with industry response. A few faithful investor advocates do their best to represent the voice of the public, and to whom small investors owe a great deal of gratitude. But you have a responsibility to engage the public in these important discussions and deliberations. In the future, may I suggest, you consider a different document and questionnaire that is geared to the general public and issued simultaneously. Most Canadians will not find themselves comfortable addressing such a large daunting document such as this one, but it is unfair to deliberate and make such important decisions without their voices being properly heard and given equal time and weight. Their voices must not continue to be drowned out by the industry, for they too have a stake in the game, often their life savings and future retirement!

It seems that whenever the industry doesn't like what the research and data demonstrate they just repeat that things are not clear.

"The Investment Funds Institute of Canada (IFIC) is calling on the Canadian Securities Administrators (CSA) to consider whether there's sufficient evidence of market failure to justify prohibiting embedded commissions and recommends that the CSA review other options."
http://www.investmentexecutive.com/-/ific-calls-on-the-csa-to-reconsider-potential-embedded-commissions-ban?utm_source=newsletter&utm_medium=nl&utm_content=investmentexecutive&utm_campaign=INT-EN-All-afternoon

"What is not at all clear is the extent to which Canada's dominant model of embedded compensation is harmful."
https://www.ific.ca/en/news/ific-ceo-responds-to-release-of-csa-consultation-paper-on-embedded-commissions/

I think Professor Cumming's research answers quite clearly that this compensation model *is* harmful to investors.

"In the buildup to the regulatory review of trailer fees in Canada, the mutual fund industry is trying to wage an ill-advised battle of misinformation. And one of the key tactics in this battle is to dispute facts and studies, including one I co-authored, ***that have proven beyond a doubt the detrimental effect of these fees.***
At the risk of making an analogy to the cigarette industry and early denial of the harm caused by cigarettes, ***I hope we stop blowing smoke and make use of the information and data provided by the mutual fund industry that clearly show trailer fees harm Canadian investors...***

"We appreciate that the industry has a substantial financial interest in keeping trailer fees in Canada, ***with over $5 billion per year charged to Canadian investors****. My co-authors and I have no financial stake one way or the other. We simply report what the data indicate."*
http://www.moneysense.ca/save/investing/blowing-smoke-on-trailer-fees/

If the research had gone the other way and shown that there was no harm to investors, the industry would have been sounding the trumpets and beating the drums over and over about that! But apparently the industry wants to shoot the messenger, since they have $5 billion per year at stake here.

I really like what Portfolio Manager, John De Goey says, "Making compensation transparent does not do anything to change pricing. Four quarters does not cost more than a dollar; not liking having to pay separately, does nothing to change the quantum of payment."
http://www.wealthprofessional.ca/news/a-portfolio-managers-view-on-the-ban-on-embedded-fees-223144.aspx

But I wonder in the financial industry, does it change the quantum of payment somehow? I can't help but feel they so desperately want to hang on to embedded commissions because they have ways of presenting it on reports that still keep things hidden and obscure from clients eyes. Since four quarters equals a dollar and since the client ultimately has to pay, lets just agree to make it plain, upfront with no blinders.

People should be informed. Informed consent should be a primary right for all clients. Why the CSA and provincial regulators allowed years for CRM2 to unfold and for fees to be hidden from clients sight is shameful. The industry fails to demonstrate why any client would be opposed to paying the same amount for advice and the same amount or less for investment products, once they actually truly understand. Why would transparent advice be less accessible to investors of any account size? It just doesn't make sense, except if they fear that when one sees what they are paying, they may not believe it is worth paying. Is there demonstrable value or not? People have a right to clearly know and decide for themselves.

Maureen Jensen in her speech at the Toronto Board of Trade in 2016 cited important research from the National Bureau of Economic Research. She said, *"research suggests **a combination of embedded fees and unsuitable portfolio construction has caused the investment returns of advised clients to lag passive market benchmarks by two to three per cent a year."The impact of these fees on investor returns is significant,"*** she said. ***"Investors experiencing this kind of outcome on a consistent basis would never break even and would, in fact, be worse off."***
http://business.financialpost.com/news/fpstreet/canadas-market-watchdogs-look-at-fundamentally-flawed-embedded-fees-on-investment-funds

With more and more employers no longer offering defined pensions, this research and its indicated outcome where investors lag benchmarks and may even be worse off, spells disaster for untold numbers of Canadians struggling to save for retirement.

Yet *"The industry is disappointed that the CSA has chosen not to consult on less disruptive alternatives and have limited the consultation to one option – a complete prohibition,"* said Bourque.

Less disruptive for whom? We are talking about Canadian citizens futures.

Maureen Jensen's comment addresses this *"The current compensation model consists of fees set by the fund manager **to incent sales. This does not put the investor's interest first, and that's a fundamental flaw that needs to be addressed."***
http://business.financialpost.com/news/fpstreet/canadas-market-watchdogs-look-at-fundamentally-flawed-embedded-fees-on-investment-funds

Deferred Sales Charge (DSC) sold funds are particularly harmful to clients.The 5% upfront payment to dealers and salesperson a.k.a. " advisors" appears to be irresistible to them despite the disadvantages to clients. The constraint on liquidity is not in an advised clients best interests. Note that DSC early redemption penalties cannot be offset against capital gains in registered accounts. Such irrecoverable penalties impair account returns for retirees and pensioners. It is especially egregious for this group whose health may change and access to their funds is crucial. I believe the CSA should act immediately to phase out the DSC option.

What about fee based accounts? There apparently are risks associated with fee-based accounts as well. One of the larger risks is reverse churning. In order for such a payment method to be acceptable,it must be in a clients best interest and be backed up by robust IIROC and MFDA enforcement ,which is sadly lacking at this point. I urge the CSA to make a renewed commitment to dramatically enhance, regulatory protective measures with a client first focus.

At the present time there is also approximately $18 billion in class A funds with discount brokers, paying trailer fees This shouldend and clients should be reimbursed those fees, since they have been charged for advice they did not even receive.

I continue to be concerned that the underlying structure is flawed and regulators are ignoring the real issue. This is no longer a transaction based sales industry, it is an advice based industry. Continually working from a wrong premise will not bring about the desired results for the industry or clients. If the foundation of a building is poor, it does not matter what you build on top of it, or how nicely you decorate the rooms in it. The foundation issue has to be dealt with first.

Ron Rhoades sums up quite nicely what is really needed when clients seek investment advice.

“We have fiduciary standards because disclosures are largely ineffective. A huge body of academic research supports this conclusion.
Say what you do. Do what you say. A fiduciary steps into the shoes of the client, and acts - with all of the expertise required of a professional adviser - with total loyalty to the client's interests.” Ron A. Rhoades
http://scholarfp.blogspot.ca/

Look at the evidence. The way forward is abundantly clear. Embedded commissions must go.

Canadians deserve advisers who acknowledge the high level of duty we are entrusting them with. Advice givers need to understand their role and have the requisite skill, training and supportive regulatory and industry culture going forward. Canadians need real professionals who are willing to embrace the true role of a fiduciary professional adviser.

It is time to do the right thing for average Canadians, who are depending on you to protect them.

I agree to the public posting of this letter.
Debra McFadden
Retail Investor

reasonably result in a reduction in the number of advisors offering financial advice. Some commentators might think this is a potentially positive likely outcome, while some stakeholders might see it as being a potentially negative outcome. What matters here is the outcome itself, not the terminology of how that outcome is to be positioned (whether the outcome is intended or not is largely and inherently a value-judgement). Stated differently, the same facts / consequences could be characterized differently depending on who is making the submission. Some might say that an outcome is positive (i.e. an "intended outcome"), while others might say (for example, decline in the number of advisors) is likely to be negative (i.e. an "unintended outcome"). My simple point is that the word "unintended" can be manipulated. It is often used as a synonym for words like "unfortunate" or "unpopular" when in actual fact, unintended consequences are simply those that people might not reasonably foresee.

By way of clarification, I believe the potential reduction in the number of advisors is both likely and positive. To me, it is neither here nor there whether that potential outcome was intended or not. It simply is. Furthermore, I believe it is an outcome that most reasonable people who understand the situation would reasonably foresee. As such, it would be disingenuous, in my opinion, to portray the consequence as "unintended". The term "unintended" implies that you didn't see the consequence coming – irrespective of whether that consequence is positive or negative. That's simply not the way many commentators use the term.

***

Please note that while I work as a portfolio manager at an IIROC member firm, I am nonetheless functioning as an independent contractor and the views expressed in this document are strictly my own. None of the comments that follow should be misconstrued as representing my place of employment. I will allow those people to speak for themselves just as I am speaking for myself.

For greater detail, I ask that the people reading this submission refer to my book The Professional Financial Advisor IV for more detail – especially chapters 4, 5 and 10 through 15. I provided copies of my book to both Dennis Yanchus and Chantal Mainville of the OSC in late 2016.

***

Rather than go into an inordinate amount of detail at the outset, I feel it would be best for me to answer the specific questions that are posed throughout the body of the consultation paper and to offer a summary and final overview once I have done so.

Therefore, my answers to your specific questions are as follows:

1. Yes. I feel the issues are essentially self-evident.
2. While not noted expressly in the introductory section, a key problem is the competitiveness of other products and investment alternatives. Stated differently, the opening section seems to deal with how embedded compensation can skew recommendations relative to competing products that pay lower commissions. However, there are a number of competing options (ETFs come to mind) which are often superior, cheaper, more transparent (regarding underlying holdings) and more tax effective (due to generally lower turnover) which are not expressly referenced at all. To my mind, the bigger problem is one of recommending the best products available; not merely the best products from among those that might pay an embedded

commission. My experience is that for many (mostly MFDA) advisors, the surest way to find your way off the product shelf is to have a product that does not offer embedded commissions. If one takes the view that mutual funds, in particular, are sold; not bought, then it should logically follow that registrants will likely prefer those products that are 'easy to sell'. In short, the 'other harms' that you ask about include foregone opportunities to substitute superior products into clients' portfolios in lieu of those that pay embedded commissions.

3. The short answer is 'no'. The longer answer is that concepts like 'access to advice' are red herrings. Changing how one pays for advice has zero economic impact on how much one pays.
4. The short answer is 'yes'. Normally, answering 'yes' would involve a non-response to corollaries a and b, however, I feel I need to respond at any rate. I have nothing to add re: a, but I do believe that, further to b, there is a real risk of regulatory arbitrage if embedded compensation is discontinued for some products and not others. Ironically, you have asked for empirically evidence in this paper. However, the nature of this question means that people will be required to offer their best guesses in light of the obvious lack of clear evidence regarding potential outcomes. I have heard a considerable amount of anecdotal evidence (some of which may have come to light after this discussion paper went to press) that many dual licensed registrants (both insurance and funds) were moving their practices toward segregated funds precisely because they did not want to be held to the standards set out in CRM II. If that trend is even modestly apparent due to CRM II, it would likely be highly apparent if embedded compensation was discontinued for mutual funds, but not segregated funds.
5. The simple answer is 'no'. This sort of policy would work best in a world where there is a level playing field and all participants (including discount brokerages) charged separately for the advice they give…. or are prohibited from charging in those instances where they expressly offer no advice whatsoever.
6. In my view, all manner of embedded compensation ought to be discontinued as per my previous response. There should be no exceptions. Embedded compensation should be discontinued across the board.
7. Yes, I agree. It simply maximizes transparency, minimizes bias and goes much further in exploding the (still prevalent after CRM II) myth that financial advice is "free".
8. Other compensations need not be under consideration for discontinuation at this time. As has been noted by the Brondesbury and Cumming Reports, embedded compensation compromises recommendations and creates an environment that can fairly be described as having advisor bias. Although I have personally not seen any research regarding advisor bias being caused (or even exacerbated) by the types of compensation noted in the original question, I do not believe it would be particularly material even if it did exist. Furthermore, some elements (small token gifts) will be difficult to monitor and might be open to interpretation if enforcement was attempted). If a limit is $100 and a company gives an advisor a golf shirt that cost $50 to manufacture, but that retails for $120, was the limit exceeded? Better to stick with the major concerns rather than getting involved in minutiae. The possible exception here is underwriting commissions. At present, some firms allow advisors to double dip – either by buying new issues directly into fee-based accounts or by buying them in commission-based accounts and then transferring them into fee-based alternatives. To my mind, the surest way to end this abusive practice – which is clearly contrary to the spirit of the regulations even if it is not always clearly contrary to the letter – would be to remove all embedded compensation from new issues.

9. In my opinion and further to the answers given to question #8 above, the answer is 'no'.
10. I have very limited experience regarding the questions asked in this section and, as such, I will refrain from commenting.
11. The idea of simplified payment remittances lies at the heart of making embedded compensation disappear, in my opinion. Too often, stakeholders come forward with the ridiculous positon that paying separately would cause clients to leave their advisors and create an "advice gap". This is total rubbish. Assuming all else to be equal, the amount being paid would be unchanged whether the payment is made via the payment of trailing commissions, the payment of direct and separately charged fees or the liquidation of pre-existing holdings to pay the fees. The quantum of payment does not change simply because the method of collection and remittance changes. The explanation that I like to use is that one dollar does not cost more than four quarters. The extent to which people refuse to pay for separate, transparent and duly itemized fees seems to be dependent on the extent to which they understand how and how much people pre-existing payment methods cost. Correlation is not causation. Certain groups would have people believe that charging separately makes advice less attainable. In fact, it simply makes the cost of advice more transparent. People refuses to pay not because they cannot do so (indeed, the cost of advice is unchanged), but because they are now being shown (in many instances for the first time) in a clear, unambiguous way just how much financial advice costs. The industry says it favours disclosure and transparency, but that is not strictly true. My experience is that certain stakeholders make disclosures only to the extent that they meet their (modest) regulatory obligations. In so doing, they are obviously not gaining an informed consent from their clients, because those same clients often refuse to pay when they are made to understand that financial advice is not "free". Facilitating payment (for instance, by redeeming units of mutual funds) would mean that those people who do not wish to pay separately could be accommodated seamlessly.
12. Categorically yes.
13. There needs to be a CRM III sort of disclosure that begins either prior to or concurrent with the ending of embedded compensation whereby consumers are told explicitly (in yearend dollar terms) how much their investment products cost. $100,000 in a front end equity fund with a 2.4% MER currently notes that compensation to the advisor and firm is (typically) $1,000 annually. It does NOT note that there is an additional $1,400 product cost being borne by the investor. In short, the quantum of product cost and the importance of product cost are not salient considerations for most retail investors. They ought to be. Making the information transparent is akin to making it salient. The entire challenge is to help investors make informed decisions. As such, the principle of informed consent needs to be championed and all means available to apply the concept should be utilized.
14. The answer to the conflicts of interest question depend on how the transition takes place. The devil is in the details, as they say. For instance, if an advisor could make more money using one format over another (if there is a period when both are at least somewhat available), one ought to expect the system that pays the advisor more to be the system that is recommended – all else being equal. Assuming all inherent conflicts can be eliminated (or at least honourably controlled for), I would not anticipate any problems.

15. In my opinion, the answers are/ outcomes will be as follows:
    - The will indeed be a greater alignment of services, products and overall advice.
    - The change will likely provide a moderate boost to the adoption of online services. The ramifications are likely too difficult to predict given the lack of statistically significant evidence on the subject. However, recent studies (Dalbar QAIB and the recent report from Morningstar Inc. of Chicago have found that mutual fund performance experienced by average Canadian fund investors is often worse than that of the funds they hold). As such, online and "robo" offerings may well gain increased acceptance as people come to understand the importance of managing both product and advisory costs and investor behavior as primary determinants of investment outcomes.
    - Discretionary is likely to increase as well. As a portfolio manager, I can tell you that my decision to offer discretionary series was driven by a different consideration – the desire to be held to a fiduciary standard. I made the decision to offer fee-based advice more than 15 years ago. Offering discretion is a logical extension of that earlier decision, which was nonetheless motivated by the principles set out in your paper: transparency, lower product cost and the breaking of the link between products recommended based primarily on preferred advisory business models.
    - Discount brokers are also likely to grow as a result of this change, but my suspicion is that the difference here will be relatively modest. The only real reason why people might switch to a discount broker as a result of the changes in 81-408 being enacted is that it might be cheaper to buy mutual funds by advoiding otherwise embedded trailing commissions. Anyone who is inclined to use a discount broker, but not mutual funds would likely be unaffected.
    - The cost of advice will be more granular as a result of unbundling. Specifically, small investors will likely end up paying moderately more for advice (but will likely be able to save a greater amount in lower product costs). Larger accounts (for instance, those over somewhere between \$500,000 and \$1,000,000) will likely pay the same or less for qualified advice. I would not expect a change in compensation methodology to lead to a material change in the services being offered. People generally do what they like and / or are comfortable doing – irrespective of how they are paid to do it.
16. In general, I would not expect broker/ dealers to offer different payments based on the segmentation of clients (for instance based on age, income, gender, profession, etc.). The primary means of segmentation will likely continue to be investable household assets, with a sliding scale being offered to offer competitive pricing for more desirable affluent households.
17. This proposal will absolutely, positively NOT result in an "advice gap". Changing how one pays does absolutely nothing to change how much one pays (*ceteris paribus*). A dollar does not cost more than four quarters. In particular:
    - Smaller investors are the ones least likely to pay – but only because they still do not (by and large –even after the reporting being done in CRM II) understand how and how much their advisor (and advisory firm) are being paid. Those who "refuse" to pay are largely oblivious to the **fact** that they have been paying for advice (often at similar or identical dollar amounts) all along.
    - I agree with the definition, but do not believe it will be manifested in the way that those who have expressed a concern about it would have people believe.

- There should be absolutely no distinction between face to face advice and 'robo' advice. This is especially true since there is no evidence (that I have seen, at any rate) that demonstrates the superiority of one format over another. Presumably, the distinction would be made on the premise that one kind (humans would always have the public believe they are better than pre-programmed algorithmic robots). Increasingly and in virtually all walks of life, artificial intelligence is disintermediating and disrupting pre-established business models. The onus is on those who claim the disruption is harmful to demonstrate that claim. To date, I have seen no such evidence.
- The things that would be most affected are mutual funds offered through discount brokerages and mutual funds offered to low-end (under $100,000 in household assets) families. Discount brokerages will be more compelling for DIY mutual fund investors. Many of the advisors serving small accounts insist that they add value through constructive behavior modification (i.e. encouraging higher savings rates). While possibly true, it might be equally true that 'robo' advisors are even more valuable (i.e. encourage the exact same behavior to the same extent, but at a lower cost). Again, I believe it is too early to say one way of another, but to suggest that the human approach is self-evidently superior is silly. Humans are the 'devil we know'. Presently, we simply do not know how effect 'robo' advisors might be in helping people to deal with their heuristic shortcomings. Time will tell.
- I do not believe the interplay between this initiatives or others will make for a material change (either better or worse) in the advice gap because I simply do not believe that there will be an advice gap.
- There is no need to mitigate things that do not exist. What are we doing to protect ourselves from a Martian attack?
- The short answer is 'no'. If anything, the expansion of online advice will serve to further democratize access to advice because the cost of advice with product implementation through 'robo' advisors will be the cheapest delivery mechanism available. Remember this: price is what you pay; value is what you get. In order to offer even comparable value, humans need to offer better advice, because the cost of 'robo' advice is lower than the cost of human advice. To my mind, 'robo' advisors represent an exciting and positive alternative for households with less than $100,000 in investable assets.
- I do not believe an advice gap will develop, but I fail to see how the concentration of advice offered by a particular channel (for instance, banks) would have an impact if it did develop.

18. Directionally, the industry would continue to transition toward unbundled formats at any rate. The issue here, however, is one of magnitude, not direction. Moving from 10% to 20% unbundled or from 20% to 25% is all fine and well, but if the pre-eminent problem is one of advisor bias, then that directional movement to (say) 25% unbundled would still leave 75% of the advisor population subject to bias-laden advice as a result of the harmful effects of embedded compensation. This matter is too important to leave to self-selection. Do police forces simply "encourage" people to refrain from drinking and driving without providing sanctions for those who fail to comply? Moral suasion is not nearly a powerful enough lever to cause such a necessary and fundamental shift to take place. Stronger measures are clearly in order.
19. Accepting that the depiction is necessarily general in nature, I believe the depiction set out in Figure 8 are reasonable. I would expect the industry to continue to evolve and migrate toward

higher end services and fees structures with algorithmic alternatives taking up the slack for the low end advisors and the clients they serve.

20. The only obstacles that exist are those that are implicitly imposed by dealers themselves. For instance, many vertically-integrated MFDA firms have been slow to offer true fee-based platforms. If they did, advisors might use them. But if advisors used them (i.e. substituted high-cost products for low-cost products in favour of their clients), it would hurt their employers. Employers call high-cost products "high-margin" products. To the extent that employers can delay the adoption of technologies and trading platforms that might be in their clients' best interests, they effectively maintain the status quo. Since most advisors at MFDA firms are more loyal to their employers (who defend their mutually-beneficial compensation models), only a modest number of would –be early adopters press for change. These people are quickly and easily marginalized as "troublemakers" when the prospect of real change is put on the agenda.
21. For purposes of this discussion:
    - I absolutely believe that industry consolidation will continue – and likely accelerate.
    - Consolidation is likely a positive development since it will leave only the largest, most well-capitalized firms standing. This, in turn, should provide greater stability and possibly even more compelling economies of scale for those people who would use these services (i.e. ordinary investors).
22. The challenges are likely to be as follows:
    - Independent dealers – operational and compliance-based in nature
    - Independent fund manufacturers – nothing but pain. They will lose market share and will have lower margins on the assets they retain
    - Integrated financial service providers – will likely fall somewhere between the two groups above depending primarily on whether they are more like the first group or the second
    - Mutual fund dealers – see Independent Fund Manufacturers
    - IIROC dealers – largely impervious. These firms have already gone through the necessary changes. They will sit back and watch the disruption that is about to hit the low (and perhaps even middle) segments of the market.
    - Online/discount brokers – will lose (most of) the cash cow of mutual fund trailing commissions, but otherwise be unaffected.

    - Regulatory arbitrage is likely to occur in the first few years. The extent to which it occurs depends primarily on relative timing. If there's a sense that there will be a long (say - 4+ year) lag between eliminating embedded in mutual funds and eliminating embedded in segregated funds, many near-retirement advisors (in particular) will simply make a modest change to their product mix in order to avoid having to make a more drastic change to their business model.
    - Dually-licensed registrants might be the most inclined to engage in product arbitrage. The major impact for them would be to have to re-paper their clients using insurance application forms. I have little insight to the other parts of this question.
23. I am unaware of any back-office limitations, but would caution you that some people (read: me) suspect that many firms opposed to this potential change will make excuses and suggest that technological and / or operational change will be too difficult to implement. The challenge, of course, is that claims of this sort are difficult to reliably confirm or refute (which, of course, is

precisely why they are made in the first place). The need for controls and oversight would simply change. Going forward, the need would be to ensure that clients were not being overcharged in some manner. At no point would any reputable person recommend not providing meaningful oversight with so much money at stake.

24. The short answer to your question is "of course". Once again, four quarters is neither less than nor more than one dollar. Changing how one pays ought to have no impact whatsoever on how much one pays. To the extent that it does (or to the extent that people allege that it does or that it has in the past), the reasons are pretty much entirely rooted in the parties not understanding how (and how much) they were paying in the first place. No rational person would be opposed paying the same amount in a different format.
25. Some ultra-progressive advisors (not entire firms) might move to a mixed model with a base retainer fee and an asset based fee on top. It guarantees a minimum annual income and often has specific (often annual) deliverables attached to the offering. This would likely round to zero as a percentage of the advisor population, however.
26. To my mind, the impact on representatives will be as follows:
    - career path – the industry will be more professional in the future. Much like young dentists entering the business, there would likely be an increased opportunity to buy a practice and to pay the retiring advisor out of the cash flow of that practice over a number of years
    - attractiveness of the job – massively positive. This is one of the very best career options available. It should do a better job than ever of attracting the best and the brightest.
    - typical profile of individuals attracted to the career – commensurate with a new doctor or accountant or engineer
    - recruitment – turning many good people away because there are only so many new spots / retiring advisors to go around
    - relative attractiveness of careers in competing financial service business lines – the top of the pyramid
27. My sense is that the mitigation measures being contemplated would do a good job of ensuring that access, choice and a level playing field are maintained for clients in all circumstances.
28. There are no other measures that I can think of that might help.
29. At the beginning of this document, prior to answering the specific questions, I made the point that "unintended consequences" is a bit of a loaded term since it's applicability depends primarily on what one's intent was in the first place. My example (again) is in regard to the population of advisors. I believe we have too many. As such, I believe that a reduction in the advisor population would be an extremely positive development for consumers – especially small consumers. As such, a reduction in the number of advisors would, to me, be both expected and intended. Most of all, it would be welcomed. Other stakeholders would likely point to a similar fact pattern and allege that these consequences would be a bad thing. In short, "unintended consequences" has become code for "bad thing". I simply disagree with this usage. The adjective is redundant and value-laden. These future outcomes should simply be called "consequences". The same goes for the word "choice". More choice is not necessarily better choice. Adding an inferior choice to a pre-existing menu that was entirely adequate is of not utility (and likely has a clear disutility) to those doing the choosing. With that out of the way, my view is that all consequences would be of the minor variety and could be dealt with relatively easily and purposefully.
30. My views are as follows:

a) Using a 1% trailing commission as a baseline, I will use my own fee schedule as a guide regarding the cross-subsidization of clients. My fees are 1.4% on the first $250,000; 0.8% on additional assets up to $1,500,000 and 0.5% on assets above $1,500,000. Accordingly, my fees are:

$250,000 – 1.4%; $500,000 – 1.1%; $750,000 – 1.0% (the point of indifference); $1,000,000 – 0.95%; $1,500,000 – 0.9%; $2,000,000 – 0.8%. Anyone who has an average client with less than $750,000 in investable assets would actually increase their revenue. This is also good news for the profitability of broker-dealers.

b) The short answer is "yes". Although my personal break-even point is $750,000, I also pass along product savings of about 1% relative to other market participants (MFDA registrants in particular). My experience is that clients with $500,000 to invest would gladly pay an advisor 10 bps more if that advisor had the decency to use product that cost the client 100 bps less. That's still a net saving of 90 bps ($4,500 annually on a $500,000 account) to the client family.

c) I'm unsure of what is being asked about eliminating a cross-subsidy. Nonetheless, I believe it might be useful to provide mandatory information to all clients with over $500,000 in mutual funds that they could realize substantial savings if they were to switch to a direct pay method and to using other products (e.g. ETFs and individual securities) as compared to their current product mix.

31. The industry could engage in a period of hyper-disclosure with a clear two page document given to all clients with embedded compensation that offers a clear, concise explanation of the change that can be easily understood (and not manipulated by unscrupulous people who continue to insist that advice is - and always was - free). This could be similar to the Client Relationship Disclosure documentation that became mandatory after the introduction of CRM I. Written client disclosure verifying that the documentation has been received would ensure that facts could not be misrepresented.
32. Transition options depend very much on the individual practice. It would be extremely difficult, in my opinion, for anyone to offer general advice on the topic of transitions, since various advisors will be at varying stages of readiness and so their clients will have different (both in identity and in magnitude) challenges in adjusting to the new order. Flexibility is paramount. My view is that an appropriate transition period would involve a clear deadline set out in 2017 with clear intermediate steps along the way. For instance, it could be announced that embedded compensation would end on December 31, 2020. It could be further announced that until that date, all funds sold with a back end load would need to have their penalty period expire on or before that date. A fund sold in 2018 might only have a 2-year DSC penalty and a fund sold in 2019 might only have a one year penalty. Funds sold in 2020 might carry a trailing commission, but would no longer be able to have a DSC of any kind. Finally, if technology allows the industry to reliably identify funds with embedded compensation (i.e. via discreet fund codes), then there could be a period where embedded funds and unbundled funds co-existed in client accounts, provided that there was a reliable way to avoid double-dipping (i.e. to ensure that only F Class funds attracted an advisory fee).
33. My dream would be to have all embedded compensation gone from Canada as we begin 2021. It is, to me, the first reasonable opportunity to do away with embedded commissions.
34. No caps should be placed on embedded commissions other than the elimination timeframes I noted above.
35. I believe the steps under consideration are sufficient.
36. There are no other alternatives that I can think of.

Thank you for your time and consideration. The exercise is a useful one and I'm sure you will be receiving a number of thoughtful responses to this important matter. Even though I strongly support the general thrust of this paper, I cannot help but wonder why it has taken so long for us to come this far. I was involved in the Fair Dealing Model Consultations over a decade ago.

Given my tenure on this file, you might imagine that there are some things that I find disheartening about the exercise. The consultation paper asks that commenters not re-hash previously-made arguments, but rather answer the pointed questions that the paper asks using demonstrable facts. The question that this begs is: “where was the insistence that people use only factual information previously”? There was a clear sense that embedded compensation causes advisor bias that came out of the Fair Dealing Model final report. In spite of this, the CSA only commissioned research that empirically demonstrated advisor bias recently- with two groundbreaking reports being released in 2015. My question to the CSA, therefore, is: “if you honestly wanted evidence of advisor bias, why did it wait you a decade to commission research to determine whether or not embedded compensation caused bias”? Dithering is not a course of action that can be reputably followed by anyone who purports to take purposeful action. If your house was burning, how long would you wait before you called the fire department? If your child was missing, how long would you wait until you called the police?

In spite of my obvious frustration, all will be forgiven if the people at the CSA can act purposefully rather than merely consult symbolically. The time has come to act. For the love of all that is decent in this world, please put an end to embedded compensation at the very first practical opportunity.

Sincerely,

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INCLUDES COMMENT LETTERS

June 2017

CSA Consultation 81-408 on the

Option of Discontinuing Embedded Commissions

the co-operators

A Better Place For You®

Introduction

On behalf of The Co-operators Group Ltd. ("The Co-operators"), we are pleased to provide comments on the CSA's Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions,* which seeks input on the option of discontinuing embedded commissions and the potential impacts of such a change on Canadian investors and market participants.

About The Co-operators

The Co-operators Group Limited ("The Co-operators") is owned and governed by 44 co-operatives and credit union centrals across the country. As one of Canada's most prominent financial services organizations we are proud to provide insurance and financial services to more than two million Canadians. We are even prouder that we provide financial security to Canadians in their communities while staying true to our co-operative values.

We have over $44.9 billion in assets under administration, employ 4,992 individuals and count 500 exclusive financial advisors in our network, while serving more than 350 credit unions with more than 5.5 million members. We provide coverage to 38,000 farms and 295,000 businesses and insure approximately 805,000 homes, 1.3 million vehicles and protect 629,000 lives.

As a co-operative, concern for the community is one of our founding principles. That is why, in 2016 alone, The Co-operators contributed over $7.5 million, which represents 4.1% of our pre-tax profit, to Canadian charities and community organizations across the country.

4,992 EMPLOYEES - 500+ ADVISORS

38,000 FARMS - 295,000 BUSINESS

805,000 HOMES - 1.3M VEHICLES - 629,000 LIVES

Financial security for Canadians and their communities is our core mission. Our customer base is primarily comprised of "mass market" investors. The insurance and financial products and services provided by The Co-operators are delivered primarily through our independently contracted, but exclusive, face-to-face advisor channel. All of our advisors sell (registered and non-registered) segregated funds, as well as TSFAs and RESPs. Through Credential Financial Inc., a member of our group of companies, some advisors also distribute mutual funds. We expect to expand this offering to all of our advisors in the future.

The CSA's paper identifies a number of important areas in which there are opportunities to significantly enhance outcomes for consumers which include conflicts of interest, limited investor awareness, and misalignment of fees with services received. We agree that consumers are best served when transactions are transparent, conflicts of interest are disclosed or eliminated, when consumers have the tools to understand the information provided to them, and when fees align with services provided.

It is our view that these shared goals are best addressed through increased choice and transparency. While we do not oppose the removal of embedded commissions, we do share the industry's concerns around unintended impacts on accessibility and affordability of financial advice for Canadians. We believe an environment with embedded commissions with clear disclosure would provide Canadians with the best option in terms of affordability and choice.

Investor Protection and Market Efficiency Issues

The CSA outlines three key investor protection and market efficiency issues raised by mutual fund fees. We agree that embedded commissions could present a conflict of interest that misalign the interests of investment fund managers, dealers and representatives with those of the investors. However, we believe this a disclosure, not a market issue. Emphasis should lie on helping advisors focus on finding good performing portfolios for low Management Expense Ratios. At The Co-operators, we achieve this goal by providing a well-rounded suite of segregated fund products and transparent fee disclosure. Some of our agencies also engage in third party mutual fund sales through Credential Asset Management (dealer) with the same commitment to fee transparency. We acknowledge, however, that this may differ in the mutual fund industry.

Regulatory Impact

Our foremost concern is that the discontinuance of embedded commissions could result in an "advice gap" in terms of face-to-face counsel. Mass and mid-market investors may be left with only self-service style information with limited capacity to take advantage of this guidance.

Financial literacy is a considerable challenge in Canada and this move would likely further compound the problem of all Canadians having access to financial advice. Based on our business model, we strongly believe that face-to-face advice leads to the uncovering of other needs, goals, objectives, risks and concerns that clients are unaware of and ultimately, to a discussion of how to close to those gaps.

The fund industry has pointed to the consequences of relevant regulatory reforms in other jurisdictions (such as the U.K. and Australia) as potential evidence of the likely impact of the discontinuation of embedded commissions in Canada. We understand it is the CSA's position that while the impacts of relevant reforms in other jurisdictions are informative and insightful, potential impacts from similar reforms in Canada might not be the same.

We do, however, remain concerned that the mass and middle-market will be underserved by a discontinuation of embedded commissions. The loss of embedded commissions will only serve to increase entry level costs for advice to the mass and middle markets. In the U.K., this change has also resulted in a reduction of the number of advisors in the business – with an estimated 11,000 advisors leaving the industry since 2008 according to the U.K.'s Institute of Financial Accounts. Those that remained focused on high-net clients.[1]

In addition, more restrictive educational standards further drove out advisors from the market. We do recognize and acknowledge that continuing education is absolutely critical to those working in the wealth and investment marketplace and it should be a mandatory requirement in all provincial jurisdictions both within the securities industry and the insurance industry.

The prospect of regulatory arbitrage across distribution channels, as well as products, to create an uneven playing field is another consideration. Unless all manufacturers and distributors move in the same direction for a level playing field, we worry a commission ban may unintentionally favour large banks. Banks have salaried staff and performance-based bonuses based on sales volumes, not per transaction, which can be a very significant portion of their income. As such, their mutual fund disclosure statements would not show a trailing commission as bonuses.

With respect to segregated funds in particular, the paper notes the similarity between segregated funds and other investment fund products – including the use of embedded commissions – and calls for a harmonized approach to regulating such products.

We agree that requirements for segregated and mutual funds should be such that consumers can easily compare products. As members of the Canadian Life and Health Insurance Association, we share their position with respect to the implementation timelines.

We are pleased that the CSA will coordinate with the Canadian Council of Insurance Regulators (CCIR) to address the potential for regulatory arbitrage between investment funds and segregated funds.

[11] Leong, Melissa. "International expert warns against banning embedded advisor commissions." *Financial Post* 5 November 2017. Web 2 June 2017

Mitigation Measures

We have expressed our concerns regarding the affordability of advice to those in the mass or middle market if they are forced to pay "upfront" fees. In fact, a recent survey suggests that almost a quarter of respondents would be less likely to use an advisor if charged directly for advice.[2] Canadians deserve choices. Clients should have the option of either paying the fee upfront or having the fee withdrawn from their account on a "no-load" flat fee basis – transparency is the key.

Other Regulatory Initiatives

In terms of disclosure, while the Client Relationship Model Phase 2 (CRM2) initiative is a step in the right direction, more needs to be done. We are aware that other industry stakeholders have urged to allow full implementation to assess its results but we believe disclosure around fees paid to manufacturers could be stronger. Statements must show both the percentage and dollar amount for the management, dealer/MGA and advisor fees - and in the case of segregated funds, the insurance fee as well.

Conclusion

Thank you for the opportunity to provide our comments on the CSA's Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions.* We hope the consultation will result in a strengthened market, one where clients can take advantage of offerings through a payment schedule that they understand, have choice over, and can afford. We also believe informed choice will encourage better servicing of clients on an ongoing basis.

Please do not hesitate to contact our Director of Government Relations, Maya Milardovic, at 519-824-4400 or maya_milardovic@cooperators.ca should you have any questions or wish to arrange a follow-up meeting.

With best regards,

Rick McCombie
EVP Chief Client Officer
The Co-operators Group Ltd.

Kevin Daniel
Chief Operating Officer
Co-operators Life Insurance Company

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[2] Hemeon, Jade. "Investors are fine with trailer fees, survey says." *Investor News* 31 May 2017 *Investment Executive.* Web 2 June 2017.

MICA
CAPITAL
CABINET DE SERVICES FINANCIERS

PAR COURRIEL
Consultation-en-cours@lautorite.qc.ca

Québec, ce 8 juin 2017

Me Anne-Marie Beaudoin
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OBJET : Document de consultation 81-408 des ACVM – Consultation sur l'option d'abandonner les commissions intégrées.

Me Beaudoin,

Il nous fait plaisir de vous transmettre nos commentaires en lien avec la consultation mentionnée en exergue.

Préambule

MICA Capital Inc. est un cabinet de services financiers inscrit auprès de l'Autorité des marchés financiers au Québec à titre, entre autre, de courtier en épargne collective et en marché dispensé. Environ 180 représentants y sont rattachés et œuvrent sur tout le territoire québécois. Cette entreprise est la propriété d'intérêts privés et n'est donc pas la propriété d'une compagnie d'assurances ni d'une institution financière. Elle existe depuis maintenant plus de 30 ans.

MICA Capital Inc. permet de distribuer, par l'entremise de ses représentants, les fonds mutuels de plus de 60 sociétés de fonds d'investissement différentes ainsi que les produits du marché dispensé d'une dizaine d'émetteurs. Nous n'émettons aucun produit et ne distribuons donc aucun produit « maison ». Par ailleurs, MICA n'est pas membre de l'ACFM (MFDA).

Nous sommes particulièrement interpellés par le sujet soulevé par votre document de consultation relatif à l'option d'abandonner les commissions intégrées.

Nous avons d'ailleurs lu avec grand intérêt le contenu du document de consultation publié le 10 janvier 2017.

Nous tenons à vous remercier de nous donner l'opportunité de faire valoir notre position, nos arguments ainsi que nos pistes de solutions envisageables. La volonté manifestée d'obtenir les commentaires des intervenants de l'industrie démontre un souci d'être à l'écoute des principaux intéressés et nous l'apprécions.

Introduction et mise en contexte du présent mémoire

Nous avons choisi de ne pas répondre à chacune des questions soumises telles que présentées dans le document de consultation. Nous préférons cerner les enjeux au cœur de cette réforme proposée et nous attarder aux conséquences négatives d'une éventuelle abolition des commissions intégrées. Par le présent document, nous souhaitons mettre en lumière des solutions que nous proposerons qui, si elles étaient appliquées, répondraient mieux aux impératifs de transparence, d'efficience des marchés et aux intérêts des consommateurs.

Nous sommes d'opinion que l'abolition des commissions intégrées soulève des enjeux de société fondamentaux et prétendons que les organismes réglementaires, avant d'aller de l'avant vers une telle abolition, se doivent de bien mesurer les impacts possibles futurs sur notre société au sens large. Outre le fait que les organismes réglementaires ont comme principales missions de veiller à la protection des consommateurs et de s'assurer de l'efficience des marchés financiers, elles ne doivent pas faire abstraction de leur rôle social et des impacts que leurs décisions peuvent avoir sur notre société, à court, moyen ou long terme.

D'emblée, nous affirmons ceci :

- Le focus de la présente consultation porte sur l'abolition des commissions intégrées. À notre avis, l'emphase devrait plutôt être mis sur le fait que les consommateurs devraient connaitre tous les frais qu'ils assument, y compris les frais des gestionnaires de fonds, et non pas seulement les commissions qu'ils payent. La transparence est de mise et nous sommes d'avis que les consommateurs doivent connaitre entièrement tous les frais qu'ils assument, peu importe le mode de rémunération qu'ils choisiront. Ils ont droit à une pleine divulgation des frais payés au moment opportun. Nous pourrions ainsi parler d'une véritable transparence!
- Les consommateurs doivent recevoir des conseils et des services qui correspondent à leurs attentes et leurs besoins;

- Les consommateurs doivent pouvoir se voir offrir un ensemble de modes de rémunérations parmi lesquels ils pourront faire un choix en tenant compte de leurs besoins et de leur situation particulière;
- Tous les consommateurs doivent avoir accès à une offre élargie et pouvoir choisir vers qui se tourner et ainsi, avoir accès à plusieurs réseaux de distribution;
- Le mode de rémunération impliquant des commissions intégrées n'est peut-être pas parfait mais il est perfectible. D'ailleurs, nous croyons pouvoir affirmer qu'aucun mode de rémunération n'est parfait. Nous proposerons des pistes de solutions à cet égard.

Nous vous exposerons, dans les prochaines pages, nos prétentions et nos craintes face aux conséquences fâcheuses que pourrait entrainer l'abolition des commissions intégrées. Nous mettrons aussi en évidence certains impacts que nous envisageons tant pour les consommateurs et l'industrie que pour la société de demain.

Mieux informer les consommateurs

Nous sommes d'avis que la transparence est de mise à l'égard des consommateurs en ce qui concerne la divulgation des divers modes de rémunération du conseiller.

La venue de l'aperçu du fonds a contribué à une meilleure divulgation. Ce document contribue à mieux communiquer aux consommateurs des informations plus claires à propos, entre autre, de la rémunération. Il est probablement trop tôt pour mesurer avec précision les bienfaits de cette nouvelle façon de faire. Nous croyons qu'il serait toutefois pertinent et utile d'attendre quelques temps pour prendre conscience de la pleine mesure des bienfaits de l'utilisation d'un tel document sur l'éducation et la compréhension des consommateurs à l'égard de la rémunération.

Peut-être pourrions-nous envisager de bonifier l'information apparaissant à cet aperçu du fonds? Peut-être pourrions-nous envisager la possibilité d'obliger les conseillers à inscrire sur les documents de souscription à un fonds le montant de commissions payées lors de la souscription et un estimé des commissions de suivi qui seront versées?

Nous proposons par ailleurs que les montants de commissions versées au moment d'une transaction d'achat d'unités de fonds (frais de rachat reporté) soient indiqués, en dollars, sur l'avis d'exécution transmis au client dans les jours qui suivent une transaction. Sur ce même avis d'exécution, il pourrait y avoir une mention qu'une commission de suivi de x% sera versée au courtier. Sur réception de son avis d'exécution, et s'il n'est pas d'accord avec ce mode de rémunération, le consommateur devrait pouvoir demander l'annulation de la transaction dans un délai donné et ce, sans aucun frais ni pénalité.

Aussi, depuis peu, les consommateurs doivent recevoir un rapport annuel faisant état de la rémunération versée au courtier au cours d'une année. À notre avis, cette information transmise aux consommateurs est trompeuse dans sa forme actuelle. Cette information n'est pas représentative de tous les frais que les consommateurs assument. Si les ACVM veulent la pleine transparence, elles n'ont d'autres choix que d'exiger que les consommateurs soient informés de tous les frais qu'ils payent. Ceci implique qu'ils devraient aussi voir apparaitre sur leur rapport annuel sur la rémunération les frais de gestion perçus par les gestionnaires de fonds. De cette façon, les consommateurs sauraient les coûts réels exacts liés à leurs placements. Nous préconisons donc une pleine et totale divulgation des frais assumés par les consommateurs. Ainsi, il y aurait une véritable transparence.

Commissions intégrées si aucun conseil

Nous sommes d'opinion que les réseaux de distribution ayant un modèle de distribution sans conseiller (par exemple, le courtage à escompte) ne devraient pas être autorisés à proposer des fonds à commissions intégrées. N'offrant aucun conseil ni suivi, il est inconcevable que ces réseaux perçoivent des commissions de suivi. D'autre part, ces réseaux font souvent partie d'un groupe intégré où nous retrouvons, à la fois, les distributeurs et les gestionnaires de fonds. Ainsi, les seuls frais que les consommateurs devraient devoir payer sont les frais de gestion des gestionnaires de fonds pour leur travail effectué.

Fausse prétention que les consommateurs pourront mieux négocier les honoraires

Quant au contrôle des coûts, avec respect pour l'opinion contraire, il serait illusoire de croire que la formule à honoraires permettra un meilleur contrôle de la rémunération que paiera le consommateur. On semble prétendre que cette formule permettra aux consommateurs de négocier la rémunération du conseiller. À notre avis, rien n'est moins certain. Ce qui risque plutôt d'arriver, c'est que les conseillers et les courtiers établiront des barèmes établissant une rémunération standardisée qui tiendra compte de la valeur de l'actif de chaque consommateur. Et ces barèmes seront appliqués de façon uniforme. Nous doutons que le consommateur ait un véritable pouvoir de négociation à cet égard. Les conseillers et les courtiers administrent des entreprises et doivent s'assurer de la rentabilité de celles-ci. Ainsi, leur tarification devra tenir compte de leurs « coûts de revient » afin de s'assurer d'une certaine rentabilité. Donc, il serait pour le moins étonnant que les consommateurs puissent négocier de façon importante car il y aura toujours un seuil que le conseiller ou le courtier ne voudra pas dépasser.

Tout comme il est difficile, voire impossible, de négocier les taux horaires d'un avocat ou d'un comptable, nous croyons qu'il est imprudent de penser que ce le sera plus pour les conseillers et les courtiers.

Les consommateurs seront-ils prêts à payer des honoraires?

Plusieurs études démontrent qu'une bonne partie des consommateurs préfère payer des commissions intégrées plutôt que d'avoir à payer des honoraires pour les services de leur conseiller. D'ailleurs, diverses sondages ou études sérieuses parus dans les médias tout récemment tendent, une fois de plus, à le démontrer. Donc, advenant l'abolition des commissions intégrées, nous devons nous demander ce qu'il adviendra de ces consommateurs à qui les commissions intégrées conviennent. N'ayant plus cette possibilité d'opter pour des commissions intégrées, seront-ils prêts à payer des honoraires à leur conseiller? Nous en doutons profondément.

Les produits financiers tels les fonds d'investissement ne sont pas des biens de consommation courante. Ces produits sont intangibles. Nous pensons qu'il ne soit pas concret ni naturel pour les plus petits épargnants d'opter pour un mode de rémunération à honoraires. Devant l'abolition des commissions intégrées, nous craignons que ces consommateurs doivent se tourner vers des solutions « sans conseil » alors que ce sont eux, les plus petits investisseurs, qui ont le plus besoin de conseils et d'éducation.

Le conseil financier est un « bien de confiance ». Il diffère fondamentalement des biens et services à la consommation, parce que:

- les avantages sont abstraits et retardés dans le temps;
- la majorité des consommateurs est incapable d'évaluer avec confiance la qualité des conseils et du caractère raisonnable du coût des services qu'elle reçoive, même après des achats répétés;
- comment un investisseur peut-il distinguer entre « décider de ne rien faire » et « avoir omis de faire quelque chose » ?

Face à cette issue incertaine, nous sommes d'avis qu'une grande proportion d'individus s'abstiendra de s'adjoindre un conseiller financier s'ils sont tenus de payer à l'avance pour un service dont ils ne parviennent pas à saisir la valeur intrinsèque.

Le libre choix des consommateurs quant aux modes de rémunération

Nous ne croyons pas que de restreindre les choix des modes de rémunération, actuellement disponibles aux consommateurs, soit dans l'intérêt de ceux-ci.

Au lieu de mettre la hache dans un mode de rémunération (commissions intégrées) qui ne semble pas être parfait, pourquoi ne pas essayer de plutôt le bonifier. À tout le moins, faisons l'effort d'essayer et voyons comment nous pouvons rendre ce mode de rémunération plus transparent pour le consommateur.

Nous croyons que les consommateurs devraient pouvoir choisir de quelle façon ils souhaitent rémunérer leur conseiller. Par contre, pour pouvoir le faire, ils devront avoir accès à un maximum d'informations leur permettant de prendre une décision libre et éclairée en temps opportun.

En tout respect, nous comprenons mal comment les ACVM pourraient décider, de leur propre chef, d'imposer leur choix aux consommateurs quant aux modes de rémunération à choisir. En ce faisant, les ACVM décident en lieu et place du consommateur en lui retirant la possibilité de choisir un mode de rémunération avec commissions intégrées qui pourrait leur convenir. En se positionnant ainsi, les ACVM décident pour tout le monde, dictent les modes de rémunérations qu'elles imposent et décident que « one size fits all ». Il nous semble un peu présomptueux pour les ACVM de penser détenir LA vérité à cet égards.

Encadrons de façon plus approfondie l'option des commissions intégrées et laissons le choix final aux consommateurs!

Perte de transparence au détriment des consommateurs

Les décisions d'investissement sont une question de choix entre différentes options, ce qui implique que les investisseurs doivent être en mesure de comparer la qualité et le coût des services financiers entre les diverses entreprises offrant ces types de produits et services.

Lorsque le coût des conseils financiers est dissocié de celui des produits financiers, la comparaison du coût total entre différents intermédiaires financiers est rendue inaccessible aux investisseurs individuels parce que les entreprises ont pour politique de ne pas divulguer publiquement les charges réelles imposées à leurs clients.

Une saine réglementation doit poursuivre deux objectifs de transparence distincts mais complémentaires:

– La protection des consommateurs par la divulgation complète et en temps opportun aux clients individuels des coûts encourus et des rendements du portefeuille;
– Favoriser la concurrence et l'efficience du marché par la promotion de la transparence des prix à l'échelle de l'industrie.

Actuellement, selon la formule de commissions intégrées, deux investisseurs détenant les mêmes fonds paient exactement les mêmes frais. D'ailleurs, ces frais apparaissent dans le prospectus et dans l'aperçu des fonds. Cette information est publique et accessible à tous. Par contre, selon la formule de rémunération à honoraires, il est tout à fait possible et prévisible que ces deux mêmes investisseurs paient des honoraires différents l'un de l'autre. En effet, un représentant pourrait établir des honoraires de 1% et un autre représentant, demander 1.25%.

Donc, en visant la transparence, les organismes de réglementation risquent d'amener une plus grande opacité et une plus grande iniquité dans les frais chargés aux consommateurs en souhaitant abolir l'option des commissions intégrées.

Restrictions quant à l'offre de services disponibles (accès aux conseils) et concentration

Nous croyons qu'en imposant un mode de rémunération à honoraires à tous les consommateurs, sans aucune distinction, ceci aura pour effet de restreindre l'offre de services disponibles à plusieurs de ceux-ci, plus particulièrement pour les plus petits investisseurs. Nous sommes aussi d'avis que d'agir ainsi amènera une concentration. Puisque les courtiers imposeront des comptes d'une valeur nominale, ceci fera en sorte que les plus petits investisseurs seront probablement délaissés et leur seule option restante sera d'opter pour un modèle « sans conseil », ce qui amènera une concentration auprès d'institutions offrant ce type de comptes. Cette concentration est-elle vraiment dans l'intérêt du consommateur? Il est légitime de se poser cette question.

Une telle façon de faire favorisera probablement les institutions financières qui sont à la fois, manufacturières et distributrices de produits financiers. Cette concentration dans des structures intégrées pourrait amener les consommateurs à se voir proposer des produits avec un potentiel de rendement inférieur. Ces institutions financières intégrées, nous le savons tous, ont souvent tendance à privilégier et offrir les dépôts bancaires plutôt que d'autres solutions ayant un potentiel de rendement plus élevé. Si tous ces consommateurs sont amenés à investir dans des CPG par exemple, ceci aura un effet important sur leurs rendements et amènera, par effet direct, une diminution d'accumulation d'actifs en vue de leur retraite.

La concentration des plus petits investisseurs vers les institutions financières intégrées est-elle vraiment souhaitable pour le consommateur et l'industrie? Nous ne le pensons pas. Une industrie concentrée peut devenir une industrie qui offre moins de choix de placements. À la limite, la concentration peut amener certaines institutions à moins bien servir leurs clients et à rendre les clients plus dépendants de leurs services étant donné le manque d'autres options de fournisseurs disponibles.

Nous rappelons aux lecteurs que l'article 8 de la Loi sur l'Autorité des marchés financiers prévoit ceci :

« 8. *L'Autorité exerce ses fonctions et pouvoirs de manière:*

(…)

> *2° à* ***promouvoir une offre*** *de produits et services financiers de haute qualité et à un prix concurrentiel pour l'****ensemble*** *des personnes et des entreprises dans toutes les régions du Québec;*
>
> *3° à assurer la mise en place d'un cadre réglementaire* ***efficace*** *favorisant le développement du secteur financier et permettant l'évolution des pratiques de gestion et des pratiques commerciales dans ce secteur; »*

(nos soulignés)

Concentration et consolidations à prévoir

Parmi les conséquences non souhaitables, les phénomènes suivants pourraient se produire :

- Une concentration des plus petits investisseurs dans les institutions financières intégrées;
- Un mouvement de consolidation massif de certains courtiers qui décideraient d'être engloutis par un compétiteur.

Ces deux phénomènes, selon nous, créeraient une diminution de l'offre pour le consommateur ainsi qu'une baisse de compétitivité, ce qui en soit est rarement bon pour les consommateurs concernés.

Gestion des conflits d'intérêts

Il est louable que les organismes réglementaires veillent à une saine gestion des conflits d'intérêts entre les fournisseurs de produits et services financiers et le consommateur.

Toutefois, nous croyons que, au lieu de mettre d'abord l'emphase sur les conflits d'intérêts potentiels liés au mode de rémunération selon des commissions intégrées, il serait plus à propos et urgent qu'ils s'attaquent aux sources suivantes de conflits d'intérêts :

- Les fournisseurs de produits financiers limités à leurs propres produits exclusifs lesquels sont assortis de bonifications en faveur de leurs employés qui le vendent. (Ex : conseiller salarié qui doit vendre le produit que son employeur l'oblige à vendre)
- L'instauration de cibles de vente, les promotions et l'évaluation du volume d'affaires à des fins de primes ou bonifications versées à des conseillers salariés;
- Le fait que certaines institutions financières offrent d'emblée aux consommateurs des produits de dépôt à faible rendement, ce qui leur permet d'obtenir des sommes pour ensuite prêter ces mêmes sommes à d'autres consommateurs;
- Uniformiser les commissions de suivi intégrées. Pour réduire les risques de conflits d'intérêts, les régulateurs pourraient encadrer les rémunérations versées par les manufacturiers de fonds aux courtiers et aux conseillers. La commission de suivi pourrait être identique, quel que soit le produit financier distribué;
- Obliger les sociétés de fonds à mettre en place des mécanismes de réductions tarifaires automatiques tenant compte des sommes investies. Nous précisons ici que quelques sociétés de fonds d'investissement ont déjà mis en place ce mécanisme.

La technologie comme solution alternative pour les consommateurs délaissés

Nous croyons qu'il est déraisonnable de penser que la technologie sera la solution alternative pour les consommateurs qui n'auront plus accès à des conseils advenant l'abolition des commissions intégrées.

Nous pensons qu'une très faible proportion de ces consommateurs se tournera vers de telles technologies. La très grande majorité de ceux-ci aura plutôt tendances à se tourner vers des institutions financières intégrées, qui sont à la fois manufacturière et distributrice de produits financiers. Ceci amènera donc une concentration plus élevée auprès de ces institutions financières, lesquelles n'offrent souvent que des produits exclusifs, proposent souvent des produits de type « dépôts » qui offrent un faible potentiel de rendement et qui, pour certaines, offrent très peu de conseils et de suivis à leurs clients.

De façon générale, les consommateurs démontrent peu ou pas d'intérêts vers des solutions sans conseil. Nous prenons pour exemple le modèle d'affaires des courtiers à escompte. Bien qu'implanté depuis plusieurs années, ce modèle d'affaires n'a réussi à rallier qu'un très petit nombre de consommateurs lorsque comparé à l'industrie des services financiers en général.

Hausse des frais d'opérations et conséquences

Nous sommes d'opinion que l'abolition des commissions intégrées pourrait amener une hausse des coûts des frais d'opérations des courtiers. En effet, si les courtiers doivent prendre en charge la mise en place de mécanismes de facturation et de perception d'honoraires, ils devront assumer des coûts importants d'implantations et de maintien. Les systèmes informatiques devront être mis à niveau ou développés pour permettre la mise en place d'un tel système. Des ressources humaines devront être consacrées à cette mise en place et au maintien du système par la suite. Tout ceci amènera inévitablement des coûts à assumer par ces entreprises.

Afin d'assurer leur pérennité, les courtiers doivent veiller à ce que chaque compte soit rentable. Si leurs coûts d'opérations augmentent, ils n'auront d'autres choix que d'imposer des tailles de comptes minimums et de charger, parfois, des frais plus élevés pour les plus petits comptes afin de maintenir une certaine rentabilité pour leur entreprise.

Si cela se produit, les organismes de réglementation auront-ils atteint leur objectif de veiller aux intérêts des consommateurs?

L'abolition éventuelle des commissions intégrées ne contribuera pas à faire diminuer les frais payés par les consommateurs, bien au contraire.

Commentaires quant aux 3 enjeux soulevés à la partie 2 du document de consultation

Enjeu 1 : Les commissions intégrées donnent lieu à des conflit d'intérêts qui entrainent un décalage entre les intérêts des gestionnaires de fonds d'investissement, des courtiers et des représentants et ceux des investisseurs.

Nos prétentions : Tout d'abord, nous déplorons le fait que cette prémisse des ACVM se fonde sur des études ou des rapports datant de plusieurs années, allant aussi loin que 1995. Il existe de nombreuses autres études sérieuses beaucoup plus récentes dont il aurait fallu tenir compte, par exemple celles préparées par CIRANO. (The value of financial advice, Claude Montmarquette et Nathalie Viennot-Briot, CIRANO, 2016)

Nous sommes en désaccord avec l'affirmation suivante contenue à la page 10 du document de consultation :

« …la structure des commissions intégrées peut encourager les gestionnaires de fonds d'investissement à considérer les courtiers et les représentants, plutôt que les personnes qui investissent dans leurs fonds, comme leur « clients »

Les fonds d'investissement et les conseillers sont des partenaires qui ont un objectif commun : bien servir le consommateur et lui offrir le meilleur rendement possible tenant compte de sa tolérance au risque et de sa situation financière. Ils savent très bien que, si les frais à payer ou les rendements ne sont pas concurrentiels, ils risquent de perdent le consommateur. Ils ont tout intérêt à demeurer compétitifs.

Quant à la possible partialité des recommandations faites par les conseillers qui pourrait amener le conseiller à recommander une société de fonds plutôt qu'une autre dans le seul but de bonifier sa rémunération, les ACVM devraient savoir que depuis un certain temps déjà, il se dégage une certaine uniformité dans la rémunération offerte par les diverses sociétés de fonds. Bien qu'autrefois, de telles disparités fussent fréquentes, ce phénomène est pratiquement disparu à l'heure actuelle. À l'occasion, il peut y avoir de très minimes écarts mais sans plus.

Enjeu 2 : L'intégration des commissions limite la connaissance, la compréhension et le contrôle des coûts de la rémunération des courtiers et des investisseurs.

Nos prétentions : Quant à la connaissance et la compréhension du consommateur à l'égard des commissions, durant les dernières années, l'emphase a été mise sur les obligations des conseillers quant à la divulgation de ces commissions. Nous prétendons qu'à court terme, cette méconnaissance ou cette incompréhension de la part du consommateur s'estompera. Tel qu'auparavant mentionné, nous préconisons, de la part du conseiller, une totale transparence envers le consommateur à l'égard de sa rémunération.

Actuellement, l'usage de l'aperçu du fonds permet au consommateur, à notre avis, de mieux comprendre le fonctionnement des commissions et de connaitre ce qu'il lui en coûte. De plus, les conseillers sont de plus en plus conscients de leur obligation d'expliquer leur mode de rémunération. Nous sommes donc d'avis que, si par le passé, les consommateurs déclaraient ne pas connaitre le mode de rémunération de leur conseiller, il pourrait en être tout autrement si nous leur posions la même question aujourd'hui ou dans un an.

Quant au contrôle des coûts, nous vous référons aux pages précédentes dans lesquelles nous avons abordé la question sous le titre « Fausse prétention que les consommateurs pourront mieux négocier les honoraires ».

Enjeu 3 : Les commissions intégrées qui sont versées ne concordent généralement pas avec les services fournis aux investisseurs.

Nos prétentions : Si nous suivons ce raisonnement, cette affirmation laisse donc croire que la seule solution envisageable serait la facturation à l'acte. Toutefois, une structure à honoraires semble être préconisée par le document de consultation publié par l'ACVM. Alors, concrètement, il n'y a aucune différence pour un consommateur entre le fait de payer 1% en commissions de suivi intégrées ou payer 1% en honoraires annuels. L'enjeu demeure donc le même.

Quant à la notion de « services continus » ou « prestation continue de conseils », il est évident que les conseillers ne peuvent suivre le dossier de chacun de leurs clients 24h/24 et 7 jours/7. Penser le contraire démontrerait une méconnaissance flagrante des implications d'une telle exigence.

De façon générale, il est à notre connaissance que les conseillers offrent une prestation de conseils auprès de leur client sur une base régulière et aussi, ponctuelle lorsqu'un besoin se fait sentir et adaptée à chacun des clients. Lorsqu'un consommateur considère qu'il n'en reçoit pas suffisamment pour son argent, il a tout le loisir de cesser sa relation d'affaires avec ce conseiller et décider de faire affaires avec un autre. Ce droit existe dans toutes les sphères des diverses activités économiques. Ceci s'appelle le libre marché de la concurrence.

Par ailleurs, il peut être facile de prétendre que le consommateur n'en reçoit pas pour son argent. Mais cette prémisse, doit-on l'avouer, peut être biaisée de différentes façons. Tout d'abord, dire cela, est l'expression d'un jugement de valeurs qui implique l'arbitraire. Pour un même niveau de service équivalent, une personne pourrait le considérer insuffisant et l'autre, penser qu'il est parfaitement adéquat. Aussi, a-t-on posé la question à des consommateurs qui utilisent un réseau qui n'offre pas de conseil ou qui font affaires avec de véritables conseillers? Par ailleurs, le niveau de services offerts à un client ne se résume pas au nombre de rencontres tenues avec lui durant une année ou au nombre d'appels téléphoniques. Tout le travail que fait le conseiller, hors la présence de son client, doit être tenu en compte : les analyses économiques, les formations sur différents produits, etc. Disons-le franchement, il arrive que le consommateur ne soit pas parfaitement conscient de tout ce qu'implique le travail du conseiller.

Ceci dit, nous prétendons qu'il est injustifiable que des consommateurs paient exactement les mêmes frais qu'ils soient conseillés ou non. Ainsi, les firmes de courtage à escompte, par exemple, ne devraient pas être autorisées à recevoir des commissions intégrées de suivi alors que le suivi est inexistant. S'il existe une aberration, c'est bien celle-là et c'est à elle que les ACVM devraient s'attaquer de façon prioritaire.

Enjeux de société

Dans la prochaine section, nous souhaitons attirer l'attention des lecteurs sur les conséquences possibles sur notre société d'une décision qui pourrait avoir comme effet de restreindre l'accès aux conseils pour les consommateurs.

L'autonomie financière des consommateurs

Résumée à sa plus simple expression, l'autonomie financière à la retraite signifie pouvoir cesser de travailler, après avoir accumulé des sommes suffisantes, tout en maintenant un train de vie pleinement satisfaisant pendant les 30 prochaines années.

Pour atteindre l'autonomie financière en vue de la retraite, il faut :

- Contrôler ses dépenses actuelles;
- Développer une habitude d'épargne disciplinée et structurée;
- Avoir un large éventail de produits financiers qui nous sont accessibles;
- Bien se connaitre soi-même et sa tolérance au risque;
- Bien connaitre le produit à choisir;
- Choisir les bons produits;
- Bien contrôler son émotivité à l'occasion des décisions à prendre;
- Et obtenir les rendements nécessaires.

Plus un consommateur a la capacité d'accumuler des sommes, plus il s'approchera de l'autonomie financière le moment venu.

Moins un consommateur a la capacité d'accumuler des sommes, plus il aura besoin d'avoir accès à des conseils de professionnels et à une large gamme de produits financiers. L'autonomie financière de ce consommateur est en péril s'il ne peut avoir accès à des conseils de professionnels.

À notre avis, le conseil professionnel est essentiel à la prospérité de tous les canadiens. Ceux-ci, peu importe leur situation financière actuelle, devraient avoir accès à des conseils de la part de personnes qualifiées afin de mieux planifier leur sécurité financière.

Au surcroit, nous sommes convaincus que ceux qui ont le plus besoin de conseils sont les plus petits investisseurs. Toute mesure ou initiative qui pourraient avoir comme conséquence possible de leur restreindre le conseil devrait être évitée. C'est le cas, nous le croyons, avec l'abolition des commissions intégrées tel qu'exposé dans ce document.

Depuis plusieurs années maintenant, la société canadienne est confrontée au désengagement prononcé de l'État dans les régimes publics. Les modifications structurelles apportées aux programmes de retraite publics et privés depuis les dernières années ont transféré aux ménages canadiens les risques liés au rendement des placements, à l'inflation, à la longévité et à l'évolution des marchés financiers alors qu'auparavant ces risques étaient largement pris en charge par les régimes publics. En conséquence, les consommateurs ne peuvent que compter sur eux-mêmes pour avoir une retraite telle qu'ils la souhaitent. Alors, ceux-ci devront, afin de maintenir un niveau de vie acceptable à la retraite, être disciplinés dans leurs investissements et obtenir les meilleurs rendements possibles.

Selon une étude réalisée par CIRANO (The value of financial advice, Claude Montmarquette et Nathalie Viennot-Briot, CIRANO, 2016), il est démontré que :

- On estime que 25 % des ménages canadiens couverts par un régime de pension agréé à cotisations déterminées (RPA-CD) ou par un REER collectif et 37 % des ménages ayant un revenu moyen-élevé sans RPA devront s'appuyer sur le patrimoine financier qu'ils auront personnellement accumulé pour vivre confortablement à la retraite.
- Au Canada, les données empiriques démontrent que les investisseurs individuels assistés par un conseiller financier accumulent un patrimoine financier beaucoup plus important. (jusqu'à 3.9 fois plus sur une période supérieure à 15 ans)
- Entre 2010 et 2014, les ménages qui ont abandonné le service d'un conseiller financier ont accumulé 45 % moins d'actifs financiers que ceux qui ont maintenu la relation avec un tel conseiller.

Ceci nous fait croire que toute initiative règlementaire pouvant avoir comme conséquence de restreindre le conseil aux consommateurs contribuerait à les appauvrir et, par le fait même à appauvrir la société dû aux impacts d'une telle initiative sur l'économie canadienne.

<u>Impacts à long terme sur l'économie</u>

Restreindre l'accès aux conseils aura inévitablement des conséquences sur l'accumulation de patrimoine de retraite pour plusieurs canadiens.

Point besoin d'être devin pour comprendre que moins les retraités auront de sommes disponibles à la consommation, moins ils dépenseront à la retraite et ainsi, moins ils injecteront de sommes dans le système économique.

En consommant moins, ils paieront moins de taxes à l'État.

En restreignant leur consommation, ils contribueront moins à la création d'emploi et d'entreprises. Moins de revenus pour les travailleurs en général et pour les entreprises, c'est aussi moins de sommes à être versées à l'État en impôts.

Ayant des revenus moins élevés à la retraite, ils paieront eux-mêmes moins d'impôts à l'État.

Bien que nous ne puissions prétendre être en mesure de quantifier exactement ces impacts, nous sommes convaincus de leur importance et de leurs conséquences négatives sur notre société et son économie.

<u>L'impact sur la relève dans l'industrie</u>

Un secteur d'activités sans relève est un secteur d'activités en déclin.

La relève dans le secteur des services financiers est déjà un enjeu depuis plusieurs années. Il est parfois difficile d'attirer et convaincre des candidats à se lancer dans cette industrie qui est très compétitive.

Disons-le, les 5 premières années dans la carrière sont cruciales et plusieurs quittent dans les premières années.

Les nouveaux conseillers commencent souvent leur entreprise en réussissant à ouvrir des comptes de clients de petites tailles ou de tailles moyennes. Assez rares sont ceux qui réussissent à ouvrir des comptes supérieurs à 100 000$ dans les premières années.

Pour réussir à convaincre les détenteurs de comptes majeurs, ils doivent souvent prendre de l'expérience et établir une certaine notoriété et crédibilité. Ceci prend souvent quelques années.

Le mode actuel de rémunération à commissions intégrées leur permet de recevoir des revenus, bien que modestes, sur les comptes de plus petites tailles. Advenant l'abolition des commissions intégrées, nous craignons que ces conseillers de la relève ne puissent plus ouvrir de plus petits comptes qui leurs assurent une certaine base de revenus. Ces consommateurs pourraient préférer se tourner vers une institution financière intégrée ou vers des solutions sans conseil. Aussi, les courtiers pourraient exiger certains minimums de taille de comptes, ce qui restreindra le développement d'affaires des nouveaux conseillers. Éventuellement privés des revenus tirés des commissions intégrées pour ces plus petits comptes, plusieurs nouveaux conseillers pourraient être dissuadés de poursuivre dans ce domaine.

L'autre façon de débuter dans le domaine est d'acquérir une clientèle existante appartenant à un conseiller bien établit qui quitte la profession. Pour que cette transaction d'achat de clientèle soit heureuse, celle-ci doit générer un certain revenu. Ne l'oublions pas, la plupart du temps, le jeune conseiller emprunte des sommes auprès d'une institution financière pour procéder à l'achat de cette clientèle. Il a donc des engagements financiers et il doit avoir une capacité de remboursement. Dans le cadre d'un achat de clientèle, le nouveau conseiller devrait tenir compte qu'il est possible, advenant l'abolition des commissions intégrées, qu'il doive se départir d'une portion de ces clients qui ont des comptes plus modestes. Il devra aussi considérer que parmi ces clients, plusieurs refuseront de payer des honoraires et quitteront. Ceci fragilisera inévitablement sa situation. Ceci pourrait même l'amener à être incapable de rembourser le prêt obtenu pour l'acquisition de ladite clientèle.

Dans ces circonstances, avant de se lancer dans le domaine des services financiers, il est donc fort possible que les candidats y pensent à deux fois et qu'ils y renoncent ne pouvant pas être assurés du succès d'une telle opération.

<u>Autres documents à l'appui de nos commentaires</u>

À titre complémentaire, nous nous permettons de vous soumettre trois études qui abordent différents éléments soulevés dans le présent document et qui supportent ceux-ci :

- **Bulletin #0721-C publié par l'Association des courtiers de fonds mutuels du Canada en date du 23 Mai 2017 :** Ce rapport expose des informations importantes concernant la valeur des investissements détenus par les ménages canadiens et démontre la répartition des avoirs investis par type de structure de rémunération. Il fait aussi ressortir le fait que 80% des ménages canadiens détient des actifs qui se situent dans la tranche de 0$ à 100 000$.

- **Global Regulatory Developments and Impacts publié par l'Institut des fonds d'investissement du Canada, en Avril 2017** : Ce rapport identifie les juridictions à travers le monde qui ont bannis les commissions intégrées et fait ressortir les impacts de tels bannissements. On dénote, entre autre, le fait que peu de juridictions ont décidé d'adopter la voie du bannissement des commissions intégrées.
- **Rapport 2017 de l'enquête de Fidelity sur la retraite** : **Retraite 20/20, Des conseils appropriés peuvent éclairer votre avenir, publié en Mai 2017 :** Ce rapport met en lumière les besoins des consommateurs d'obtenir des conseils professionnels afin d'atteindre leurs objectifs et mets en évidence le fait que les consommateurs ayant un plan sont mieux préparés à la retraite que ceux qui ne bénéficient pas de conseils. Ce document tend à démontrer la plus-value apportée aux consommateurs par les conseils de professionnels.

<u>Nos propositions</u>

Nous résumons ainsi les propositions que nous faisons, bien humblement, aux organismes de réglementation :

- Maintenir l'option des commissions intégrées et ainsi, donner le libre choix aux consommateurs parmi toutes les options de rémunération de son conseiller;
- Rendre obligatoire la divulgation de <u>tous</u> les frais, y compris les frais des gestionnaires de fonds, sur le rapport annuel de rémunération et frais devant être transmis aux consommateurs;
- Bonifier et clarifier l'information en lien avec les différents modes de rémunération possible ainsi que les frais des gestionnaires de fonds apparaissant sur l'aperçu du fonds;
- Rendre obligatoire, sur le formulaire servant à faire l'achat d'un fonds, l'inscription du montant, en dollars, de la commission à être versée au courtier pour cet achat ainsi qu'un estimé raisonnable de la commission de suivi, en dollars, qui sera versée au courtier;
- Rendre obligatoire, sur l'avis d'exécution transmis au consommateur, l'inscription du montant, en dollars, de la commission versée au courtier pour l'achat ainsi que l'inscription qu'une commission de suivi de x% sera versée au courtier;
- Accorder aux consommateurs un droit d'annuler la transaction en cas de désaccord en lien avec la rémunération apparaissant sur l'avis d'exécution qu'il recevra suite à une transaction d'achat de parts de fonds;
- Les réseaux de distribution ayant un modèle de distribution sans conseiller (par exemple, le courtage à escompte) ne devraient pas être autorisés à proposer des fonds à commissions intégrées;
- Interdire aux courtiers d'exiger de leurs employés/conseiller de vendre leurs produits exclusifs, de fixer des cibles de vente de leurs produits exclusifs et d'assortir ce type de

vente à des bonifications basées sur un volume de vente de produits internes. Si cette pratique était maintenue, il serait nécessaire que cette information soit divulguée clairement, et en temps opportun, aux consommateurs;

- Uniformiser les commissions de suivi intégrées. Pour réduire les risques de conflits d'intérêts, les régulateurs pourraient encadrer les rémunérations versées par les manufacturiers de fonds aux courtiers et aux conseillers. La commission de suivi pourrait être identique pour chaque société de fonds, quel que soit le produit financier distribué;
- Obliger les sociétés de fonds à mettre en place des mécanismes de réductions tarifaires automatiques tenant compte des sommes investies.

Conclusion

Nous demandons aux régulateurs de continuer de veiller à s'assurer que le cadre réglementaire de l'industrie continue de permettre les services de véritables professionnels à tous les Canadiens et de veiller à ne pas compromettre l'accès à des conseils pour les petits investisseurs. Cela signifie de donner aux investisseurs un accès continu à une large gamme de produits et services financiers adaptés à leurs besoins et à des prix compétitifs. Cela signifie également de ne pas imposer des réformes qui seraient disproportionnées par rapport à leurs bénéfices concrets et réels et qui seraient susceptibles de causer plus de tords que de bienfaits.

Dans tout processus de changement règlementaire, les organismes de réglementation doivent mesurer les impacts. Ils doivent se demander si les effets négatifs qu'entraineraient l'abolition des commissions intégrées sont proportionnels à l'objectif de vouloir mitiger les conflits d'intérêts. Nous invitons ces organismes à tenir compte de la balance des inconvénients et d'en faire bénéficier le consommateur!

Les organismes de réglementation du commerce des valeurs mobilières tentent de protéger les investisseurs tout en soutenant des marchés financiers efficients. Ils veillent, entre autre, à ce que les investisseurs bénéficient d'un accès équitable aux marchés. Avec respect pour l'opinion contraire, nous croyons que l'option d'abolir les commissions intégrées ne protège pas l'investisseur et ne lui permet pas de bénéficier d'un accès équitable aux marchés, pas plus qu'elle n'assure l'efficience des marchés compte tenu de la concentration prévisible, de la restriction de l'offre et des risques de perte d'intérêts possible d'une éventuelle relève.

Protéger les consommateurs de produits et services financiers, c'est aussi, et surtout, leur permettre l'accès à des conseils et à des produits diversifiés au meilleur coût possible, en toute transparence.

Nous demandons aux autorités règlementaires ainsi qu'aux divers paliers de gouvernement concernés de ne pas sous-estimer et bien mesurer les impacts négatifs que pourrait avoir l'éventuelle abolition des commissions intégrées sur notre société de demain et le sort éventuel de millions de consommateurs canadiens qui pourraient se voir privés de conseils. Soyons vigilants et optons pour une société qui donne les moyens aux consommateurs, à tous les consommateurs, de se bâtir une retraite satisfaisante!

En terminant, nous vous remercions de cette opportunité de vous soumettre notre point de vue quant aux questions soulevées.

Au besoin, nous demeurerons disponibles pour toute demande d'informations complémentaires ou encore, à participer à d'éventuelles rencontres d'échanges.

Veuillez accepter, Me Beaudoin, l'expression de nos salutations les plus cordiales!

Gino Sebastian Savard, B.A., A.V.A.
Président

Yvan Morin, LL.B., Avocat,
Vice-président, affaires juridiques,
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COMMENTS REGARDING:
CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING ***EMBEDDED COMMISSIONS***

Prepared by: Keith R. Odegard
Date: June 8, 2017

Background

I am founder and Chief Financial Officer of an independent mutual fund dealer, Pewter Financial Ltd., which has operated continuously in Alberta since February, 1983. Our firm currently relies on embedded fees for approximately 95% of our revenue. As a very small dealer, we have adopted a low cost operating model which has allowed our firm to survive in spite of the costs of increased regulation. Due to the uncertain regulatory environment, we have not expanded the business since 1997 and have no plans to invest any additional resources into the retail mutual fund industry.

The comments that follow do not follow Appendix D – Summary of Consultation Questions, since I believe the issues raised below will not fit easily into the listed questions. Following the Socratic method of instruction, each of the following sections is followed by questions that securities regulators may wish to consider.

A. Tyranny vs. Freedom

The proposed action by the Canadian Securities Administrators ("CSA") to prohibit embedded commissions for mutual funds is at its most basic level the imposition of tyranny on residents of Canada. The proposal seeks to prohibit individuals of legal age ("the public") from making a contract that includes a provision for embedded commissions. Imposing the will of a dictatorial authority to limit the rights of individuals is tyranny. It matters not the intentions of the CSA to "protect" investors. A common theme amongst dictators was that their unilateral decision to take rights and freedoms away from citizens since this action was in the "best interests" of the population. The idea that Canadians do not have the capacity to make decisions and enter into contracts without the oversight of a supposedly benevolent regulator is both illogical and an affront to the principals of freedom and democracy upon which this country was founded. The CSA appears to believe that the public is incapable of making a private contract which includes embedded fee provisions, but the same public is entrusted with the responsibility of electing politicians that govern the country. These same elected politicians hire all securities regulators. Paradoxically, the CSA believes the public has the wisdom and sophistication to select the rulers that choose securities regulators but does not have the knowledge or ability to enter into private contracts that include embedded commissions.

Questions:

1. Does the reader believe that free and open societies are superior to closed authoritarian societies where citizens have limitations on their rights, including the right to freely make contracts (e.g. Canada vs. Venezuela)?
2. Does the reader wish to have their right to negotiate and agree to private contracts with other members of the society curtailed?

B. Tilting the Playing Field

The prohibition of embedded fees for mutual funds will favour entities that sell non-mutual fund products to the public. There are no other products in which the relevant regulators require that the retail/client contact person or entity has to be compensated separately from the other components of the product or service. For example, banks are not required to make a separate charge to customers for the costs of the bank employee that prepares the documentation involved with the customer purchasing a GIC. Life insurers are not required to prepare two invoices for their the customers, one for the charges of the life insurance agent retail services and another one for the all other charges grouped together (e.g. wholesale costs, administration costs, costs of the actual product, etc.). Embedded fees are used by virtually all industries, besides the financial service industry, that supply goods or services to the Canadian public. When selling an automobile, automobile dealers are not required to provide their customers with an invoice related to their services as retailers and another invoice that includes all non-retail components of the automobile (e.g. direct manufacturing costs, manufacturer administrative costs, marketing costs, etc.). Grocers are not required to identify the retail portion in the price of tomatoes. If the CSA insists that consumers are harmed when purchasing goods or services that include embedded fees, they should be lobbying for laws to ban embedded fees from all goods and services currently available in Canada. Targeting one area of the economy (financial services), and within that one industry area, one specific model of operations (independent retail mutual fund dealers) is not logical.

The imposition of this proposed regulatory overreach to ban embedded fees will diminish the ability of independent dealers to successfully compete against other product and service suppliers that are given free rein to design their own pricing/compensation policies. This policy will also further dissuade potential independent mutual fund dealers from entering the industry since it discriminates against one sector of the financial services industry (independent mutual fund dealers) and promotes another sector of the financial services industry (large entities that are both manufacturers and retailers of mutual funds).

Questions:

1. Why should the CSA be permitted to ban a specific compensation arrangement, when virtually all other goods and service providers are free to determine their own pricing/compensation model?
2. Does the reader believe all goods and service providers should be required by law to separate the retail and non-retail portion of the good or service when selling to the public?

C. Geographic Concentration of Financial Services Industry

The proposed policy will further concentrate the financial services industry in Toronto, Ontario by discouraging independent retail mutual fund dealers across the country. Rather than a widely dispersed industry that includes many small dealers that are independent from any one manufacturer, the proposal, through regulatory fiat, will unfairly support large financial institutions that have the ability and desire to both manufacture and retail their own mutual fund products. The concentration of all financial services in a limited number of large deposit taking institutions increases the risks to the financial system in Canada. This concentration of power can result in all the problems associated with the "too big to fail" philosophy, which places the risk of catastrophic failure of a large entity on the public, rather than with the shareholders and staff of the failing financial institution. The concentration of power and control of financial services in Toronto is detrimental to all other regions of the country, since decisions affecting non-Toronto regions are made by financial institutions based in Toronto. These decisions will likely be based on the best results for the Big Bank/OSC coalition. The current system of allowing local and regional retail independent mutual fund dealers to compete on a level playing field against the Toronto-based big banks results in a more stable financial system. Free competition amongst numerous suppliers provides the best results for the public, no matter what goods or service they are purchasing.

Questions:

1. Does the reader believe that limited competition that results from regulatory fiat is in the best interests of the public?
2. When making decisions regarding the purchase of any goods or services, does the reader prefer to have one choice or a wide variety of choices for the supply of the good or service?
3. Should the provision of virtually all financial services for Canada be controlled by institutions based in Toronto, Ontario?

D. Prohibition of Self Interest for Mutual Fund Dealers

CSA Staff Notice 81-327 includes the following statement (emphasis added):

We believe there is considerable scope for better aligning the interests of investment fund managers and dealers/representatives with those of the *investors they serve*.

The CSA appears to be under the misapprehension that the retail mutual fund industry exists to serve the interests of their clients. The CSA appears to believe that dealers are engaged in the industry as a charitable activity rather than as profit-seeking businesses. That independent mutual fund industry dealers exist to provide a “public good”, to Canadians. In Canadian society, suppliers of other goods and services are not required to operate their businesses on a charitable basis. Large banks and other businesses exist to earn as much profit as possible for their shareholders. No one else operating a business is required by regulators to operate the business as a charity. According to the regulators, mutual fund dealers are required to “serve” the public, not operate profit generating businesses. Paradoxically, while regulators are permitted on an individual basis to operate from self-interest (e.g. by seeking the highest salary and benefits from their public regulator employers), the self-interest of mutual fund dealers is attacked. It appears that securities regulators are permitted to act in their personal self-interest, but those working in the retail mutual fund business exist to “serve”. This approach is illogical. Securities regulators, large banks and independent mutual fund dealers and all Canadian businesses should all be permitted to act in their own self-interest (including the right to make private contracts), this is a fundamental tenant of a free and open society.

Questions:

1. Is it logical for the CSA to adopt the idea that one small specific segment (retail mutual fund dealers) of one sector of the economy (financial services) should be required to operate their business as a charity, while their direct competitors can operate as profit seeking businesses (e.g. banks, insurance companies, trust companies, etc.)?
2. Has the reader, if employed by the public sector, ever approached their supervisor and requested a reduction in the reader’s salary, since such a reduction would “serve” the public interest by reducing the cost of the reader’s salary to the public purse?
3. Why is the pursuit of self-interest acceptable for customers, regulators, banks, other businesses but not for independent mutual fund dealers?

E. Quest for Regulatory Perfection

The CSA appears to be searching for perfection in their design of a regulatory system. Rather than insuring that investors are informed of the nature of their proposed investment purchase (provision of a prospectus), the regulators have imposed an additional suitability standard. No other goods and services providers, to my knowledge, are required to meet a suitability standard test. For example, if a person wishes to purchase a home, the realtor is under no obligation to determine if the house chosen by the purchaser is “suitable” for their requirements. The Ontario Securities Commission (“OSC”) is pursuing an even higher standard for dealers, the fiduciary standard. The fiduciary standard is virtually impossible for a profit-making business to meet, since businesses exist to earn profits not “serve” customers. Any profit earned by a business is unacceptable, since the business should have been returned any profit to the customer to fulfill their fiduciary duty.

Rather than seeking a perfect regulatory system, the CSA's goal should be to operate a regulatory system which supports the fundamental foundational concepts of a free society, including the unfettered right of the public to enter into contracts with each other.

Questions:

1. Is it logical for the CSA to attempt to design a regulatory system that seeks perfection as a realistic goal?
2. Does the CSA have any obligation to support the fundamental principles of a free society in the design and enforcement of its regulations?

CONCLUSION

In the past 20 years, the level of competition in the retail mutual fund industry has diminished. The number of dealers continues to decline due to the uncertain regulatory environment. Dealers are forced to operate in an industry where the basic tenets of logic and fundamental principles of a free society are ignored. No logical entrepreneur would invest resources in a business environment where the regulators have unchecked power and are proposing to use that power to favour a specific class of competitors (large banks) over independent dealers. As a result, the Canadian public is left with fewer and fewer choices to meet their financial service needs. Many Canadians want to establish relationships with large banks that are manufacturers and retailers of proprietary financial products. Others wish to form life-long relationships with independent financial service retailers that have access to a wide variety of financial products from competitive manufacturers. In a free and open society, the Canadian public should have the freedom to choose the financial service provider that best fulfills their needs. This freedom should also include the freedom to determine the amount and method of payment of the compensation that the financial service provider will receive.

Québec, le 8 juin 2017.

Projet : CP81-408

Madame,
Monsieur,

Je m'adresse à vous en tant que client en fonds communes depuis plus de 25 ans. J'ai eu une discussion avec ma conseillère dernièrement concernant le projet des autorités d'abolir les commissions aux représentants en épargne collective. L'argument étant que les représentants autonomes sont en conflits d'intérêt.

Voici une fausse solution à un faux problème. Où est le conflit d'intérêt? Alors que ma conseillère peut m'offrir une diversité de produits venant de différentes compagnies. Ce qui n'est pas le cas pour les conseillers de mes deux institutions bancaires. Ceux-ci m'offrent les produits des institutions qui les emploient et qui leur mettent de la pression pour produire. Présentement, je fais affaire avec la TD et le mouvement Desjardins. C'est avec ma conseillère autonome que je fais le meilleur suivi et le plus de rendement sur mes placements.

Je suis parfaitement au courant qu'elle retire une commission sur mes placements et c'est tant mieux, parce que c'est à grâce à elle si je peux maintenir mon capital sur mon FERR depuis plus de 7 ans. J'espère qu'elle pourra continuer de recevoir des commissions sur nos comptes, parce que cela me donne une certaine garantie qu'elle sera encore là dans 10 ans.

Comme client, j'ai besoin de ma conseillère autonome. C'est elle qui me guide le mieux dans cet univers de la finance. Comme conseillers, ils (elles) ont tout à fait le droit de gagner leur vie. Je ne vois pas où est le problème par rapport aux commissions.
Un problème que je perçois, c'est la surcharge administrative que vous voulez imposer à ces personnes.

Je vous invite à revoir vos orientations et à supporter l'ensemble de ces conseillers autonomes au détriment des grandes institutions.

Sincèrement Vôtre

Guy Roy

June 8, 2017

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
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Sent via Email: comments@osc.gov.on.ca, Consultation-en-cours@lautorite.qc.ca

Re: CSA Consultation Paper 81-408 Consultation on the Option of Discontinuing Embedded Commissions

Dear Sir/Madam:

Executive Summary

It is logical that the prosed changes to embedded commissions would be indirectly beneficial for the exempt market, as it effects a smaller proportion of our products and will create grave systematic risk for mutual fund dealers and independent brokerages. However, as indirectly beneficial as it could be for the exempt market, it is bad policy. Therefore, NEMA is against the proposed changes stated in CSA Consultation Paper 81-408 on the Option of Discontinuing Embedded Commissions. As an alternative, NEMA is supportive of investor choice through diversity in dealership business models in Canada, and transparency of compensation. It is concerning to us that the research presented in the proposal focuses on the micro results of investors paying more fees when working with advisors as opposed to the macro results of investors who work with advisors accumulating more wealth.

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About Us

The National Exempt Market Association (NEMA) was originally founded in 2011 as the Western Exempt Market Association. We are an organization dedicated to the growth of the Canadian Exempt Market's public profile and the improvement of its reputation. Through our members, NEMA has firsthand insight and knowledge of the operation and corresponding needs of the Exempt Market in Canada. By nature, our members are generally small businesses that raise capital for other small businesses. As such, our members are much more vulnerable to changes in securities laws than larger firms and organizations who have the resources, both legal and financial, to absorb and adapt to such changes. NEMA appreciates the opportunity to comment on the CSA Consultation Paper 81-408 Consultation on the Option of Discontinuing Embedded Commissions.

Process of Compiling this Report

This response is a compilation of NEMA membership views from the exempt market. NEMA has been active in soliciting member and stakeholder feedback. In addition to a vast amount of email correspondence, NEMA participated in one-on-one conversations with members. Please note that this response addresses only those specific questions in the consultation paper that our members have indicated to be of the greatest importance, and compiled them into one response.

Response to the CSA Consultation Paper 81-408 on the Option of Discontinuing Embedded Commissions

It is outside the scope of the regulator's mandate to dictate market conditions, especially around remuneration structures for the private sector. The free market develops that based on stabilizing revenues and investor appetite for compensation models. Embedded commissions, if fully disclosed, increase alignment of the advisor with the investor (as they do not have to 'eat what they kill' and have a steady income stream). It is not in the investor's best interest to work with a brokerage or advisor that does not have a relatively consistent income stream, especially in a down market. NEMA asks the CSA to reflect on the compensation model options that Dealerships will be left with, whether it be fee only or salary with quotas, and reflect on the consequences of that. It is of our opinion that there will be far fewer dealerships, and the ones that remain will inevitably consolidate, leaving investors less choice and, in some cases, only bank provided options.

In addition, if embedded commissions are eliminated – they should be eliminated across the board. If enacted, the CSA should extend such a ban to all embedded structures in securities raises, including initial public offerings, banking products and insurance related products.

NEMA is not recommended a blanket policy of embedded commissions, but is illustrating that it is unreasonable to have these expectations for one area of distribution over the other.

NEMA feels compensation models need to be flexible for dealerships advisors, and the investors they serve. As an alternative to eliminating embedded fees, the full disclosure of such fees should be communicated between advisor and client at the time of the first phase of the sales cycle, when the mutual expectations are defined and agreed upon. This is not to say fees should be bartered, as one would do for a used car, but that the fees are stated and understood upfront.

Commission and related expense disclosure are disclosed in the exempt market, and have been for decades. The commissions are disclosed on the Risk Acknowledgement Form,[1] and the investor has to sign off on them before the sale. For retail investors, The risk acknowledgment form in our industry has always stated very clearly that amongst the real risk potential of losing all invested funds, and that the advisors recommended the product is being paid X for placing the investor in the deal.

Commissions and other related management expenses are disclosed in an Offering Memorandum (OM). Only about 20% of exempt market products currently have embedded forms of compensation, so it is understood that this is more of an issue with publically traded mutual funds. Since the real concern is about embedded fees in the Mutual Fund industry, a possible solution could be to create a Risk Acknowledgement Form for the mutual fund industry that indicates the potential risk of loss, and clearly states what the commissions and fees are relative to the fund being purchased.

In addition, as stated in the consultation paper, the results of the disclosure regimen of CRM II policy changes have just been implemented, which outlines what clients are paying for the services provided. The possible benefits and issues of the CRM II structure have not been discerned yet, so making such material industry policy changes at this time is rushed and duplicitous. We are cognizant that the regulators do not value disclosure models, and NEMA published a critical assessment[2] about the weak research methodology of the Cain, Loewenstein & Moore[3] studies from which this assumption is based.

[1] The Client Acknowledgement form is included in NI 45-106

[2] The Debated Impotence of Disclosure: http://theprivateinvestor.ca/the-debated-impotence-of-disclosure/

[3] *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest* by Daylain M. Cain, George Loewnstein, and Don A. Moore. Published January 2005 by The University of Chicago; and *When Sunlight Fails to Disinfect: Understanding the Perverse Effects of Disclosing Conflicts of Interest* by Daylain M. Cain, George Loewenstein, and Don A. Moore. Published January 2010 by the Journal of Consumer Research.

The results indicated that the advisors gave higher values to the estimators under the direct conflict condition rather than the control condition. The values were higher still if the conflict was disclosed. The researcher's conclusion was that disclosure gives advisors a moral license to mislead the client. What the researchers also found interesting was the way the estimators acted with the information under the different groups. Estimators discounted the values from advisors, but they did not discount them enough to compensate for the additional premium the advisors put on the coin value they recommended to estimators, and estimator guesses were more inaccurate in the disclosure condition. From this, researchers concluded that disclosure is actually harmful for the estimators.

The validity of generalizing the results of this study to financial services (or any other industry) are limited. First, this was a game, similar to the game of bluff, there was no explicit moral or ethical obligation for the advisor to act in the estimator's best interests. In addition, there were no consequences for the advisor not to act in their own best interest. Second, the conflict of interest was direct, meaning the advisor profited at the estimator's loss, this total non-alignment would not happen in industry, as reality is much more complicated than that, especially when factoring in reputation risks. Third, there was not an option for investors not to play, or 'invest,' which is a consequence of real world scenarios. Finally, the advisor had very little information, they were given a range of money in the jar, but not the actual value, so advice, biased or not, was a guess.[4]

Similarly, It is concerning to us that the research presented in the proposal, such as the CSA commissioned paper, *A Dissection of Mutual Fund Fees, Flows, and Performance* by Douglas Cumming[5] generally draws conclusions that a client's investment performance is reduced when they pay embedded compensation to an advisor, so investors are being harmed by investing in recommended funds versus do it yourself (DIY) or low-fee models. In the micro results of investors paying more fees when working with advisors as opposed to the macro results of investors who work with advisors accumulate more wealth.

However, household finance does not fit into any clean textbook models, as there is complexity in conflicting goals, emotional issues, and subjective opinions on 'value' where advisors play a significant part, and should be compensated accordingly. The value of the advisor has been

[4] The Debated Impotence of Disclosure: http://theprivateinvestor.ca/the-debated-impotence-of-disclosure/
[5] Retrieved from: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20151022_81-407_dissection-mutual-fund-fees.pdf

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ignored. For example, one robust industry study in the UK by Old Mutual[6] found that consumer's outcomes are more positive when consumers attain investment advice, with the average retirement income at 17,168 euros without an advisor, versus 20,873 euros with advice. Interestingly, when advice is paired with concrete goals, the average retirement income rose again to 24,175 euros – that is a significant increase in overall prosperity outcomes, and indicates that micro investment outcomes should not invalidate overall investor macro outcomes of overall wealth accumulation.

Concluding Remarks

NEMA is optimistic that the CSA will contemplate the comments received by us, and other industry participants, about the detriment of these proposals. NEMA recommends looking at how CRM II and other recent new legislation affects the market before enacting further changes. Implementing policy because a few other Commonwealth countries[7] have implemented policy to transition to fee only is, in our opinion, not a strong enough reason. Independent non-commissioned research should be looked at for this policy consideration, and in a few years the UK and Austria will be an ample case study and provide good guidance. In addition, enforcement actions against rogue advisors that harm investors are also recommended.

For further elaboration on our views or for questions, please contact Dr. Pettipas at cora@nemaonline.ca or 403-992-9809.

Regards,

Dr. Cora Pettipas PhD, DBA, CFP, FCSI — President

Craig Skauge — Chairman

[6] The study is called *Retirement income uncovered: The new normal*. Retrieved from: https://www.oldmutualwealth.co.uk/products-and-investments/pensions/pensions2015/retirement-reports/

[7] The UK, Australia and the Netherlands

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De : Patrick J. Carricato
Envoyé : 8 juin 2017 01:20
À : CSA ACVM Secretariat
Objet : One Advisor's Perspective about Embedded Fees

To the CSA Secretariat,

Advisors and financial institutions keep saying that the small investor will be hurt if embedded trailer commissions are banned. Why? Wouldn't advisors be able to charge the same 1%/ yr. out-of-pocket?

Before answering these questions let me first preface this with my particular circumstances. I've been a financial advisor for more than 22 years. I deal almost exclusively in mutual funds for my income. I provide my clients with as much service as they need and only ask for up to the 1% trailer commission as compensation (FE 0%). That means no front-end fees, no DSC fees, no switch fees, no transfer fees, no nominee account fees, no annual maintenance fee, and no account close-out fees. In other words, it is about the lowest full service cost that any investor could ask for. Since my only compensation is a percentage of AUM, my incentives are to keep client costs to a minimum and to keep their portfolio performance up to the best possible for their risk tolerance, objectives and time horizon. Our rigorous compliance system ensures that I cannot exceed this risk tolerance. These incentives are what I need for my best interest. These same incentives are also what my clients need for their best interest. So although I am already a fiduciary, my method has a best interest standard built-in. So when it is claimed that I have a conflict of interest, I would ask, what method would be better? Other methods that I have investigated either encourage bad behavior, and/ or involve more fees and /or involve conflicts of interest. Also, when it comes to the perceived conflict of interest issue presented by the regulators because I am paid by the fund companies, I would argue that it does not exist. According to Morningstar Canada, there are 10,774 commission based advice mutual funds vs. 628 no load do-it-yourself funds. The majority of the commission based funds pay a 1% trailer commission. Therefore, I am not tied to any one mutual fund company that could raise a conflict of interest issue and there is no shortage of being able to find some of the best, high quality mutual funds and managers in the industry. As a matter of fact, if I were compensated in any other form other than trailer commissions, I would still recommend the same mutual funds that I am currently recommending. That alone should be proof that I have no conflict of interest.

Now to the question at hand. Advisors like myself, treat embedded commissions as a pool of income from which they are paid to service their clients. Most of my clients generate a 1% trailer commission regardless of their account size. This allows me to provide the service my clients require regardless of how much they have. My experience has been that the younger, less experienced investors, with the smallest accounts require the most education and time to service. The clients with larger accounts don't complain because the 1% is standard across the industry and they know what my incentives are. However, if the trailer commission is no longer embedded, clients would be required to pay this 1% out-of-pocket. Larger investors would then expect more, and better service to match what they pay. Since there are only so many hours in a day, advisors would then need to shift their time toward the larger accounts to compensate.

At the other end of the spectrum, the 1% of a smaller, say $10,000 account, would only generate $100 of commission per year. At an hourly rate of $150, this translates to less than 1 hour per year for service. The annual KYC paperwork alone "without an appointment" would cost the advisor more than that. Add to that the required change from client-name account to nominee account will cost the client an extra

$100/yr. Therefore, the small investor would pay $200/ yr. or 2.0% to get less service than the embedded 1% provides now. If you include a "reduced" MER of say, 1.5%, the small investor would pay a total of 3.5% of AUM. That's a prohibitive fee for getting less service than the current average MER of about 2.5%, which includes the 1% trailer. The smaller investors will either leave voluntarily or be asked to leave by advisors who can't afford to service them. The end result is unhappy small investors and potentially unhappy large investors, if the advisors don't shift. That's a whole lot of unhappy investors.

A good analogy to all this is our healthcare system. It's universal so everyone pays a percentage of their income in taxes to fund the system. This means that the wealthy end up contributing the most to the system but still get the same care as the poor. If the cost of our system wasn't embedded, and everyone had to pay out-of-pocket, the rich would demand more, and better care, while the poorest would go without care at all. This, unfortunately, is what will happen in our financial world.

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Investors Group

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June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
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Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions (Consultation Paper)

We are pleased to provide comments on behalf of Investors Group Inc. (Investors Group) on the CSA's Consultation Paper dated January 10, 2017 which seeks to assess the potential effects on investors and market participants of discontinuing embedded commissions; identify potential measures that could assist in mitigating any negative impacts of such a change; and obtain feedback on alternative options that could sufficiently manage or mitigate the investor protection and market efficiency issues identified by the CSA.

Our company

Investors Group is a diversified financial services company and one of Canada's largest managers and distributors of mutual funds, including the exclusive distributor of its own products. It carries out its distribution activities through its subsidiaries Investors Group Financial Services Inc. (IGFS) and Investors Group Securities Inc. (IGSI), which are members of the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC), respectively, with assets under management of over $85 billion as at April 30, 2017. Investors Group also carries out insurance advisory services through I.G. Insurance Services Inc. Serving our clients since 1926, Investors Group distributes its products and offers financial planning through 93 region offices, represented by over 4,500 representatives to approximately one million clients across Canada.

Investors Group is part of IGM Financial Inc., which is a member of the Power Financial Corporation group of companies.

Overarching Comments

Investors Group agrees with the CSA in the desire to better align the interests of investment fund managers, dealers and representatives with those of investors; to deliver greater clarity on the services provided and their costs; and to empower investors in the dealer compensation process. We are committed to improving our clients' financial well-being.

For over 90 years, we have firmly believed that building long-term relationships with clients is the best way to help individuals reach their financial goals at each stage of their lives. Our focus is on comprehensive financial planning that includes investments, retirement, tax planning, estate planning, insurance and mortgages. We have long encouraged and provided financial support to representatives to obtain the Certified Financial Planner (CFP) designation or, in Québec, the Planification Financière (F.Pl.) certification, which we believe instills high standards of competence and professionalism through rigorous requirements of education, experience and ethics. More recently, we integrated these programs into our internal training programs and in May of this year, we made the enrollment and completion of the CFP or F.Pl. for all representatives mandatory within a prescribed period. We further provide our representatives with financial planning support and training through comprehensive financial planning tools and access to financial planning, investment planning, retirement, mortgage, securities, tax and insurance specialists. As at March 31, 2017, approximately 1,578 Investors Group representatives hold a CFP or F.Pl. designation, and another 2600+ are working toward their certification.

We do not believe we should wait for regulators to tell us what is right for our clients. We should be doing that ourselves. Toward that end, we have developed at IGM Financial Inc. a list of seven commitments that reaffirm our core values, from putting our clients first to fostering a culture of excellence.[1]

On September 19, 2016, Investors Group announced that we would discontinue the deferred sales charge (DSC) purchase option for our mutual funds effective January 1, 2017. While DSC was created to provide discipline to long-term investing, we concluded that the marketplace had evolved. Investors Group remains committed to servicing mass-market households because we know that the benefit of advice on wealth accumulation is ongoing and significantly greater the longer the advice relationship.[2] While we do not anticipate the CSA's proposal to discontinue embedded commissions will impact our ability to provide a wide array of financial products and services to households with little to invest, in part because of the vertically integrated nature and size of our firm, we know that there will be many dealers and their representatives who may only be able to continue to service more modest clients because of the embedded commission model.[3]

Therefore, as the CSA deliberates on whether or not to proceed with a ban on embedded commissions, we believe an essential prerequisite for the CSA to consider must be for any reform to not disproportionately impact or favour certain registrants to the detriment of others. As the CSA acknowledges in the Consultation Paper, discontinuing embedded commissions does just that, favouring deposit-taker owned fund dealers who today already dominate investment fund distribution in Canada, and significantly disadvantaging independent and small fund dealers. This, we believe, could ultimately lead to an even greater concentrated market, with fewer choices for products and advisory services resulting in less innovation and competition in our capital markets, to the detriment of Canadian investors. We also know that fewer choices of compensation model

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[1] Our stated commitments are: (i) inspiring financial confidence, (ii) putting our clients first, (iii) helping our clients reach their financial goals, (iv) keeping stakeholders informed, (v) fostering a culture of excellence, (vi) being a good neighbour, and (vii) making sound decisions for the long term.

[2] Advice has a sizeable and ongoing, positive impact on financial assets that increases with the tenure of the advice relationship, controlling for all other variables: the ratio of advised to non-advised financial assets was found to be 1:7 early in the advice relationship, growing to 3:6 for relationships 15 years or longer (Source: CIRANO, *The Gamma Factor and the Value of Financial Advice,* 2016).

[3] The MFDA indicates that MFDA members provide advisory services to close to nine million households in Canada, or about 56% of all Canadian households, and of them, about 83% (or 7.3 million households) fall within the mass-market space, defined as those with less than $100,000 in financial assets. MFDA non-deposit taker owned fund dealers form a significant part of the industry servicing 2.36 million households and licensing approximately 32,000 advisors within the MFDA membership, of which 56% (or 19,021) of these advisors have small books of business and predominately rely on DSC commissions to finance their operations (Source: MFDA Bulletin #0721 C – *MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients* (May 23, 2017) ("MFDA Client Research Report")).

can limit access to advice and result in higher overall cost if only fee-based compensation services are available, particularly for households with more modest investment levels.[4]

Given these potential outcomes, we question whether the "complementary" benefits the CSA say may occur with discontinuing embedded commissions outweighs the very real and adverse impacts that will occur to some dealers, their representatives and most importantly, to Canadian investors.

We firmly believe that when fully implemented, the outcomes that will be achieved with the CSA's Point of Sale disclosure (POS) and Client Relationship Model (CRM) projects, together with the reforms in CSA Consultation Paper 33-404 (CSA CP 33-404),[5] will substantially address the key investor protection and market efficiency issues identified in the Consultation Paper. Moreover, as the Investors Group decision to discontinue DSC illustrates, we submit that the financial services industry in Canada today is undergoing rapid and significant changes due to investor preferences and competitive market forces independent of regulation, which is furthering the CSA's stated objectives.

Therefore, to the extent the CSA considers that there remains any regulatory gap, we believe that there are other regulatory options that the CSA can and must consider first that will, in conjunction with current regulatory reforms, address the CSA's concerns while maintaining investor choice, accessibility to advice and a fair and efficient capital markets. In our view, the discontinuation of embedded commissions is not required to address the key issues identified in the Consultation Paper.

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[4] In the United States, the average total cost of fee-based advice is comparable to the cost of advice in Canada (2.00% to 2.20%), however the cost is higher for modest investors with less than $100,000 of financial assets (2.40%) than for high net worth investors (1.70%) (Source: Investor Economics & Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canada-U.S. Perspective,* 2015). Where regulation has been changed to ban or limit commissions, the absence of embedded compensation has been found to lower the cost of the product, but the cost of advice was seen to go up. It has also been found that in jurisdictions that have moved to fee-based compensation, those with less wealth or income found it more difficult to get advice than others. Ultimately, all forms of compensation affect advice and outcomes and there is not enough evidence indicating that fee-based compensation will lead to better long-term outcomes than commission-based compensation (Source: Mutual Fund Fee Research prepared for the Ontario Securities Commission on behalf of the Canadian Securities Administrators, written by Dr. Edwin Weinstein, PhD The Brondesbury Group, Spring, 2015 ("The Brondesbury Report")).

[5] CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients (April 28, 2016). In our response letter to CSA CP 33-404, we identified some potential unintended consequences arising from the targeted reforms and provided some alternative suggestions where possible. We also stressed the importance of treating firms and advisors subject to the same proficiency requirements and standards of conduct the same, no matter the product shelf, and the need to provide firms and their representatives the flexibility to provide streamlined services and financial advice. In our view, the targeted reforms, applied consistently to registrants and business models, and with flexibility in the framework to recognize client engagements will vary in scope and services, can achieve positive outcomes for Canadian investors.

On this point, we believe it is noteworthy for the CSA to consider that while regulators globally have been focused on issues similar to those articulated in the Consultation Paper, a number of regulators and particularly government policy makers, when engaged in this review, have explicitly chosen not to ban embedded commissions. Their reasoning, in part, includes the recognition that it would be detrimental to impose a reform that will have a negative impact on independent and smaller market participants and create further concentration of asset management with deposit-takers. In New Zealand, policy-makers very recently decided to focus their regulatory efforts on the conduct of those providing financial advice, rather than imposing a ban or restriction on commissions, concluding that "banning commissions is not a 'silver bullet' that will improve the quality of advice".[6] While in the United States, we note that the Department of Labor (DOL) fiduciary rule still permits firms and their individual advisers to receive most common forms of compensation for advice to retail clients under the best interest contract (BIC) exemption, so long as the firm and adviser provide advice in the client's best interest, charge only reasonable compensation, and avoid misleading statements about fees and conflicts of interest.[7]

Given this global regulatory landscape, we believe the CSA should provide a more detailed analysis as to why the approaches taken in such countries such as Sweden, Hong Kong, Germany, New Zealand and Singapore, all of whom have chosen not to ban embedded commissions, would not be equally appropriate approaches for the Canadian market and for Canadian investors.[8] This analysis was absent from the Consultation Paper and we believe it is worthy of a more in-depth discussion and a public consultation before a regulatory decision is made to discontinue embedded commissions in Canada.

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[6] Ministry of Business, Innovation & Employment (MBIE), *Factsheet – Review of Financial Advisers and Financial Services Providers Acts*, July 2016 (see also: MBIE, *Review of the Financial Adviser Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008*, July 2016. We also have seen Sweden's minister for Financial Markets and Consumer Affairs indicate that the government will be proposing legislation that will not ban commission-led sales of financial advice and products in order to allow investors to continue to have access to a wide range of products and advice (Source: Investment Europe, *Swedish government proposes not to ban commission-led sales*, May 24, 2016).

[7] The White House, Office of the Press Secretary, *Factsheet – Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings*, April 6, 2016.

[8] Currently, only four countries have imposed a ban on embedded commissions: Australia, Netherlands, South Africa and the United Kingdom. In the Netherlands, the discontinuation of embedded commissions is a voluntary arrangement among the five large banks that dominate investment fund distribution. While under the MIFID II reforms, the imposed ban on embedded commissions only applies to independent financial advisors, which make up only 11% of the European market. Despite MIFID II, a number of jurisdictions have concluded not to impose a ban on embedded commissions, including: Belgium, Denmark, France, Germany, Ireland, Italy and Sweden. Additionally, we have seen a number of other jurisdictions decide not to proceed with the regulatory option to discontinue embedded commissions, among them: Brazil, Hong Kong, India, Israel, Japan, New Zealand, Singapore and South Korea.

Structure of Our Response Letter

In our submission, we provide insights and specific data of our experience in the Canadian market, as well as offer alternative regulatory options for the CSA to consider that we believe address the stated concerns in the Consultation Paper. In the appendices to our letter, we provide more detailed responses to some of the operational and tax questions posed in the Consultation Paper and also give some insights into the value of active-management, which we find positioned in the Consultation Paper as being somehow an undesirable outcome for investors that will be remedied through the discontinuation of embedded commissions.

Our submissions are predicated on the desire that (i) we retain an innovative, competitive and fair financial services industry in Canada, which provides investors with access to choices to a broad range of products, manufacturers and dealers, and (ii) that financial advice in Canada remains accessible and affordable for mass-market householders.

Importance of Preserving an Innovative, Competitive and Fair Financial Services Industry in Canada

a. Avoiding regulatory arbitrage

As we have noted in prior consultations, it's important to remember that the securities industry is only one part of the financial services sector in Canada. Insurance and deposit products are also significant segments of the industry. For example, deposits and short-term savings vehicles in the bank branch channel account for approximately $1.2T, just slightly less than the approximate $1.4T in mutual fund assets in Canada.[9] We have long advocated that the obligations owed by registrants to their clients and the regulation of retail financial products should not depend on the legal nature of the investment vehicle being sold or the licence held by the registrant. Insurance and deposit investment products are also significant segments of the industry, and compete directly with the sale of investment funds. As the CSA is aware, there are embedded commissions and costs built in to many of these other financial products, notably segregated funds as well as spreads on guaranteed investment certificates (GICs) and daily interest accounts (DIAs).

From the client experience, it is only fair and reasonable that the same set of rules that apply to investment funds apply to other similar financial products. With the POS and CRM projects, as well as the proposals in CSA CP 33-404, there already exists a schism in terms of disclosure and registrant conduct regulation across the financial services industry in Canada. This, in our view, creates complexity and confusion for investors and can lead to inconsistent client experiences and investment outcomes.

We believe it is noteworthy that in each of the jurisdictions that has introduced a complete ban on embedded commissions, the ban has extended beyond investment funds. This is a very important distinction to what is proposed in the Consultation Paper. We welcome the CSA's support for a

[9] Investor Economics, *Household Balance Sheet*, 2015.

harmonized regulatory approach for similar products, and the recent paper by the Canadian Council of Insurance Regulators (CCIR) on segregated funds.[10] However, the potential for regulatory arbitrage remains. The Consultation Paper gives no indication of the timeline for the CCIR's review or a commitment for coordinated action with the CSA, nor is there any discussion in the Consultation Paper of whether a similar review is being considered by the Office of the Superintendent of Financial Institutions (OSFI) with respect to banking products, such as GICs and DIAs.

At Investors Group, we apply the same standards of conduct and compliance supervision as applicable to our duly registered securities and insurance representatives in each jurisdiction. For example, we have similar supervision programs for mutual fund and segregated fund recommendations, including trade review processes related to suitability in relation to client KYC information.

As part of the CSA's deliberations, the potential impact of product and regulatory arbitrage cannot be disregarded or discounted. We found it particularly disconcerting that the CSA suggests in the Consultation Paper that the high level of horizontal integration at deposit-taker owned dealers somehow leads these firms to focus less on any one business line and more on "gathering assets across all business lines and on directing clients to the appropriate business line". Respectfully, we submit the recent CBC Go Public reports suggest otherwise.[11]

Without harmonized product and registrant conduct regulation across the financial services industry, the concerns expressed by the CSA in the Consultation Paper with respect to embedded commissions and misalignment of interests will continue to be just as relevant in the distribution of other types of financial products. This in our view is inconsistent with the CSA's mandate of achieving strong investor protection and fair and efficient capital markets.

We therefore strongly urge the CSA to work collaboratively with insurance and banking regulators. Given the make-up of the financial services sector in Canada, we do not believe it is sufficient for the CSA to say that it "assumes" that the self-regulatory organizations and regulators of non-securities products will remain vigilant and take any necessary action in the case of non-compliance. Should a decision be made by the CSA to proceed with discontinuing embedded commissions, any such securities regulatory reform must only proceed if it is accompanied by concurrent and consistent regulatory initiatives for investment fund-like products across the insurance and banking industries.

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[10] Canadian Council of Insurance Regulators, *Segregated Funds Working Group Issues Paper*, May 2016.

[11] See: CBC News reports by Erica Johnson, http://www.cbc.ca/news/canada/british-columbia/td-tellers-desperate-to-meet-increasing-sales-goals-1.4006743 (March 6, 2017), http://www.cbc.ca/news/business/td-bank-employees-admit-to-breaking-law-1.4016569 (March 10, 2017), http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575 (March 16, 2017), http://www.cbc.ca/news/business/bank-s-deceptive-titles-put-investments-at-risk-1.4044702 (March 29, 2017) and http://www.cbc.ca/news/business/financial-investment-rules-client-interests-1.4069847 (April 17, 2017).

b. Preserving a competitive and innovative industry

The CSA acknowledge that discontinuing embedded commissions will have more of an impact on some dealers (such as smaller independent dealers) than others. In fact, the Consultation Paper notes that a ban on embedded commissions will have little to no effect on deposit-taker and insurer owned dealers as most households who purchase investment funds purchase through such dealers, which dominate investment fund distribution. While the impact of a ban on embedded commissions may appear small in terms of distribution, we believe it is critical for the CSA to consider the important role non-bank dealers and manufacturers play in the Canadian market, especially relative to this segment's size.

The concentrated and vertically integrated distribution landscape in Canada has made it increasingly difficult for independent dealers and investment fund manufacturers to effectively compete and ensure investors retain access to choice in terms of financial advice and financial products. As the CSA now considers discontinuing embedded commissions, considering how such a regulatory change will affect the vibrancy of the financial services industry in Canada is critical, as this too has a significant impact on the client experience and investment outcomes.

In our view, the assertion in the Consultation Paper that "investment funds are less popular than traditional savings vehicles with mass-market households" is much more a result of the oligopoly and horizontal integration of the banks, than a testament to investor preference. We strongly disagree with what seems to be the CSA's sentiment that the avoidance of an "advice gap," because deposit-taker owned dealers in Canada will continue to service mass-market households, somehow negates the adverse impacts that a ban on embedded commissions may cause.

Market Forces are also Driving Changes Independent of Regulation that are Achieving Regulatory Objectives

We strongly believe that competitive market forces are already effecting industry changes that the CSA identifies as some of the positive outcomes that they expect may occur from discontinuing embedded commissions. In particular, we are seeing today (a) the growth and availability of direct-pay (negotiated advisory fee) options to all investors in all channels; (b) reductions in fund fees and fund fee complexity; (c) increased price competition and (d) market innovations in product distribution and advice.

a. Fee-based and direct-pay options continue to grow in all channels

The CSA is correct to identify that the share of mutual fund assets held in fee-based purchase options (F series) is growing, and growing quickly. Competitive market pressures are driving the growth of F series for many fund manufacturers, with frequent changes to the F series offering or pricing. Fee-based program assets as a percentage of total assets is gaining ground in IIROC platforms, and in full-brokerage the shift in advisor compensation is in-line with the shift to fee-based.[12] Investors Group, through IGSI, introduced non-discretionary Fee Based Accounts and dealer discretionary Separately Managed Account (SMA) programs in 2016.

b. Reduction in fund series and fund fee complexity underway

In the last few years, we have seen a number of proactive actions taken on the part of investment fund managers aimed at reducing fund fee complexity and series simplification. At Investors Group, we have made an ongoing and active effort to reduce the number of funds on our product list. Our perception is also that fund management fees and embedded distribution costs have become more uniform, and are continuing to decline. Finally, we continue to see fund managers either simplifying asset house-holding programs or move to a flat fee pricing strategy. While we believe there will always be some differences across asset-managers, in part because of competition and innovation, this dynamic innovative and competitive environment, coupled with recent regulatory changes, has led to improved client experiences and investment outcomes.

c. Increased Price Competition Occurring

In the last few years, we have seen a number of investment fund managers announcing fee cuts,[13] trailer fee cuts, administration fee cuts as well as an increasing number of share classes with lower MERs year-over-year.[14] Asset-weighted management expense ratios (MERs) and management fees for long-term funds[15] also continue to decline.[16]

d. Market innovations in product distribution and advice

The CSA is correct to identify the growth of online advice within the Canadian market. We were surprised, however, to see the CSA imply that the adoption by incumbents of online platforms will somehow have a negative impact on the pricing pressures these new entrants have brought to the market. We find no evidence in the Consultation Paper to support this assertion. Rather, we see this as an opportunity for incumbents to leverage new technologies to create efficiencies and enhance client experiences and investment outcomes.

In our view, the increasing innovation and technology we're seeing with online platforms will continue to offer investors additional choices both in services and products. Coupled with the impact of the proposals in CSA CP 33-404 and the POS and CRM projects, we anticipate there

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[12] Source: Strategic Insight, *Retail Brokerage and Distribution*, Summer 2015.

[13] Includes companies that have introduced preferred pricing programs.

[14] December 2014 – December 2015, source: Insight Advisory Service, July 2016.

[15] Excludes funds with performance fees, funds with management fees charged at account level and labour sponsored funds, source: Insight Advisory Service, July 2016.

[16] Ibid.

will continue to be pricing and competitive pressures on more traditional registrant models to demonstrate alignment of overall services and advice with dealer compensation.

The Current Regulatory Initiatives underway achieve the Key Investor Protection and Market Efficiency Issues Identified by the CSA

a. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

Investment Fund Managers

Today we identify and respond to material conflicts of interest through avoidance, controls and timely disclosure. This includes disclosure related to our proprietary business model.

Our experience is that the majority of embedded commissions offered by investment fund managers in the market today are substantially the same across asset classes and series and that manufacturer margins and costs (management expense ratios) are decreasing. All of this means that fund managers today are aggressively competing on fund costs and performance. For Investors Group, the competitiveness of the market in which we seek to attract and retain not only clients but also representatives, requires that we compete on fund costs and most importantly, fund performance, in order to maintain and grow market share.

At Investors Group, we strongly believe in an alignment of interests between our Portfolio Managers and our clients and this principle underscores our approach to incentives. All our Portfolio Managers have a substantial financial interest in delivering competitive relative investment performance and those managers who deliver poor relative investment results simply do not receive incentives for that performance. We also believe that it is important to focus on long-term performance and as such the majority of our incentives are measured against 3-5 Year results. In addition, our Portfolio Manager deferred incentive program is designed to further enhance this alignment through co-investment where a portion of the managers' incentives are linked to the performance of the fund(s) they manage.

In our view, the introduction of the proposals in CSA CP 33-404 will impose further pressure on fund managers to compete on fund costs and performance. For firms with a proprietary product list, such as Investors Group, the know-your-product (KYP) proposals will require such firms to compare all of the products on their shelf against key criteria such as fees, costs and performance, to establish their relative competitiveness to each other and to the market. This, in our view, responds directly to the issue cited in the Consultation Paper with respect to research which finds that flows with embedded commissions, and/or where there is an affiliated dealer, may be less sensitive to past performance.

We therefore strongly believe that with the reforms and/or guidance that will emerge from the proposals in CSA CP 33-404, the CSA has effectively addressed any residual reliance fund managers may still have to compete on embedded commissions to promote sales or retain assets.

Dealers and their Representatives

The stated purpose of the proposals in CSA CP 33-404 is "to better align the interests of registrants with the interests of their clients". As we've indicated, we believe the CSA achieves this aim, and that CSA CP 33-404 addresses many of the concerns expressed in the Consultation Paper, namely that embedded commissions may encourage dealers and their representatives to recommend higher cost fund products, or promote a particular purchase option, that pays them a higher commission to the detriment of investor outcomes.

In fact, we consider the breadth of the proposed conflicts of interest reform and accompanying guidance in CSA CP 33-404 on compensation arrangements and incentive practices to capture much more than simply any potential influence caused by embedded commissions. The proposal requires firms to assess whether any remuneration could reasonably be expected to inappropriately influence how representatives deal with their clients. Investors Group supports this more principle-based approach to addressing all types of compensation bias, as this approach recognizes that conflicts of interest and the potential for misalignment of interests can exist in any fee model. As noted in The Brondesbury Report, "all forms of compensation affect advice and outcomes".[17]

Alternative Regulatory Option to Address Issue 1

***Cap Embedded Commissions* –** We believe that the CSA should consider further whether a maximum limit (cap) on the amount of the trailing commission that investment fund managers may pay to dealers and their representatives could solve for any residual concern related to this issue, as an alternative to discontinuing embedded commissions. As noted in the Consultation Paper, this option would not preclude dealers and their representatives from directly charging their clients commissions or fees, either as a supplement or a substitute to embedded commissions. It could also serve as an interim step, to measure if standardizing and reducing the variability of trailing commissions across funds sufficiently reduces any residual incentives for dealers and their representatives.

It surprises us that the CSA states that in pursuing this option it would be taking on a non-traditional role to set fee caps and that it would be very challenging to determine and justify the appropriate cap rate in the circumstances. The U.S. Financial Industry Regulatory Authority (FINRA) imposes limits on embedded 12b-1 fees. We also note that the CSA does, in fact, set fees, most recently lowering the cap on active trading fees that are listed on a Canadian exchange.[18] We submit the CSA could, *through a public consultation process*, come to similar appropriate caps for embedded commissions paid by the manager. As we discuss below, we believe the other issues identified with embedded commissions are effectively addressed (or can

[17] The Brondesbury Report, p 4.

[18] CSA Amendments to National Instrument 23-101 Trading Rules and Companion Policy 23-101CP to National Instrument 23-101 Trading Rules (January 26, 2017).

be through other regulatory options) and so the "shortcomings" raised by the CSA with respect to this option in not addressing all of the other concerns raised in the Consultation Paper should not be seen as a barrier to proceeding with this more measured approach.

b. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

We believe the POS and CRM projects address the issues the CSA has identified with respect to embedded commissions limiting investor awareness, understanding and control of dealer compensation costs. From the beginning, the POS project was intended to increase investors' awareness and understanding of such costs, as well as better equip investors to compare the costs of one mutual fund to another, and to understand the impact of such costs on their investment returns. In fact, the CSA went even further in expressing the anticipated benefits of POS in an early release, indicating that some anticipated benefits of a more effective disclosure regime would include a heightened engagement of investors in determining the product and compensation costs, with "less risk of investors buying inappropriate products or not fully benefiting from the advice services they pay for".[19]

Similarly, the CRM reforms introduced, in the first phase, new relationship disclosure to investors at account opening, explaining the types of products and services provided by the dealer as well as more fulsome information on charges, including transaction charges, which they may expect to pay in connection with their investment.[20] Phase 2 of CRM (CRM2) next introduced new annual account level reporting on charges and other compensation of commissions and other amounts paid to dealers, including any embedded commissions in dollar amounts. Like the POS project, the CRM project was intended not only to increase investors' awareness and understanding of dealer compensation costs, but to also lead to better, more informed decision making when it comes to dealer compensation costs and the corresponding level of service that's being provided.

The CSA has identified investor knowledge, attitude and behaviour, registrant practices, fees and product offerings, as all possible positive impacts of the POS and CRM2 projects.[21] With this in mind, we do not agree with the suggestion in the Consultation Paper that discontinuing embedded commissions is necessary to create greater investor fee awareness, or opportunities to negotiate and have greater control over dealer compensation. It's our understanding that this is exactly what the CSA's research project to measure the impacts of POS and CRM will tell us. This position

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[19] CSA Notice and Request for Comment Implementation of Point of Sale Disclosure for Mutual Funds (June 19, 2009).

[20] This includes the initial sales charge and DSC options and any trailing commissions or other embedded commissions paid.

[21] See press release: CSA to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model (August 22, 2016).

also seems contradictory to the ongoing regulatory work by the MFDA and the CSA[22] to move forward with still further disclosure enhancements to CRM2 as an effective way to make investors more aware of the embedded fees paid to issuers, such as mutual fund management fees, and the non-cash incentives that may be paid to the dealer or adviser and its representatives.

Alternative Regulatory Options to Address Issue 2

Dealers Offer a Direct-Pay Option – If the CSA concludes that there continues to be a necessity to further promote investor understanding of dealer compensation costs and empower investor engagement over how such costs are paid, we recommend the CSA consider and consult on the regulatory option of requiring dealers with an embedded commission option to have a direct-pay arrangement available to all clients. This option, we would envision, could allow investment fund managers to facilitate investors' payment of dealer compensation, as contemplated by the Consultation Paper. The direct-pay option could be offered and explained alongside the embedded commission option at account opening for new clients, and by notice to existing clients, giving clients a clear choice in remuneration methods.

Enhance Annual Report on Charges and Other Compensation – CRM2 does not extend to the ongoing costs of owning securities with embedded fees paid to issuers, such as mutual fund management fees and operating expenses. As a way to make clients more aware of such fees, the CSA could proceed with the proposals published in July, 2016,[23] to add a general notification in the annual report that would remind clients invested in mutual funds, or other securities with embedded fees, about these costs and that such costs may reduce the client's investment returns. The CSA has also suggested adding specific disclosure to the annual report on the non-cash incentives that may be paid to the dealer or adviser and its representatives.

We welcome the CSA's continued review and consideration of expanding CRM2 to include the full management expense ratio (MER) of investment funds. Should this work proceed, we believe that it will be important that there be corresponding disclosure to investors of the ongoing costs of similar financial products with embedded commissions, such as the spread on GICs and DIAs.

c. Embedded Commissions paid generally do not align with the services provided to investors

The concern raised by the CSA in the Consultation Paper of the need for advice and services to better align with the costs paid by investors (directly or indirectly through the trailing commission) is an important issue. However, just as all forms of compensation may affect advice and outcomes, in our view this issue of advisory services aligning with dealer compensation paid is

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[22] MFDA Bulletin #0671-P – Report on Charges and Compensation – Consultation Regarding Cost Reporting for Investment Funds (December 18, 2015) and CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103, Companion Policy 31-103CP and National Instrument 33-109 (July 7, 2016).

[23] Ibid.

an issue not limited to an embedded commission model, nor solved by discontinuing such payments.

Today fee-based accounts, which are the predominant direct-pay arrangement in the market, are typically based on a percentage of the client's assets under management, without necessarily being customized to the investor's specific needs or reflective of the level of service delivered. Clients selecting a direct-pay option today may not be aware of the fee levels other clients are paying, often will have no market strength to negotiate fees, and may not realize or be able to calculate the impact those fees have on the returns of their portfolio. In fact, we have seen IIROC, in their review of compensation related conflicts, indicate that fee-based accounts may not always be in the best interests of clients.[24] As noted in The Brondesbury Report, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation.[25]

We believe the increased performance reporting and saliency of fund costs and dealer compensation created by the POS and CRM projects will lead to better alignment of overall services and advice with dealer compensation paid. The CSA has indicated that these initiatives, fully implemented, are expected to prompt investors to question the overall level of services and advice they are receiving, which in turn is anticipated to cause representatives to better demonstrate their value proposition or, lead to investors switching to lower-cost alternatives, including online platforms. If the CSA's articulated aims for the POS and CRM projects are met, investors will be empowered to make more informed decisions on whether the commissions they're paying, whether embedded or not, are commensurate with their specific needs, expectations and preferences for service and advice.

We also believe, contrary to what's expressed in the Consultation Paper, that the proposals in CSA CP 33-404 will, in fact, have an impact on aligning compensation with services provided to investors. In our view, the targeted reforms, particularly the proposals related to know-your-client (KYC) and suitability, will create a more consistent minimum level of service and advice to be provided to investors, a key objective of the proposals. This in turn, we anticipate, will prompt greater competition amongst dealers and their representatives to demonstrate their value proposition and review the level of services provided to their clients, again, whether the compensation is embedded or not.

Finally, we strongly support the proposals in CSA CP 33-404 for increased proficiency for representatives, mandated on-going continuing education (CE) requirements and for allowing only the use of designations earned through an approved credentialing organization. Heightened proficiency and CE on key securities regulatory obligations such as suitability, KYC and KYP as well as conflicts of interest and ethics will, in our view, further help to ensure a consistent quality

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[24] See IIROC Notice 16-0297 Managing Conflicts in the Best Interest of the Client – Status Update (December 15, 2016) and IIROC Notice 17-0093 Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review (April 27, 2017).

[25] The Brondesbury Report, p 18.

of service is provided to all investors. As we indicated in our response letter to CSA CP 33-404, we encourage the CSA to consider mandating a financial planning designation as a way to instil a high standard of competence and professionalism in the financial services industry.

Alternative Regulatory Options to Address Issue 3

***Enhanced Dealer Supervision* –** The CSA's concern that the "one-size-fits-all" nature of embedded commissions may continue to be misaligned with the services and advice actually provided to investors is, as we've noted, just as relevant a concern in direct-pay arrangements. Accordingly, we propose that if the CSA wants to fully address the issue of alignment of the costs paid by individual investors with the services and advice provided, a more impactful regulatory option for the CSA to consider would be, as part of the next iteration of CSA CP 33-404, to explicitly enhance the guidance related to existing dealer obligations; specifically, to clarify the need to supervise that a commensurate level of advice and service is in fact being provided in exchange for the payment by the dealer to the representative, whether that payment is embedded or not.

***Greater Specificity at Account Opening* -** The CSA could also require that the relationship disclosure delivered to clients at account opening include greater specificity as to the advice and services that will be provided in exchange for the dealer compensation to be paid.

***Mandating only "D" Series be Available on Discount Brokerage Product Lists* –** Finally, while we agree with the CSA that it may not be desirable for the CSA to compel investment fund managers to create a new "execution only" series (typically denoted "D" series which has a reduced trailing commission), we would encourage the CSA to proceed with mandating that discount or order-execution only (OEO) dealers be required to only distribute D series or a series without any advisory commission on their product list. This will address the issue the CSA has identified in the Consultation Paper that the majority of mutual fund series sold through the online/discount brokerage channel are the full trailing commission fund series despite the increased availability of discount/DIY fund series in the market.

This regulatory initiative would allow the CSA to address the specific issue of investors who do not seek services and advice to not inadvertently pay for them. We believe this change could be easily implemented by amending IIROC Member Rule 3200, which sets out the minimum requirements for IIROC dealer members seeking approval under Rule 1300.1(t) to offer OEO services. We note that IIROC recently issued guidance for comment on OEO services and activities, which makes this proposal timely.[26]

[26] IIROC Notice 16-0251 Guidance on Order Execution Only Services and Activities (November 3, 2016).

The importance of Retaining the Accessibility, Choice and Affordability of Financial Advice

a. The importance of preserving financial advice for Canadians

According to Investor Economics, 63% of the $3.8T in personal financial assets is held in accounts where a financial advisor is engaged.[27] Personal savings is a key component to the accumulation of financial wealth and retirement readiness. In this regard, the role of financial advice is a critical element, contributing positively and significantly to the retirement readiness of Canadians.[28]

As the CSA has noted, evidence shows that the average individual's knowledge of basic financial products and concepts is quite limited. In fact, in the 2016 CSA Investor Education Study,[29] it was found that investors' primary source of investment information comes from their advisors. A 2016 Pollara survey among mutual fund investors highlights the confidence investors have in financial advice and the positive savings behaviours they've adopted because of advice.[30]

Economic theory explains that there is a net positive value of using a financial advisor.[31] In addition, financial advisors play an important role in counteracting the behavioural biases of investors by coaching them towards long-term savings habits, advising against panic sales, and providing good quality information to promote better long-term decision-making. [32]

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[27] Investor Economics, *Household Balance Sheet*, 2016.

[28]Canada's retirement system is well balanced and effective, with 83% of Canadian households on track for retirement. Of the mid- to high- income households with no employer pension plan, "savers" (i.e. households with an above-average savings rate) are far more prepared for retirement than "non-savers" (i.e. households with a below-average savings rate). "Savers" are almost twice as likely to use financial advice and significantly more likely to use tax-advantaged savings vehicles such as RRSPs and TFSAs than non-savers – both of which are linked to increased financial security in retirement (Source: McKinsey & Company, *Building on Canada's Strong Retirement Readiness,* Feb 2015). Canadians over 65 rank 7th highest among OECD countries in terms of relative income compared to the national mean income of the total population, and have the 11th lowest poverty rate – on both measures, ranking better than the USA, UK and Australia. (Source: OECD, *Pensions at a Glance*, 2013).

[29] Key Highlights CSA Investor Education Study 2016 prepared for the CSA by Innovative Research Group, Inc., April 2016.

[30] Pollara, *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry,* 2016.

[31] PricewaterhouseCoopers, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds* (Submission by the Investment Funds Institute of Canada on Consultation Paper), June 2017.

[32] Benzartzi & Thaler, *Heuristics and Biases in Retirement Savings Behavior,* 2017. The authors identify the biases as loss aversion, short-term thinking and overconfidence.

Research has demonstrated the significant value of the advice model to the investing public, at all demographic, income and asset levels. Among other things, advised households (i) are twice as likely to save for retirement at all ages (ii) have significantly higher levels of investable assets at all ages (iii) improve their regular saving for retirement at all income levels (iv) rate themselves as more financially knowledgeable, and (v) are more confident in their ability to achieve a comfortable retirement.[33]

A number of academic studies (in Sweden,[34] Australia[35] and the United States[36]) provide tangible estimates of the significant positive net benefits that financial advisors provide to investors through a holistic approach of financial wellness. We have similarly seen this demonstrated in recent Canadian research.[37] In fact, this research found that not only do investment outcomes improve with advice tenure, but that an interruption in the client-advisor relationship can worsen client investment outcomes.

The value of financial advice is not simply the value of selecting securities to invest in. The value proposition includes providing ongoing financial education, making appropriate investment policy decisions around portfolio construction and regular rebalancing, tax planning and most importantly, in providing behavioural advice and coaching with respect to client habits around

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[33] Advised households are not only more likely to save but save at twice the rate of non-advised, passive households (8.6% compared to only 4.3%) and among the behavioural disciplines, savings is the most affected by the presence of advice. Controlling for all other explanatory variables, having a financial advisor has been found to increase the probability of a respondent declaring confidence in achieving a comfortable retirement by more than 13% relative to a similarly situated non-advised respondent (Sources: CIRANO, *Econometric Models on the Value of Advice of a Financial Advisor*, 2012 and *The Gamma Factor and the Value of Financial Advice,* 2016). Advised households, at all age levels, are twice as likely to save regularly for retirement than non-advised households, with advised households having higher net worth than non-advised households across all ages and income levels (Source: IFIC *The Value of Advice,* 2011).

[34] In Sweden, researchers compared a group of investors who received financial advice and a control group of investors who did not receive financial advice and assessed the impact on savings of having a financial advisor to be an additional 22% saved (Source: Hermansson & Song, *Financial advisory meetings and their impact on saving behavior – a difference-in-difference analysis,* 2016).

[35] KPMG EconTech used a regression analysis and estimated the impact of having a financial advisor to be an additional $1,590 per year in savings greater than investors without advisors. The analysis controlled for factors that influence savings behaviour such as income, wealth and employment (Source: KPMG EconTech, *Value Proposition of Financial Advisory Networks – Update and Extension,* January 18, 2011).

[36] In the United States, researchers showed that using a financial advisor improves savings behavior through the positive impact on overall financial planning including awareness of retirement needs and diversification of retirement savings. They additionally highlighted the better response of the advised to the financial crisis in 2008 compared to those without advice (Source: Marsden, Zick & Mayer, *The Value of Seeking Financial Advice,* 2011).

[37] Ibid., footnote 34.

savings and market discipline.[38] The importance of these aspects of the client-registrant relationship should not be underestimated. As part of the CSA's deliberations, the CSA should be mindful of not proceeding with regulatory changes that may diminish the range and choices of advisory services provided to Canadians.[39]

b. The importance of ensuring there remains choice in advisory services, that is affordable and accessible for modest investors

Financial advice is not only used by the wealthy. Approximately 47% of households in Canada with less than $100,000 in assets use financial advice, compared to approximately 56% of households with greater than $100,000 in assets.[40] This is significantly greater than other countries, such as Australia and the U.K.[41]

Modest investors (those with under $100K in investible assets) make up 80% of all Canadian households,[42] and 83% of the households serviced by MFDA members.[43] We also know that in 40% of cases where there is a financial advice relationship it was initiated with financial assets not more than $10,000. In addition, in 70% of such instances, investments were under $50,000 at the start of the relationship.[44] This means nearly three quarters of all advice relationships begin with financial assets of not more than $50,000.

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[38] Beyond active management ("Alpha") and asset allocation ("Beta"), better financial planning decisions ("Gamma") have a significant impact on an investor's retirement outcomes. "Gamma" can increase the arithmetic "Alpha" on a portfolio by approximately 1.59% (Source: Morningstar, *Alpha, Beta and Now… Gamma,* 2012).

[39] We note that among Canadians, a recent global study found that there's still a strong preference for taking guidance from a human financial advisor over advice generated through an algorithm powered by artificial intelligence (Source: HSBC, *Trust in Technology: Country Report/Canada*, May 24, 2017).

[40] Ipsos Reid, *Canadians & Financial Advice*, 2015.

[41] In Australia, only about 10 percent of the population receives advice in a given year (Source: Rand Corporation, *Financial Advice Markets – A Cross Country Comparison,* 2015). In the U.K., approximately 17% of the population currently uses advice (Source: BlackRock, *Global Investor Pulse Survey,* 2015).

[42] Investor Economics, *Household Balance Sheet*, 2015.

[43] MFDA Client Research Report, p 6.

[44] Pollara, *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry,* 2016. These percentages have been nearly identical for the last three years.

The willingness to pay upfront for advice (direct pay arrangements) depends on the level of wealth, formal education and financial knowledge of the investor.[45] Most Canadians also still have a strong preference for taking guidance from a financial advisor over online platforms.[46] Therefore, it is critical that the regulatory framework continues to promote Canadians' engagement to seek and obtain the delivery of financial advice when they are just beginning to save, by ensuring financial advice remains attainable in terms of cost, administration and delivery.

Conclusion

We firmly believe that the impact of the regulatory actions taken to date by the CSA, once fully implemented, together with the changes already underway in the Canadian marketplace, substantially address the concerns identified by the CSA in the Consultation Paper. To the extent that there remains any regulatory gap, we believe that the CSA can achieve the desired regulatory outcomes through alternative regulatory options that sufficiently manage or mitigate the issues identified in the Consultation Paper, without the same adverse impacts that a complete discontinuance of embedded commissions may cause.

The market and business models are changing at a rapid pace, particularly with respect to compensation structures, as evidenced by our own transformation. We would encourage the CSA to allow this evolution to continue, without the further regulatory intervention of a ban on embedded commissions. Preserving choice and accessibility to high quality financial advice as well as an innovative, competitive and fair financial services industry, is critical.

As the CSA moves forward in its deliberation on CSA CP 33-404 and the Consultation Paper, we encourage the CSA to consider the formation of working groups with market participants, to assist not only in identifying and working through various operational questions and issues, but to effect as seamless a transition process as possible for investors. We envision a model where the CSA would commit to ongoing and frequent engagement with stakeholders throughout any implementation process, to assess whether further CSA guidance and/or any extension of a transition period is needed.

Investors Group welcomes the opportunity to participate in such an endeavour.

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We thank you for the opportunity to provide comments on the Consultation Paper. We look forward to an ongoing collaboration. Please feel free to contact Donald MacDonald, Senior Vice-

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[45] Michael S. Finke, Sandra J. Huston and Danielle D. Winchester, *Financial Advice: Who Pays* (Association for Financial Counselling and Planning Education, 2011).

[46] Ibid., footnote 17.

President, General Counsel & Secretary at (204) 956-8088 or myself, if you wish to discuss this further or require additional information.

Yours truly,

Jeffrey R. Carney
President and Chief Executive Officer

Appendix - Tax Impacts

Overview

Generally, mutual funds pay a management fee to the investment fund manager, and the investment fund manager then compensates the dealer out of its management fees. Within this structure, the management fees paid to the investment fund manager are deducted by the fund to arrive at taxable income. Typically, in a mutual fund, distributions are paid to the investors to eliminate taxable income in the mutual fund. If there is a ban on embedded commissions, then the management fees paid by the mutual fund are reduced, and conversely the taxable income of the mutual fund would increase. There would be additional taxable income in the mutual fund requiring additional distributions to be paid to investors to eliminate taxable income in the mutual fund.(1)

In a direct-pay model, the investor is responsible for compensating the dealer. Generally, these advisory fees are tax deductible to the extent that these fees are reasonable, are for non-registered accounts, are not commissions, and are:

- For advice as to the advisability of purchasing or selling a specific share or security of the taxpayer, or;
- For services in respect of the administration or management of shares or securities of the taxpayer.

Generally, the additional distributions paid to investors should be offset by the advisory fees paid to the dealer.

In order to facilitate the payment/collection of the advisory fees, the investment fund manager/investor/dealer may agree to redeem units to fund the payment of the fees. The advisory fee is subject to GST/HST/QST (Sales Tax).

We set out below our observations of the key implications to investors, investment fund managers and dealers in transitioning all clients to direct-pay arrangements.

Impact of Removing Embedded Commissions	**Investor**	**Investment Fund Manager**	**Dealer/Advisor**
More fund series are likely to require distributions and quantum of distributions are likely to increase	Additional administration required to track distributions and report for tax purposes.	Increased demand on system resources to process higher volume of distributions.	Additional system resources to track the transactions. Additional investor support to track and understand transactions
Tax neutrality of “embedded commission” component not ensured	Tax deductibility of fees paid by the investor to its dealer dependent upon the services being provided in exchange for the advisory fees being charged.	N/A	Communication with the investor to be managed
Additional volume of transactions as a result of redemptions to fund direct-pay fees	Additional administration required to track transactions and report gains/losses for tax purposes including monitoring superficial losses.	Increased demand on system resources to process higher volume of transactions.	Additional system resources to track the transactions.
Advisory Fee subject to Sales Tax	Amount of Sales Tax payable by the investor on the advisory fee will be determined by the investor’s province of residence as opposed to the	Impacted to the extent the investor’s units in the funds are redeemed to pay for the advisory fees. The investment fund manager requires the systems to determine the quantum of the	Exempt commission paid by the investment fund manager being replaced by a taxable advisory fee paid by the investor. Systems to be enhanced to handle

	"blended rate" of the fund. Generally, Sales Tax paid will be added to the cost of the advisory fee.	Sales Tax to withhold on behalf of the dealer.	the additional administration and compliance required to collect, report, and remit the Sales Tax (and related taxable revenue).
Rationalization of fund series would require an exchange of investors' units within a fund	Generally, an exchange of units from one series of a fund to another can be accomplished on a tax deferred basis. Eliminates a level of complexity in understanding offering.	Initial increased demand on system resources to process transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Simplifies investment fund manager's offering.	Initial additional system resources to track the transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Eliminates a level of complexity in product offering.

(1) A mutual fund corporation can only distribute (by way of dividend) its net capital gains and dividends to shareholders. A reduction of management fees within the corporation could result in trapped income, which would be subject to tax. The end result is double taxation on the income; once in the corporation and again in the investor's hands upon redemption.

Appendix – Operational Impacts

Overview

We believe that consistent with the predominant trend in direct-pay arrangements today most dealers would, if embedded commissions were discontinued, shift to a fee-based account model, which is typically based on a percentage of the client's assets under administration. On review of this structure, we have identified the following primary operational implications of mandating this type of direct-pay arrangement:

1) Developing the systems and processes necessary to collect and report client fees for a much wider range of clients and account types;

2) Increased transaction volumes and client reporting which may increase dealer and investment fund manager administration costs;

3) Enabling the charging of fees in some registered account types that have rules regarding withdrawals for the purposes of paying fees; and

4) Transitioning existing clients' funds positions and systematic purchase and redemption transactions to direct-pay accounts.

1) Systems and process changes

Changing systems and processes to administer direct-pay arrangements will require significant effort and expense by dealers and investment fund managers.

Client name accounts will be particularly challenging to automate and effectively administer and report on a client's fee payments, because transactions to collect the account fee must be charged directly to one or more mutual fund positions held within the account. Direct-pay arrangements for mutual funds in accounts held in nominee name and administered on a nominee systems platform, on the other hand, will be able to be administered more effectively and efficiently.

Nominee accounts allow for a cash position through which all securities buys, sells and daily calculated and accrued account fees can be processed. A cash position enables the client to maintain a cash balance and the dealer to collect client paid fees from the cash balance without the dealer having to sell any of the mutual fund positions in the account to cover the fee. It also enables the dealer to automate the collection of the client's accrued fees part way through a month based on the client's transactions through the cash position (e.g. - a full redemption of all fund positions in the account).

The challenge is that many dealers, including Investors Group, currently administer a large proportion of their clients' mutual fund positions in client name accounts. Today, approximately 95% of Investors Group's 1.65 million accounts are held in client name. Therefore, the transition to a direct-pay model would require us moving essentially all of our clients' fund positions to a series that can be held in a direct-pay account, and possibly moving the positions from a client name account to a nominee account.

The recent changes that the industry has implemented as a result of POS and CRM2 serve as a good starting point with respect to the extent to which systems, procedural and educational enhancements and updates will be needed to effectively transition all clients to direct-pay arrangements. We found the CRM2 requirements in particular to be very complex and requiring significant time and expense to implement. These changes involved obtaining accurate and complete data at a detailed level that was not always readily available, analyzing the data to categorize the transactions and fee types, and building new functionality in our systems. Gathering the data proved more difficult when it resided in a vendor's system.

The costs and complexities associated with these changes were significant. We estimate that the cost to discontinue embedded commissions and transition towards a direct-pay model would be several multiples more of this amount. We anticipate that the time and costs that will be incurred to effectively implement a transition to direct-pay arrangements will directly impact our ability to engage our people and energies in investing in digital services and technologies to improve the client experience. While we are confident that we could transition our clients effectively, our concern is that for smaller independent dealers and investment fund managers, the complexity and costs of transitioning their clients and business models to direct-pay arrangements will potentially create business viability concerns.

2) Transaction volumes, client reporting and administration expense

Discontinuing embedded commissions will likely increase the volume of fund transactions in clients' accounts due to more fund distributions to clients, the introduction of client fee transactions, and the likelihood of more fund redemption transactions to cover the client's direct-pay fees. From an operational perspective, volume increases could increase the costs of administering client accounts because of the systems resources required to process the higher volume and associated increased reporting of the transactions to clients.

3) Registered Accounts

Moving to direct-pay arrangements will also present some challenges to certain types of registered plans in a client account. We would encourage the CSA to consider exempting these accounts should the CSA move forward with discontinuing embedded commissions.

a) RRIF / LIF Plans

   i) The minimum / maximum payment calculations will be impacted by the decrease of the account's market value due to the application of fees that will presumably be paid out of the investment.
   ii) The RRIF / LIF minimum payment is calculated based on the year end market value. If investment fund managers facilitate the payment of dealer compensation from the investor's fund investment, the application of the fees will decrease the year end market value and consequently the minimum in the following year.
   iii) The LIF maximum payment is also calculated based on the year end market value. Collecting dealer compensation by payments from the fund investment will decrease the year end market value and consequently the maximum in the following year.

b) RESP and RDSP Accounts

For investment fund managers to facilitate the collection of clients' payment of dealer compensation from the investor's fund investment, the deductions would need to be charged to the income portion, followed by the capital portion and subsequently the government incentive portion of the notional information.

Based on Investors Group's agreement with the Employment Social Development Canada, we would note that fees cannot be charged to the government incentive portion of the account. Therefore, the ability of the investment fund manager to facilitate direct-pay arrangements as a way to alleviate the concern that mass-market investors may be hesitant to pay directly for advice may not be as impactful as envisioned for these types of accounts.

4) Transitioning Clients

Current securities regulations require receipt of client approval for switches between mutual fund series, moving from a client name account to a nominee account, and moving to a direct-pay arrangement – all of which also require significant client communications and administration challenges and expense. Most significantly, these changes often are disruptive for clients. The opportunity for regulatory relief that would enable dealers to notify clients of these types of transitions instead of obtaining and administering client approvals could significantly simplify the process for dealers and investment fund managers to transition clients to direct-pay arrangements while minimizing client disruption.

The CSA proposes two alternatives for dealers to transition to a direct-pay arrangement over a three year time period. From both an operational perspective and to provide clients with the best possible transition experience, Investors Group believes the best approach should the CSA proceed with a ban on embedded commissions would be to set a defined transition period and deadline and allow dealers and investment fund managers to determine how best to manage the transition to meet such a deadline. A phased account method may not fit the particular circumstances of a client holding multiple account type, and may be very difficult to achieve without significant disruption to clients.

Adding to the transition challenge will be that many dealers rely on systems vendors in various capacities. These vendors may provide services to more than one dealer and there may be multiple impacts on them from the dealers they service. Vendor resource constraints may limit their ability to meet the needs of dealers within a short transition period.

Accordingly, Investors Group believes that a transition date of 36 months as proposed in the Consultation Paper may be too aggressive. We strongly recommend that if the CSA proceeds with a complete discontinuance of embedded commissions, there is a commitment by the CSA to seek feedback from stakeholders part way through the transition period, to assess and determine whether guidance and/or an extension will be needed to effect an orderly transition to direct-pay arrangements.

Appendix – The Value of Active Management

Overview

Active and passive management are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors should view investing from a total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers subscribe to a common belief that markets are not perfectly efficient, which creates an opportunity for portfolio managers to exploit security mispricing and outperform the overall market. Passive managers, on the other hand, seek to replicate the return of a given market index.

Market efficiency describes the degree to which the price of securities reflects all public and non-public information (timeliness and interpretation). Hypothetically, if the capital markets were perfectly efficient, active managers on average would not outperform the markets as securities would already reflect their fundamental value. On the contrary, if markets could be described as inefficient, there would be many opportunities for active managers to identify and profit from mispriced securities and hence outperform the overall markets. In practice, capital market efficiency resides somewhere in between these two scenarios. Active management can add value to portfolio returns over a broad range of different asset classes.

Active management generally refers to an investing strategy whereby a portfolio manager makes specific investment decisions with the typical goal of outperforming an investment benchmark or index. Active management can have advantages over market capitalized indices - and more importantly - protecting investor wealth over full market cycles - particularly during market downturns.

Actively managing asset allocation enables investors to be focused on individual objectives beyond benchmarks and the short term. This is essential for aging investors as they move from wealth accumulation into decumulation, where the emphasis is on consistency and persistency of income. It is much more difficult for wealth levels to recover from an investment loss when capital is being liquidated in retirement.

To better protect investors' capital, active managers are able to purchase securities that are undervalued and sell securities that become overvalued. They are also able to minimize losses by avoiding troubled securities and overly concentrated sectors or regions. Many active investment strategies also have the ability to hedge currencies, buy put options to lessen drawdowns, retain cash to reduce volatility, and utilize other tools to minimize potential investment losses. Furthermore, actively managed funds are able to effectively diversify their assets by avoiding the limitations of the benchmark through the avoidance of security and sector overconcentration.

Challenges

Successful active management is by no means an easy task. By simple definition, and for the most part, it can be a “zero sum game” where the gains of one investor come at the expense of another. Vanguard Asset Management describes it as follows:

> “The concept of a zero-sum game starts with the understanding that at any one time, the holdings of all investors in a particular market make up that market. As a result, for every invested dollar that outperforms the total market over a given period, there must by definition be another dollar that underperforms. Another way of stating this is that the asset-weighted performance of all investors, both positive and negative, will equal the overall performance of the market.”

Writing in The Financial Times, Yves Choueifaty CEO of TOBAM noted an additional challenge:

> “By definition the average active manager cannot outperform the benchmark because the benchmark is determined by the sum of activity carried out by both active and passive managers. And because passive managers have no impact on the benchmark – they merely follow it – it is, in fact, the sum of all the bets taken by active managers that determines the benchmark. It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers”.

Investing in the index does not on its own however ensure a positive outcome. For example, over the 25 year period beginning in 1929, the S&P 500 index did not recover to its former high until 1954. Yet, considerable wealth was amassed during this period through effective trading of individual securities. As cited by the CMG Capital Management Group:

> “It’s a little-known but startling fact: The average buy-and-hold stock market investor spends 74% of his or her time recovering from cyclical downturns in the market (from 1900 – May 2015). We like to think of investment approaches as types of aircrafts. Passive investments are like hot air balloons. In favorable conditions, they can indeed carry passengers to their financial goals.
>
> Active investments, on the other hand, are like planes. When winds are fair, they, too, can carry you in the right direction. They also have the flexibility to maneuver through bad weather, protecting their passengers from harm and keeping them moving toward the destination”.

The relevance of these numbers gain even greater importance in the context of Deutsche Bank’s Bradley Jones whose analysis revealed that a portfolio comprised of 60% equities and 40% bonds produced negative real returns over a rolling ten year holding period for almost a quarter of a 111 year period in the US market commencing in 1900. This is perhaps even more pervasive in a low interest rate environment where negative returns have come into existence and depending upon global events, could become more prevalent.

With this in mind, arguably the ultimate goal and value of active management is to provide downside protection, with secondary consideration given to muting volatility and out performing in bull markets. MFS Investment Management stresses this importance in their piece, “There’s No Substitute for Skill”:

> “To outperform in falling markets, active managers must have differentiated risk management. It should be an important part of their investment process, rather than an overlay, using active security selection to view risk from multiple perspectives before adding a security to a portfolio. Through a strong risk framework, they must manage risk on several levels, from the security to the portfolio to the firm. Investors consider this capability a high priority.”

Opportunities

Russell Investments has stated:

> “Dynamic active management – the real-time management of portfolio exposures to specific factors, countries, sectors, or currencies – can be used to help to avoid downside risk in chosen asset allocations. With this kind of focus, active management works to help create a smoother ride that can help to keep investors from exiting the market at the worst possible time”.

Perhaps most importantly for the retail investor, Russell also singles out the importance of after-tax returns, for of all the costs incurred by an investor - be it trades, investment management, or advice, the greatest cost will be taxation.

> “As so many of us have heard over the years, ‘It’s not what an investor earns. It’s what they keep.’ Being active around after-tax returns is often an underappreciated way active managers can help to provide value to investors. Unlike index-based passive investing, active management can use an expanded toolkit to actively maximize after-tax returns. This includes active loss harvesting – potentially increasing the absolute return an investor sees. Active, by its very nature, strives to do better”.

For many managers active management employs innovative factor weightings to outperform market capitalized indices. Morgan Stanley identifies these new approaches as:

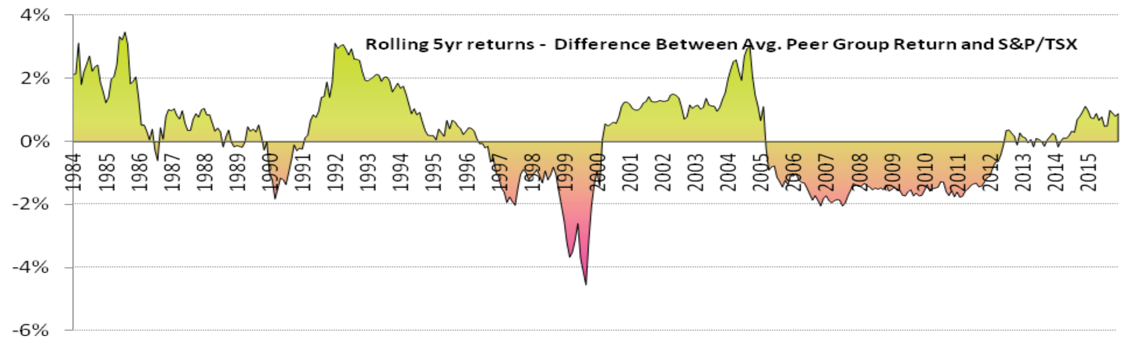
> “’Smart-beta’ strategies which attempt to replicate pure factor strategies (like value, momentum or low volatility) are the next evolution in the active/passive debate. While their systematic approach may be a low-cost replacement for some active managers, we still believe that 35 to 40% of the top managers add idiosyncratic alpha over long periods of time and thus their investment selections can be additive to diversified portfolios.”

Employing new approaches to challenge long held beliefs enables diverse opportunities for active managers**.** MIT’s Andrew Lo, well known for his paper, “Physics Envy May Be Hazardous to your Wealth!” (that demonstrated how the economic system developed by financial markets created a false sense of mathematical precision as the models developed were not as predictive as those used in physics) urges investors to view financial markets and institutions from the perspective of evolutionary biology rather than physics:

> “Markets are well behaved most of the time, but like any other human invention, they are not infallible and they can break down from time to time for understandable and predictable reasons”.

Analysis

According to data from Morningstar Canada, the average performance of the actively managed Canadian Equity peer group (Canadian Investment Funds Standards Committee (CIFSC) category) has exceeded that of the benchmark S&P/TSX index 58% of the time since 1980. Even more impressively, 1st quartile funds in the same category outperformed the index 79% of the time.



During each bear market since 1980, the benefits of active management have been quite evident as the average return of the CIFSC Canadian Equity peer group exceeded that of the passive index as can be seen in the following table.

Start	End	S&P/TSX Composite	25th Percentile Return	50th Percentile Return	Cdn. Equity Avg. Fund Return
Jun-81	Jun-82	-36.7	-26.7	-29.1	-30.8
Aug-87	Nov-87	-25.4	-20.8	-25.0	-24.1
Jan-90	Oct-90	-20.1	-10.5	-15.1	-12.8
May-98	Aug-98	-27.5	-23.7	-25.7	-25.5
Sep-00	Oct-02	-22.6	-12.0	-14.9	-14.5
Jun-08	Feb-09	-43.5	-39.8	-43.4	-42.6

Various studies and writings in recent years have pointed to the seeming inability of most actively managed funds to match or beat their index benchmarks. Most of these studies, however, looked only at average equity funds without making distinctions between those that were truly active and those that were not.

A more discriminating study in 2009 by Martijn Cremers and Antti Petajisto found that investment funds that were truly active, taking positions that significantly deviated from their benchmarks, were able to outperform those benchmark indices both before and after expenses.

Supporting Strong Capital Markets

Passive investment vehicles have low costs mainly because they do not do any of the research and trading that active managers do. Without this research and making prices informative, individual securities can become mispriced and markets distorted. According to Lasse Pedersen of AQR Capital Management:

> "If most investors were passive, the liquidity in individual securities not included in the index would vanish as investors would only trade the index. Securities could become severely mispriced. The collapse of liquidity and the lack of active management would make the process much less informative. When the secondary market is illiquid and uninformative, buying in the primary market becomes much riskier."

A lack of liquidity in the market is not an issue if you don't have to sell or buy immediately. Actively managed funds are not forced to liquidate securities to meet investors' needs as they usually maintain a cash reserve. This cash reserve also benefits active management strategies by allowing them to exploit the market when mispricing occurs. In fact, the more investors use ETFs and other passive strategies, the more opportunities are created for active managers and the larger those opportunities are.

A further benefit is that within the market, active managers can profit at the expense of passive strategies in assessing the value of an initial public offering (IPO). Pedersen continues:

> "Research has shown that IPO securities are, on average, sold at a discount relative to their price in the secondary market when the shares start trading on the exchange. Informed investors can buy the new shares cheaply and then sell some in the secondary market to other (passive) strategies at a premium. As a result, passive investors are not guaranteed the same IPO performance as the group of active investors since they trade at different prices and quantities."

In competing for outperformance, active managers seek relevant information, analyse it to determine value, and select securities accordingly. In the process, they help to set prices and provide trading liquidity. The efficient allocation of capital in our market-based economy relies on this mechanism. According to Nitin Mehta, managing director of the CFA Institute for Europe, the Middle East and Africa:

> "Passive investors are relative free riders, having to pay only the marginal cost of market participation as price takers, rather than the higher average cost for making fair prices and supporting the real economic purpose of financial markets".

Conclusion

Active and passive investments are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors need to view investing from total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers have shown they have the ability to outperform the index and can be less volatile than the index during bear markets. They are able to avoid less attractive, slow growing companies and provide greater exposure to companies with superior valuations or growth potential. Equities are inherently risky and active strategies can diversify that risk by investing in stocks with lower correlations, and by underweighting sectors that are overly concentrated in the index.

Effective diversification is about maintaining the right balance of stocks, not simply owning a basket of the largest stocks. Active management does not aim to invest only in the largest companies nor look to match the weight of the best performing stocks in the index. Instead, the focus is on selecting the most fundamentally sound and profitable companies, as well as those that are not highly correlated and so can be expected to react differently to market events.

Given the many uncertainties that global capital markets present, investing in stocks and bonds has never been more challenging. Actively managing those risks is critical for those who depend on stocks to grow their wealth and bonds to add an element of stability to their investment portfolios.

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June 9th, 2017

Consultation on the Option of Discontinuing Embedded Commissions – CSA Paper 81-408

To the members of:

- British Columbia Securities Commission
- Alberta Securities Commission
- Financial and Consumer Affairs Authority of Saskatchewan
- Manitoba Securities Commission
- Ontario Securities Commission
- Autorité des marchés financiers
- Financial and Consumer Services Commission, New Brunswick
- Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
- Nova Scotia Securities Commission
- Securities Commission of Newfoundland and Labrador
- Superintendent of Securities, Northwest Territories
- Superintendent of Securities, Yukon
- Superintendent of Securities, Nunavut

In the Care of

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Hello to all of you:

Thank you for allowing me the opportunity to comment on this consultation. I am an Advisor who has been licensed to sell insurance and mutual fund products for 19 years now. I earned my Certified Financial Planner Designation in 2005. I have a wide range of personal and business clients that I work with, in the small city of about 80,000 people where I live.

While I agree completely that client interests must be kept at the forefront at all times, I have several concerns with regard to your proposal, and in general with the direction that CSA policy has gone in the last 10 years. I will highlight these concerns below, and will make comments from my perspective. I will also pass on comments that I have received from my clients. I have spent a lot of time in client meetings discussing these potential changes with them and they do have opinions on it:

Embedded Compensation

This is simply a compensation structure. It is neither good nor bad and it seems short sighted that a Regulator would look at this as “a national problem”. There is nothing wrong with an Advisor being paid for the work they do. There is something wrong when the Advisor’s interests come first. THAT is the problem. But that will be a problem in any pay structure. How can you let Canadians believe that removing a compensation structure will make people behave better? Let me use an example you can easily understand. If a CSA or Securities Commission employee has the option to earn a bonus, they will certainly look at the requirements to earn it and will work towards those bonuses. This does not mean they are doing their job poorly. It simply means that they are working to their pay structure while doing their job to earn some extra pay. If the requirements to earn that bonus changed next year, they may change their work habits to earn that bonus…while still doing their job. Is this now a conflicted employee? They changed their behavior to make more money. This is human behavior. People want to get the most benefit for the work they do. It is part of who we are.

If you take away embedded compensation, you will simply expose Advisors and Consumers to another pay structure that inevitably will lead to the same questions. Someone will still do their best to make the most of their pay structure. You will never get away from it. Removing the embedded pay structure does not fix the human behavior problem which is the real heart of it all. This new policy will change nothing for Consumers from my point of view and falls very short of being a real solution for my clients.

What is the Problem?
There are symptoms of a problem. We hear of Investors who are victims of fraud. This not acceptable. Some Advisors run afoul of the regulatory rules, and should be punished. We hear that Advisors can make more money running their business one way or another at the expense of clients. But these are the symptoms of, and not the problem itself.

In my eyes, it is the behavior of Advisors *and* Investors that cause these problems. (yes, I include investors in this too.) People want things and will do what they have to, to get them. Advisors want to be paid. Clients want high returns with no risk or cost. Clients want Advisors to predict the future with 100% efficiency. These behaviors will never go away no matter what rules you put in force. I believe that removing the embedded compensation system will not make a difference to those behaviors. A 1% trailing commission is not what caused some elderly investor to be defrauded. It was poor behavior. An embedded fee did not get a client a -40% return because they took on more risk than they should have. The problem is behavior. So let’s fix that.

Embedded Fees are Hidden
I see in many other submissions that the fees are hidden. If only consumers could see them, it would change their lives! If only they could understand them! I don’t think this argument holds much water with the advent of CRM2. You may not understand how the fees work, but you can certainly see how much you are paying to your Advisor now. It shows a dollar value and those consumers who are confused must understand that. Have the conversation with your Advisor. Get value for the cost you are paying. It’s up to consumers on this point now. My clients get this. It is simple and I take the time to explain it to them.

At this point it doesn’t matter how the consumer pays. The amount that gets paid to a Dealer shows up on the statement, so this argument is passé, and in the future, should be disregarded completely. If you use an Advisor it will cost you something.

Fees eat away at retirement fortunes.
In many submissions, I hear that fees eat away at retirement fortunes and are unreasonable. I don't understand this. The fee that the lawyer charged me for the will he wrote ate away at my retirement fortune too. How about the car I buy? The groceries? Any product or service that is provided in this world comes with a sales/service cost.

Here is an example: Think of the fees I pay to my Regulators. Year after year, I pay these fees. I have no choice in what Regulator to choose. I can't negotiate the cost or the services I access. I have absolutely no say in the direction or creation of policy in the industry. It sounds like a pretty bad deal when you put it that way. It sounds like any fee increase to me could be perceived as a conflict of interest to the Regulator. And every dollar that leaves my pocket makes it harder for me to feed my family.

But if I want to be in this industry and get the benefits of a solid Canadian financial system, then I must pay. If I don't like it, I need to find another way to do my work or change careers.

Financial advice is the same. I am tired of hearing this argument from consumers. They have many options, and one of those options is to pay a professional advisor to help them. That help will cost you something. Typically it is 1%. The fee will be on your statement. If you don't like it, then you can try to renegotiate a lower fee, or you can save all of those fees and do it yourself. It sounds like many of the consumers out there think that the fees are too high. They are welcome to manage their finances anywhere they like. But if they think that Advisors will work for free, they will be disappointed.

CRM2 – Some great progress.
Let's focus on some good regulation that recently came from the CSA. The fact that the amount of compensation an Advisor's firm is paid is now disclosed on statements has changed everything for consumers. This is a good measure that allows Consumers the opportunity to weigh the value of what they get, for what they pay. **This, more than any other stroke of a pen the CSA can make, will force Advisors to be better and treat their clients the way they want to be treated.** It helps to guide behavior between the consumer and the Advisor **which seems to me to be the problem you want to correct.** I have had numerous conversations with clients in regards to this and not all of them were comfortable for me. The clients asked some hard questions, but in the end, my client and I either chose to work together or not. This is exactly what you were hoping for with CRM2. The CSA should let the ink dry on this initiative to see where the Advisor/Consumer relationship ends up. Don't go wildly down a path of eliminating pay structures that have little to no bearing on encouraging good behavior from advisors.

Clients are assumed to have no knowledge and are vulnerable.
While it is true that some clients are vulnerable, it is flawed on your part to think that consumers are completely helpless when it comes to investing. This is not the case and the idea that you are taking away choices in how my clients deal with me is not going over well. In my discussions with clients, every single one of them has said something along these lines: "Now that I know how much I am paying, why would they take away my choice in how I pay my Advisor? What

good does that do me? I'll decide the best way for me to work with an Advisor and how they deliver their service to me. If they can't deliver, I'll go somewhere else." This is exactly the kind of conversation that CRM2 was supposed to encourage. Will eliminating embedded compensation make that conversation better? I doubt it. It will just become another detailed conversation that will confuse consumers about their finances.

The idea that most consumers are vulnerable is overwhelmingly not the norm. Although many clients do not have finance as a hobby, they are successful business people who have taken post secondary education, bought houses and properties, made business deals, raised children and understand how business works. To create rules that limit how these people deal with Advisors is condescending to them and their intelligence. They don't get this type of paternalistic treatment in any other area of their financial lives. My clients demand a choice. You are taking it away from them.

You rule to the lowest common denominator in all areas.
I am not sure where your policy ideas originate from, but I can tell you the direction that they always end up going. They end up punishing every Advisor in this nation with a minutiae of rules and paperwork. It forces unwanted disclosure on clients. It creates a system of boxes and forms that cannot be filled out properly and for the most part does not help consumers understand finances better or reach their goals. This new proposal will simply add another layer of disclosure to an already bloated meeting agenda for Advisors and consumers.

Creating an outstanding number of rules will not solve the problem of keeping consumer interests first, or make Advisors behave better.

CSA policies already are excluding smaller investors from quality advice. This policy will only make this worse.
I can only cite anecdotal evidence from my book of business, but I have discussed this with many advisors from many different companies including banks. The trend in the last 2-3 years has been to increase minimum account sizes. The cost of compliance and disclosure has forced most Dealers and Advisors to focus on their large clients. Smaller clients are "encouraged" to go elsewhere. I can't afford to take care of smaller clients at a price they can afford because of the gigantic compliance burden that is thrust upon us.

Here is the problem for society if this continues forward: My block of business works this way: I need small clients to grow to become larger clients. Aging clients eventually pass away and must be replaced. If I don't have smaller clients growing into my block to replace them, eventually I will go out of business. This proposal will eventually exclude all small clients from accessing advice and will also prevent new advisors from joining the industry as they typically start with smaller clients. As that spiral continues, the advice channel disappears and Canadians are left to manage the complex tax, investment and financial world in Canada on their own.

Check what the account minimum size is now with a broker at a major bank. You will be surprised at the size of client you need to be to get their help. If these trends continue, the CSA may need to offer courses on financial literacy to make up for this gap! My 19 years experience in this industry tells me that most consumers cannot wade through the complex landscape of financial acronyms without any help from a professional?

You seem out of touch with what my clients want.
When I discuss the potential ban on embedded compensation with my clients, they overwhelmingly state that they don't see how this will help me give better advice to them. Why should their ability to choose how they deal with me be limited? Regardless of how many rules you make or change, clients will either trust an Advisor and work with them…or not. Shouldn't they be able to look at the numbers, discuss my services to them and agree on the best way to proceed? It seems closeminded to imply that all clients would want to do business the same way and your proposals are forcing consumers down a path where there will eventually only be one way.

My clients want to deal with a professional that will build a long-term relationship with them. They want to be educated about finance, and to trust the advice and professionalism that their Advisor provides to them. They do not want to become financial advisors themselves. That is what they want us to do for them. If we meet their needs, they will choose how they deal with me and how I get paid. Your proposals are making it harder and harder for the Advisor/Consumer relationship to continue.

Some general comments for the direction of policy in the future – which applies to this consultation as well:

No advisor input.
It baffles me that a Regulator that regulates Advisors, that has so many financial resources, would not jump at an opportunity to include Advisors in policy development. It actually offends me that we are not included. I am making an effort to reach out with this letter because I think this is important for my clients.

Where are the Advisors on your board of directors, policy boards and outreach panels? Do you even have groups like this? Perhaps Advisors who actually deal with consumers on a day to day basis would have some great ideas on how you could solve some of the problems you have identified. I find it hard to believe that you have repeatedly excluded Advisors from this process and feel that as a Regulator, it is your duty to be inclusive of all groups you represent. Put another way, you would be doing your job better if you used all of the resources that are at hand. The Advisor community is an excellent resource. Please consider using it in the future.

No input from Consumers. Is there a real problem for Canadians in regards to embedded commissions?
When I discussed this proposal with my clients, 100% of them were completely unaware of it's existence. It is pretty hard for a consumer to comment on this process when they don't know it is happening. This is a serious issue and part of your responsibility as a Regulator. If this is such a major issue, why are clients not aware of it? Why are they not concerned? Why am *I* bringing it up to them in my meetings and not the other way around? I have two potential answers to those

questions: You have done a poor job of promoting and educating people on what you are doing, and/or people aren't nearly as concerned as you imply they are. Maybe this is not an issue with the public? I find it VERY hard to believe that out of all of the clients that I brought this up with that none of them had any real knowledge of the problem. I took the time to explain it to them and they were still not worried about it when they left my office. It makes it seem like this is complete overkill and is not really going to help Canadians at all.

You may defend yourselves and say that you have done a good job in educating Canadians and given them every opportunity to participate. But look at the process for comments. Your document is 100+ pages long! It takes a special consumer to read through this and put in the time to craft a response! I applaud those that did it. This process excludes ordinary consumers and even Advisors by it's sheer volume and complexity. None of my clients are willing to go through that process to defend their financial future against something they aren't concerned with. ***At the end of the day, Millions of Canadians will be surprised by an industry change if you go ahead with these proposals.***

Advisors can't keep up to the pace of regulation and change.
Overwhelmingly, Advisor colleagues tell me that they cannot keep up with the pace of Regulatory change. You have created a cottage industry of rule making without waiting to see if the last rules you put in force worked. If you gave the industry some time to catch up and implement the changes you wanted, you might see that many new potential policies would not be needed. For the most part, Advisors are out there doing their best. They are truly helping clients. They are trying to improve and be better. But at this point in time most Advisors are frozen in fear to complete a form incorrectly, or have the wrong size font on their business card. This regulatory whirlwind does not help to improve our industry when Advisors and clients can't keep up or understand what is changing. Advisors should be helping their clients. Piling more regulation on top of regulation will not create a good environment for Canadian consumers.

A solution is waiting for you…Increasing Advisor Professionalism

A Financial Advisor Profession
If you increased the professionalism of Advisors, it would solve many of your problems. As a member of Advocis and the FPSC, I am bound by a code of ethics that puts client's interest first at all times. With this as a guide, I see many of the regulations forced on the industry by Securities Commissions as redundant. I don't need to have each minute situation guided by a different rule. I have one overarching rule that guides me through all of the minutiae in a day. It's easy for me, and the largest number of Advisors follow this already.

These organizations (Advocis & FPSC) have a professional solution in place already and they just need to be included in your policy development to make them even more relevant to Canadians. If we can find a way to guide the ethics of Advisors, the other small issues simply become details. I strongly encourage you to reach out to these groups and see what they have to offer to make our industry better. **Making Financial Advisors a profession, will create better advisors, provide a more streamlined approach to regulation and most importantly will**

provide a great boost to consumer confidence, literacy and outcomes. If you can accomplish this you will have helped Canadians and our industry to be better.

Thank you again for the opportunity. Please feel free to contact me if you have any questions.

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June 9, 2017

Delivered by Email

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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
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Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
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Dear Sirs/Mesdames:

Re: CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* - Comments of the Investment Management and Securities Litigation Groups of Borden Ladner Gervais LLP

We are lawyers in the Investment Management and Securities Litigation practice groups of Borden Ladner Gervais LLP and are writing this letter to the Canadian Securities Administrators to provide our collective comments on the above-noted Consultation Paper. We provided our comments to the CSA on the CSA's December 2012 Discussion Paper on mutual fund fees, as we have done on virtually every consultation and rule proposal that has affected the investment fund and asset management industry for the past 20+ years.

BLG has been privileged to work with many managers of mutual funds and other investment funds operating in Canada and internationally for over 50 years. We have assisted in the structuring and establishment of hundreds, if not thousands, of mutual funds, and other types of investment funds. As such, we have seen first-hand the huge growth in the investment funds industry – not only in terms of its increased importance for investors, but also the heightened sophistication of strategies, features and services associated with the various funds. We have also seen the significant rise in regulation and regulatory focus on investment funds. We often assist in industry initiatives, including those organized by The Investment Funds Institute of Canada (IFIC), the Portfolio Management Association of Canada (PMAC), and the Investment Industry Association of Canada (IIAC). Our lawyers participated in the working group that formulated IFIC's comment letter on the Consultation Paper, as we did with the 2012 Discussion Paper.

We have also been privileged to work with many registered dealers (members of the MFDA and members of IIROC) and with many advisors, and understand their business models and successes, as well as the pressures (regulatory and operational) facing them in their work with Canadian investors to assist those investors to meet their financial objectives.

We considered both the 2012 Discussion Paper and this Consultation Paper with interest and commend the CSA for their thoughtful review of the policy issues the CSA see with the current fee structuring models – and for their significant attempts to back up their positions with evidence and research, particularly with this Consultation Paper. It is clear that much thought, resources, research and analysis have gone into this Consultation Paper and for this reason we wish to clarify that, although we do not agree with the CSA's proposals (for the reasons we outline below), we do recognize the CSA's extensive efforts and the importance of the issues raised in this Consultation Paper for investors – and also for the financial services industry.

It is in this spirit and with this background that we provide the CSA with our collective comments and thoughts on the Consultation Paper. Our comments should not be taken as the views of BLG, other lawyers at BLG or our clients.

Fundamentally our comments on the Consultation Paper have not materially changed from our earlier comments on the December 2012 Discussion Paper. We do not consider that the CSA have made a case for banning "embedded commissions" and we consider that the propositions put forward in the Consultation Paper may do more harm than good not only to investors, but also to participants in the Canadian asset management industry. In our view, the CSA's conclusion that banning embedded commissions, and requiring the industry to adopt other fee models, will have an overall positive, better result for investors, is ultimately unsupported by 'hard' evidence.

In addition, we urge the CSA to:

1. Consider the implications of the proposals put forward in the Consultation Paper on all facets of the industry – as we discuss below, the CSA has not considered important elements of the asset management industry or SRO regulation, as it relates to the overall fees discussion, which we consider problematic.

2. Consider carefully all comments received on the Consultation Paper, notwithstanding those comments may not raise "new arguments" or may not be "fact" or may not be supported by evidence. The onus should not be on the

industry to refute CSA opinions and views with "evidence" – the industry's views and opinions based on participants' own extensive experience with the needs and preferences of investors, provided by way of commentary on the Consultation Paper should be considered just as carefully as the CSA considers its own views and opinions.

3. Carefully tie together all of the regulatory initiatives undertaken over the past 10 years into a holistic package – with a unifying message and clear coherent regulatory goals and principles, along with a more creative, less prescriptive approach to regulating the industry. We provide more commentary on this below.

Our comments on the Consultation Paper follow (each of which elaborates on the above-noted fundamental comments).

1. Commentary on the Overall Underlying Premises of the Consultation Paper

Underlying the Consultation Paper is the deeply held assumption (and regulatory conviction) that embedded compensation is "bad" and that other forms of compensation arrangements would be much better for investors and industry participants. However, when one looks at trailer fees (leaving aside, for the moment, DSC (including low load) arrangements), it is clear that trailer fees are merely a packaging alternative to having an advisory fee paid apart from the management fees and expenses indirectly borne by the investors in the fund. In many instances, the current fee structure where trailer fees are paid by fund managers out of the revenue generated from the funds provides a simple, "all-in" cost to the investor.

In the Consultation Paper, a great deal is made of the following:

- investors are said to be not fully aware of the embedded compensation; and
- if investors paid for advice outside of the fund, they would be more aware of the fee and, as a result, have bargaining rights, including more control over the fees they pay.

Yet the Consultation Paper provides no real evidence of this correlation.

We find it very disheartening that after requiring industry participants (fund managers and dealers) to spend literally hundreds of millions of dollars to comply with pre-sale Fund Facts delivery and CRM2 disclosure obligations, the CSA members are quick to conclude that these measures do not – and indeed cannot - adequately inform an investor who cares to equip herself with the knowledge of the cost of her investment and who performs which service for the investor. The reality is that many investors will not take the time to read these documents – and only focus on "the bottom line", which is not to say that these documents are not useful and should be discounted. Arguably, with embedded compensation that "bottom line" is easier for the investor to understand as they see performance of the fund, after deduction of fees. The Fund Facts and CRM2 initiatives are still in their infancy, and, therefore, we firmly consider that it is premature to reach definitive conclusions on their ability to explain how the embedded compensation model works and impacts the investor's investment outcome.

If the CSA believe investors will not really read and understand the documents they will receive under Fund Facts (pre-trade delivery) and CRM2, why will they be any better off in a fee-based or direct pay account? There is no evidence or factual basis for any assertion that the fact that investors are paying an account level or direct pay fee will be any better understood at the time of payment or account opening, or on an ongoing basis. Arguably, investors will be worse off as they may be inclined to focus only on the fund performance, which naturally looks better when one moves the dealer compensation outside of the fund. While on page 78 of the Consultation Report the CSA address the potential inconvenience of the separate fee payment, there is no real discussion about how this fee will appear on account statements or in the presentation of fund performance, and how these presentations and fee payments would create a tangible positive difference in investor understanding.

No evidence has been provided to suggest that the average retail investor would have any ability to negotiate the fee that they would pay for advice in a fee-based account or in a direct pay scenario, which is one of the other key assumptions underlying the Consultation Paper. Indeed, in its Report, the Brondesbury Group expressly concludes "no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation" (page 20) and that "some experience in jurisdictions that have banned commissions suggests that the net benefit for investors remains elusive" (page 20). In our experience, fee-based accounts for smaller account sizes are not typically negotiable and can be higher than embedded commissions, especially in the case of investments in bond and fixed income funds.

This point seems to be lost in the Consultation Paper, which instead focuses only on quoting the "obvious conclusion" from the Brondesbury Group report – that embedded compensation negatively impacts performance when compared to funds without embedded compensation. This suggests that the CSA may not have given sufficient weight to the different, and simpler, packaging argument. When one considers banning or restricting one alternative, it is critical to have fully compared it to the other likely alternatives. In our view, a complete analysis is missing from the Consultation Paper.

Also, if the "sticker shock" of seeing the dealer fee broken out in the manner contemplated in the Consultation Paper were to cause investors to cease to invest or to pursue other investment options which offer less advice, it is an open question whether this would be beneficial to the average investor – many of whom are by their nature not "do-it-yourself" investors with the resources or financial literacy (not to mention inclination to go it alone) to produce superior investment outcomes.

In addition, the Consultation Report does not provide many details to support the "bias" argument - that is, representatives of dealers provided biased advice based on compensation alone. In our experience, trailing commissions are fairly standardized across the industry, with many of the exceptions which existed in the past having disappeared in response to market competition and unfavourable perception pressures.

We also note that the Consultation Paper makes much of the lack of description of what services the investor receives in return for his/her indirect absorption of trailer fees and whether investors get services of commensurate value, but does not question whether the same would be true for other alternatives of direct payment for distribution services by investors.

The Consultation Paper indicates that the embedded compensation structure results in cross-subsidization, with the suggestion that this is a negative. Investment funds, by their nature, involve elements of cross-subsidization and that as fund structures evolve, the level of cross-subsidization is diminishing. We would suggest that fee-based accounts are also subject to cross-subsidization. Just like funds with embedded compensation where, until one crosses a particular threshold, the investor is paying the same fees as investors with less (and potentially considerably less) money, investors in fee-based accounts are also subject to pricing that only changes at certain break points.

To suggest that a retail investor, armed with the knowledge that they are paying an account-based or direct-pay fee, will suddenly have much better control over the fee they pay strikes us as unrealistic and, at the very least, not backed by any empirical evidence. There is no reason to believe the smaller investor will have any negotiating power to lower his or her fees. If they are put off by the "cost" of advice they may gravitate towards "no advice" or very generic advice options which offer less investor protection (and potentially less ability to meet investment objectives) for those who need it most.

At page 80 of the Consultation Paper, the CSA acknowledges the very real possibility of product arbitrage. In our view, if the CSA conclude significant changes must be implemented we submit these should only be made once this product arbitrage issue has been addressed. Failure to do so may well leave investors with a worse possible outcome in the longer term.

We believe it would be completely unreasonable to eliminate the right to collect redemption fees payable under DSC arrangements that were entered into in good faith by fund companies and investors prior to the announcement any new rules as is suggested as a possible outcome on page 82 of the Consultation Paper. This would interfere with contractual arrangements that were entered into in good faith and fail to recognize the funding obligations of the fund companies which are inherent in offering an investor the option of having all of the investor's money invested without the payment of a front-end commission.

2. Assumption that Embedded Compensation Creates an Insurmountable Conflict of Interest – Fact? Or CSA Assumption? Implications of Such Assumption

The Consultation Paper discusses conflicts of interest resulting from embedded commissions; more specifically, it states embedded commissions create a conflict of interest that misaligns the interests of investment fund managers, dealers and representatives with those of the investors they represent. This deviation in interest, changes the behaviors of said fund managers, dealers and representatives at the "expense of the market efficiency and investor interests." (page 11) Thus, the CSA proposes that embedded commissions should be avoided [that is, prohibited] in favour of different compensation structures.

In the context of registrants, the CSA explain in the Companion Policy to NI 31-103 (section 13.4) that a registered firm must identify conflicts that should be avoided, determine the level of risk that a conflict of interest raises and respond appropriately to the conflicts of interest. The CSA also outline three methods to respond to conflicts of interests, namely, avoidance, control and disclosure.

Specifically, in the area of avoidance, the CSA state that if a registrant allows a serious conflict of interest to continue, there will be a high risk of harm to clients or to the market. If the risk of harming a client or the integrity of the markets is too high, the conflict needs to be avoided. Registrants must avoid all conflicts of interest that are prohibited by law. If a conflict of interest is not prohibited by law, registrants should avoid the conflict if it is sufficiently contrary to the interests of a client that there can be no other reasonable response.

Accordingly, the guidance suggests that avoidance as a means of response to a conflict of interest is required where “there is a high risk of harm to clients or the markets”, where the conflict is prohibited by law or where the conflict is “sufficiently contrary to the interest of the client that there can be no other reasonable response”.

In our view, the Consultation Paper does not apply the aforementioned tests to the conflict of interest presented by embedded commissions, which makes it difficult to understand the basis for the CSA’s position that conflicts of interest related to embedded commissions should be responded to by compulsory avoidance.

The CSA outline different potential negative impacts of embedded commissions on the market, without any analysis linking those negative impacts to a high risk of harm to clients or the integrity of the markets.

In particular, we are concerned that in failing to apply their own tests for avoidance of conflicts of interest as described in section 13.4 of NI 31-103CP, the CSA are, in effect, changing the tests and guidance in this respect. We submit that if the tests or guidance on when a conflict of interest must be avoided are changing, this needs to be clearly articulated to the market and in particular, to registered firms. Also, it needs to be articulated in a way that allows registered firms sufficient time to identify such conflicts and restructure their systems and affairs to implement an avoidance response to manage such conflicts of interest. However, we feel this approach would be misguided, given that we continue to consider that disclosure is the best option to moderate this potential conflict of interest.

Finally, the Consultation Paper discusses perceived conflicts of interest resulting from the commission structures at both the level of the fund manager and the dealer/representatives.

While it may be accurate to suggest that conflicts of interest exist for fund managers (in theory), that is, fund managers have a profit motive (more assets in funds equals more management fees), which causes them to incent dealers to distribute their mutual funds, we do not consider that a case has been made by the CSA that this conflict is at odds with the fund managers’ duty to act honestly, in good faith and in the best interests of the mutual funds, as required under securities legislation. It is only when the conflict is elevated to this level that securities legislation requires consideration of the conflict of interest by an independent review committee of the mutual funds (IRC) under National Instrument 81-107. We are not aware of prevailing industry practices – or any earlier position of the CSA – that would suggest fund managers should refer trailing commissions or incentives paid to dealers to the IRC of the funds for a recommendation. In our view, the CSA regulate this area in ways that moderate the most obvious conflicts of interest for fund managers through National Instrument 81-105. It would only be if the CSA considered that NI 81-105 did not operate to deal with the conflicts inherent in a commission-based industry, that further action would be necessary. We do not consider that simply paying commissions for distribution services means that the fund manager is acting without regard to its fundamental duty of care towards its mutual funds. We find particularly tenuous (and an example of an opinion being stated as a fact by the CSA) the assertion made throughout the Consultation Paper that mutual fund managers are more reliant on compensation and incentives paid to dealers to gather in assets than performance. In other words, performance is less important to fund managers than paying dealers to sell their funds according to the CSA, which assertion is not supported by evidence and our experience of working for many years with fund managers.

We understand that commissions and incentives may create conflicts of interest at the dealer and advisor level, which may lead (theoretically) to mis-selling of mutual funds (recommendations for mutual funds based solely on the compensation that the dealer/advisor will receive). However, again these conflicts have been regulated, since 1998 by NI 81-105 and through written and oral disclosure (enhanced as it is by CRM), as well as regulatory and legal standards of conduct on advisors and the dealer firms, who have extensive compliance monitoring obligations, including suitability requirements and supervision. The CSA explain that recommendations to investors by advisors cannot be made primarily on the basis of the compensation that the advisor will receive. We consider that this is an area where further discussions by the CSA with the SROs and their members may be useful. We comment on SRO regulation further below.

3. Continued Reliance on Clear Disclosure is Preferable to a Ban on Embedded Commissions

In our view, the recently implemented regulatory initiatives of pre-trade fund facts disclosure and the client relationship model initiatives should not be dismissed as effective mechanisms to alleviate the concerns noted in the Consultation Paper. We are firm in our view that the CSA should continue to monitor the impact of these initiatives before proceeding with a rule to ban embedded commissions. The increase in investor awareness that has the potential to result from these initiatives will allow investors to better assess the conflicts posed by embedded commissions (assuming they exist) and better evaluate whether the benefits of the services provided by their dealing representatives outweigh the costs. If these documents are considered to be deficient in some way by the CSA, we ask (as noted above) why the industry was required to implement these proposals with the degree of prescriptiveness and precision inherent in the proposals. If these documents and the delivery mechanisms to investors are deficient, then we urge the CSA to explain why – and undertake a serious rethinking of the nature of disclosure and the myriad of disclosure requirements that exist in current securities regulation.

The notion that investors should be given the freedom to make their own investment decisions, provided that they have access to all relevant information, is a fundamental – and long-standing - tenet of securities regulation. As a general principle, the purpose of disclosure in securities law is to promote equality of opportunity and information for all investors in the market. The CSA have relied on this principle in crafting regulation that requires timely disclosure by the issuers, advisers and distributors of financial products in instances of material change, knowledge asymmetries and conflicts of interests. Disclosure of relevant facts is intended to allow the investor, when apprised of such disclosed information, to make reasonably informed investment decisions on a level playing field with other participants in the market. We find it concerning that the CSA state (as they do throughout the Consultation Paper) that disclosure is now not sufficient and will never be able to work to mitigate any conflicts of interest – at least not ones similar to the conflicts of interest that the CSA consider are inherent in embedded commissions.

The Consultation Paper suggests that the implementation of point of sale disclosure and CRM initiatives will not address the inherent conflict of interests posed by embedded commissions, which, the CSA argue, incent dealing representatives to recommend products that maximize their revenue and incent investment fund managers to compete for sales on the basis of compensation they pay dealers, rather than performance. The implication of the Consultation Paper is that the conflict of interest posed by embedded commissions is so great that even disclosure of those conflicts does not provide investors with sufficient protection and that avoiding the conflict entirely is the only viable option.

There are several instances outside the context of embedded compensation in which conflicts arise between a registrant and its client where the CSA has long agreed that relying on disclosure to provide investors with sufficient protection. For example, a dealing representative that enters into an arrangement to pay for client referrals must disclose such arrangement to any client so referred. The purpose behind this disclosure is to alert the client that the referring individual was compensated for making such referral so that the client may take that fact into account when evaluating the merits of the representative's services and recommendations. Further, a registered firm that makes a recommendation to a client to buy a security issued by a related issuer must disclose the nature and extent of the relationship between the firm and the issuer. The purpose behind this disclosure is to alert the client that the registered firm has a relationship with the issuer that may influence the registered firm's recommendation. This disclosure provides the client with an opportunity to take that fact into account when weighing the potential benefits of making the investment against the potential risk posed by the conflict.

These disclosure requirements, amongst others, recognize that conflicts of interest may exist between more sophisticated financial services participants and clients who rely on those firms. For the sake and necessity of efficiency in the capital markets and providing investors with broad investment opportunities, instead of mandating that these conflicts be avoided, these rules require that conflicts are disclosed so that the investor can determine whether the cost or risk (i.e. the potential that the registrant may put its interest before that of the investor) is reasonable for achieving a desired outcome.

There are, of course, instances where the CSA has determined that a conflict is only appropriately mitigated when avoided. Conflicts must be avoided by operation of section 13.4 of NI 31-103 where they are prohibited by law or if the conflict is "sufficiently contrary to the interests of a client that there can be no other reasonable response". This is a high threshold, and in our experience these examples arise when there is a true risk of self-dealing to the strong potential detriment of the client. We submit that the conflicts of interest identified in the Consultation Paper relating to embedded compensation do not rise to this high threshold.

Like the examples set out above, point of sale disclosure and the CRM initiatives provide investors with fulsome disclosure of the costs and potential conflicts that arise when investing, as well as the potential benefits of such investment, so that investors may make a relative assessment of the risks and potential rewards. It is useful to reiterate the cost and performance data that are disclosed to clients at each stage of their investment:

Point of Sale: The CSA notes that fund facts aim to improve fee transparency by disclosing the costs of buying, owning and selling mutual funds. A fund facts document delivered at the point of sale discloses:

- Sales charges at the time of purchase
- Deferred sales charges at the time of redemption
- Trailing commissions paid to the dealer by the investment fund manager
- Management expense ratio
- Trading expenses ratio
- Total fund expenses

In addition to fee transparency, the fund facts document also provides data on performance of a fund, including:

- Annual total return of a series for either the past 10 years or since the series' inception (whichever is less)
- The best and worst returns for the series in a three month period over either the past 10 years or since the series' inception (whichever is less)
- The value of a hypothetical $1000 investment in the fund over either the past 10 years or since the series' inception (whichever is less)
- The annual compounded rate of return that equates the hypothetical $1000 investment to the final value

The fund facts document allows investors to get a sense of the initial and ongoing costs of investing in a fund and the potential risk and reward of the investment (based on historical data).

CRM2: CRM2 introduced new disclosure requirements relating to investment performance at the account level and the commissions and other amounts paid to dealers:

- **Account Opening:** Investors receive information on charges they may expect to pay in connection with their investment. If they invest in a fund, this information should include:
  - The management fee
  - The initial sales charge and DSC options available to the client
  - Any trailing commission or other embedded fee
- **After a Trade:** Following a transaction, investors are provided with a trade confirmation that discloses each transaction charge, deferred sales charge or other charge applying to the transaction, and the total amount of all charges.

- **Annually:** Annual reports now provide a summary of all charges incurred by the client and all compensation received by the dealer, including:
    - Total dollar amount of transaction charges
    - Total dollar amount of each type of payment other than a trailing commission made to the dealer or its representatives by another registrant in relation to registerable services provided to the client, which would cover upfront commissions investment fund managers pay to dealers for sales made under deferred sales charge arrangements
    - Total dollar amount of trailing commissions received by the dealer in connection with securities held

  The annual report also shows a detailed breakdown of performance, including the change in market value of the account, and the annualized total percentage return of the account for the last year, the last three years, the last five years and the last ten years.

All of the above disclosures aim to provide mutual fund investors with detail of the cost of investing and the performance of investments, at a product level (in the case of fund facts disclosure) and at an account level (in the case of CRM2). This increased awareness will allow investors to better understand the conflicts that may exist in an embedded fee structure and prepare them to evaluate these conflicts. Repeated disclosure about fees and compensation (at the time of account opening, at the time of investment, after investment, and annually) will allow investors to, over time, become more educated and informed about the fees they are paying. The CSA have stated that “increased performance reporting coupled with the increased saliency of fund costs and dealer compensation should cause investors to question the services provided by their representatives” who are in turn expected to respond by demonstrating their value proposition and reviewing the level of services provided. We submit that the CSA and industry should monitor how this process materializes before rejecting the effectiveness of these disclosures.

4. Commentary in the Consultation Paper does not sufficiently recognize the impact of SRO Regulation.

In our view, the CSA should consider very carefully SRO regulation of dealers and representatives before making the sweeping statements about whether or not trailing commissions and other incentives paid by fund managers create insurmountable bias and conflicts that requires embedded commissions to be banned. In our view, existing SRO regulation serves to moderate many of the issues noted as problematic by the CSA.

(a) Suitability should remain distinguished from and not confused with performance. Any discussion of performance should, in turn, include a full discussion of risk, its meaning and consequences.

The Consultation Paper states that embedded commissions raise conflicts of interest that misalign the interests of fund managers, dealers and representatives with those of investors in that it may:

- reduce the fund manager's focus on fund performance, which can lead to underperformance;
- give rise to compensation bias to incent dealers and representatives to recommend higher cost fund products that pay them higher embedded commissions other than other *suitable* lower cost and, preferably *better performing* products.

The Consultation Paper also states that investors may be caused to question the true costs and value of their services and that the CSA "… anticipate(s) that investment fund managers may respond to dealers' different product demands by producing lower-cost funds and focussing more on performance, thus potentially increasing competition and market efficiency" (p. 87). It says that there may be a "reduced incentive for products to be recommended on the basis of inducements received by the representative – potentially leading to a shift in recommendations from funds that were inappropriately favoured to *those that may be more suitable* for an investor. *If these funds are better performing funds, the shift in recommendations may reward better performing* investment fund managers with an increase in market share … (p. 90). Similar comments are made at page 93 of the Consultation Paper:

- "…. Dealers and representatives would specifically be required to consider the *impact of their compensation on performance as part of their suitability analysis*. To the extent that a product is recommended because it benefits the dealer or representative but there is an *equally suitable* product on the dealer's list that *would be less costly* for the client, such recommendation would not comply with the suitability obligation or the dealer's general duties to their client" ;
- "Combined with enhancements to KYC, KYP, suitability and proficiency, the CSA anticipate that representative recommendations *may shift to more suitable products* that may be lower cost possibly better performing products. To the extent that the CSA CP 33-404 proposals result in shifts in product recommendations *toward lower cost and better performing products,* we anticipate that these proposals may also have the indirect effect over time on investment fund managers as they may respond to these shifts by producing lower cost funds *and place greater emphasis on performance.* " .

We encourage the CSA to maintain concepts of suitability and performance distinct from one another as they may be easily confused in some instances, in particular those instances where investors have not enjoyed positive or more positive ("better") performance. Current legal and regulatory expectations in respect of suitability, as further described herein, require an in depth review of an investor's financial circumstances, investment objectives, risk tolerances, time horizon and investment knowledge. Performance does not form part of a suitability review. In other words, an investor may be suitably invested in every respect, while not having enjoyed positive or better performance or profitable investments. The lack of profitability or performance does not equate to a registrant failing to make a "suitable" recommendation.

Similarly, caution should be exercised so that a “more suitable” recommendation is not seen as a more profitable one or one that simply had lower fees. There may be multiple reasons for recommendation of one product over another to an investor, particularly where those products are not identical in all key regards, apart from fees, which may be one of a number of considerations.

Finally, any discussions regarding ‘better performance’ should be had in the context of a fulsome discussion of market risk and its various aspects and how that risk may be uniformly defined as amongst all members of the CSA, all SRO and all market participants, which uniform definition currently remains lacking. Such a discussion should also address the CSA’s underlying assumptions with respect to risk and the necessary role it plays as a tool in market investments.

(b) Regulatory policies should endorse the regulatory rules and expectations surrounding ongoing advice and recommendations which are not limited to trades but include recommendations to invest (and hold) over the longer term

The Consultation Paper states that the CSA believe investors do not receive ongoing advice from dealers and representatives that is commensurate with ongoing trailing commissions paid. In particular, it states as follows:

- “If investors are getting basic one time services centred *on the trade* as opposed to ongoing advice and services in exchange for ongoing embedded commissions paid out of their funds’ management fees, they may be indirectly paying too much for the services they are actually receiving. (p. 15)

- Moreover, since the aggregate amount of embedded commissions that investors pay increases as their holding period increases, those investors who remain invested longer may pay more fees than others for the same basic service. (p. 15)

- There is also the possibility that some representatives may have less of an incentive to service clients after the initial sale were we to move to more widespread use of fee-based arrangements. This may lead to “reverse churning”, in turn defined as when a dealer places a customer’s assets in a fee-based account (or receives some form of asset-based compensation) chiefly to collect the fee then subsequently does little for the client, in terms of actual advice, trading or account activity, in exchange for that fee. (p. 65)

- Embedded commissions will remain a ‘one-size-fits-all” fee that may not align well with the services and advice actually provided to individual investors in accordance with their specific needs, expectations and preferences’. This misalignment in turn, may cause investors to pay more fees than necessary relative to the services they receive, thus impending returns (p. 89).

- **…** there is currently no securities regulation that prescribes, or guidance that articulates, the specific services that an advisor is expected to provide in exchange for ongoing trailing commissions. Under N1-31-103…. Dealers/representatives are required to provide certain services at that time of the trade (eg. Suitability, know your client) but no requirement to provide ongoing advice focussed on the client’s portfolio (p. 122 Appendix A).

Somewhat similarly, IIROC Notice 17-0093 dated April 27, 2017 states in part as follows:

> *When asked by Dealers to justify this preferential payout for fee-based revenue, most said they believe fee-based accounts align registrant interests with client interests better than commission based accounts. While this may be true in some cases, there are other cases such as "buy and hold" where the client will be paying ongoing fees without receiving a commensurate level of ongoing service. Certain dealers also stated that, given the attention placed on embedded commission by the CSA, they are focussing on fee-based as the alternative.* (pp. 16, 24)

We consider these assumptions to be not supported in regulatory policy and industry practice.

Our regulatory regime has moved beyond obligations based solely upon a trade. Recommendations to buy and hold are encouraged and prudent for investors with a long term strategy and time horizon. Such recommendations do not imply a lack of duty on registrants and as such we cannot assume a lack of activity of their part in all instances.

IIROC Dealer Member Rule 1300.1 (p) to (r) provides that a suitability determination is required when an order is accepted, *when a recommendation is provided and when certain events occur* (as discussed further below). A recommendation to hold requires consideration of a client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account's current investment portfolio composition and risk level. In order to further comply with the requirements under Rules 1300.1 (p) to (r), due diligence must be used to ensure that the suitability of all positions in the client's account are reviewed and the client receives appropriate advice in response to the suitability review that has been conducted.

Under IIROC Rule 1300.1, a suitability analysis must also be performed when securities are received into a client's account by way of deposit or transfer, there is a change in registered representative or portfolio manager or there is a material change in the client's life circumstances or objectives that has resulted in revisions to the client's 'know your client' information as maintained by the dealer.

IIROC Notice No. 12-0109 dated March 26, 2012 provides that:

- all recommendations must be suitable to the client. Suitability of orders and recommendations need be considered based on factors included the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account's current investment portfolio composition and risk level.

- the regulatory obligation to ensure that orders and recommendations are suitable includes not only an obligation to ensure that the specific investment product is suitable for the client but also the order type, trading strategy and method of financing the trade recommended and /or adopted are also suitable;

- the suitability analysis starts before the order is even received, recommended or executed; and

- good business practices encourage holistic suitability reviews which would include periodic suitability reviews of client accounts, suitability reviews of accounts that may be affected by significant market events and of accounts holding securities that have undergone a material change in risk profile.

IIROC Notice No. 12-0109 also provides that account information must be updated any time there is a material change in a client's circumstances and recommends annual contact with clients to verify the accuracy of account information.

Like IIROC Rule 1300.1, MFDA Rule 2.2.1 (c) provides that that each order accepted or recommendation made (including recommendations to borrow to invest) for any account is suitable for the client based on the essential facts relative to the client and any investments in the account. MFDA Rule 2.2. 1 (e) has the same trigger events for a suitability assessment as IIROC Rule 1300.1.

MFDA Bulletin MSN -0069 dated April 14, 2008 sets out guidance for maintaining accurate and complete KYC information, know your product and the suitability process, all of which are applicable to a hold recommendation.

All of the above-noted regulations are cited in support of the fact that there is much more to a "recommendation" to invest in an investment fund than is acknowledged by the CSA.

(c) Unsuitable Leverage Strategies are fully addressed by SRO standards, particularly by the MFDA

The Consultation Paper states that the CSA also believes the discontinuation of embedded commissions would also eliminate the incentive for representatives to potentially engage in unsuitable leverage strategies (as explained in Appendix A") (p. 70).

It is unclear from the Consultation Paper just how embedded commissions have proven to be a meaningful incentive for unsuitable leverage strategies. It is of note that the MFDA in particular has expended multiple efforts to ensure suitability of leverage, samples of which are found in their rules, policies and notices.

MFDA Rule 2.2.1(c) requires that recommendations to borrow to invest be suitable based on essential facts relative to the client and any investments in the account. MFDA Rule 2.2.1(f) provides that to ensure the suitability of the use of borrowing to invest is made whenever the client transfers assets purchased using borrowed funds into an account, whenever the dealer or adviser become aware of a material change in client information or there has been a change in the adviser responsible for the account and where the use of borrowed funds is determined to be unsuitable, the client is so advised and provided recommendations to address the inconsistency.

Part III of MFDA Policy No. 2 describes procedures for identifying and reviewing leveraged transactions and in particular, minimum criteria that require supervisory review and investigation including investment knowledge, age, time horizon and financial circumstances.

MFDA Bulletin MSN-0069, Suitability, sets out multiple responsibilities regarding leveraged transactions. It states in part as follows:

> Leverage is not suitable for all investors and the appropriateness of a recommendation to use leverage must be assessed on a client-by-client basis, having regard to the client's age, financial circumstances, objectives, risk tolerance, time horizon, the manner in which they intend to secure and repay their loan and any other factors that are known at the time or reasonably ascertainable and may be relevant in the circumstances.

MFDA Bulletin MSN-0069 provides further detailed guidance regarding Part III of MFDA Policy No. 2. In addition, MFDA Notice MSN 0074 dated May 19, 2010 sets out the MFDA's requirements for clear, plain language, leverage risk disclosure for investors.

(d) The practical needs and realities of an aging population should remain part of a frank discussion with both the CSA and the SROs and it is not a sufficient answer to ban embedded commissions

Finally, the Consultation Paper states that the CSA believes that embedded commissions incent unsuitable use of DSC arrangements and refer to MFDA Compliance Bulletin No. 0670-C, 2015 DSC Sweep Report, December 18, 2015, which uncovered instances of inappropriate use of DSC. The Consultation Paper points out that this included: "clients over the age 70 that were sold funds under DSC arrangements" and "clients that were sold funds with DSC redemption schedules that are longer than their investment time horizon" (p. 109).

We recommend that all regulators (particularly the MFDA) take a meaningful look at the life expectancies of Canadians and their personal and financial circumstances which are unique to every individual irrespective of age. For example, a 70 year old may well live for at least another decade or considerably longer. Irrespective of his or her lifespan, he or she may wish to have sufficient funds for estate planning goals. In other words, a long term time horizon may well apply and a DSC option may be suitable for that client.

IIROC Notice 16-0114 dated May 31, 2016 recognizes that senior clients are not a homogeneous group and that issues that affect some, may not be relevant to all older clients. Product due diligence, know your product and know your client are considered to be most relevant in this discussion. IIROC also points out (correctly, in our view):

> *While the presumption is that senior clients' time horizon is the duration of their retirement, senior clients may have differing time horizons for their accounts (eg. where a senior client wishes to leave a legacy to a family member). Dealer members should ensure that the rationale to support the time horizon used for each senior client is appropriately documented.*

Each of these regulatory requirements would require a representative to consider the appropriateness of DSC features for their older clients.

5. Effect of a Ban on Embedded Compensation on Investment Fund Managers

The Consultation Paper does not discuss the potential impact on fund managers, particularly new or niche fund managers, that a ban on embedded commissions may very likely have. Today, trailing commissions or other up front commissions paid by fund managers to dealers not only reimburse dealers for the distribution services they provide investors, but they are designed, in part, to also compensate dealers for the significant regulatory obligations relating to KYP and due diligence related to the funds they recommend to their clients. It would not be surprising to us if dealers were to narrow their shelf (particularly if the ban on embedded commissions were to be implemented alongside the "targeted" reforms discussed in the "Best Interest Standard" consultation paper) simply because the KYP and related due diligence were considered to be too onerous in connection with the investment funds managed by a new fund manager or a niche player or less well known fund manager. Furthermore, the elimination altogether of compensation from anyone other than the dealer's client could very well result in a further narrowing of the dealer's shelf, leaving only the most mundane of investment products, if there is no incentive or insufficient compensation for a dealer to invest the time necessary to do due diligence on, and assume the increasing regulatory risk of investing client money in, novel or alternative investment products.

We consider that this is a significant market-place issue that is deserving of consideration by the CSA. The ban on embedded compensation may have additional unintended consequences by reducing competition in the market-place and placing greater barriers to entry into the fund industry.

6. Missing Elements from the Consultation Paper

We point out several elements below that we consider to continue to be missing from the CSA's consideration of the issues around embedded compensation:

(a) The Consultation Paper does not discuss the tax considerations that are a key part of any discussion of investment funds, their fees and structuring. We urge the CSA to consider the tax aspects of their proposals before moving forward with them, if indeed this is the ultimate decision. We would be pleased to provide the CSA with any other information about taxation of investment funds and fees payable outside of the fund that the CSA might find helpful in this context.

(b) The Consultation Paper fails to acknowledge the CSA's regulation of mutual fund sales practices through National Instrument 81-105, which has been in place since 1998. This instrument contains rules that seek to moderate the conflicts of interest that are inherent in a commission, incentive-based distribution model. These rules also forbid fund managers to pay any money or incentives directly to dealing representatives (advisors). The CSA were very deliberate in its formulation of NI 81-105, including the extent to which the CSA would be willing to regulate specific incentive practices and commission levels. Any future CSA initiative in the area of mutual fund fees, must, in our view, include a consideration of NI 81-105, including any necessary reforms and updating of NI 81-105.

(c) The evolution of investment fund fees provided many *benefits* to investors, including considerations relating to changes in industry focus from front end load commissions to DSC to low load sales charges and also of investing in investment funds, generally, which include:

(i) With DSC and low load sales charges – 100 percent of the investor's cash is invested, whereas with front end load, particularly at the 8-9 percent levels in the mid-late 1980s, the commission comes out of the initial investment, meaning less money is actually invested in the funds.

(ii) With DSC and low load sales charges – if the investments are held for the prescribed period (which has shortened over the years), the investor pays no sales charges at all.

(iii) Front end load commission based sales can lead to more active trading in investment funds (which may result in churning of investments, being traded in order to maximize commission based income).

(iv) The desirability of investor choice – provided there is appropriate advice and suitability assessments (which is inherent in the distribution model of registered dealers and representatives), coupled with clear disclosure, we consider that allowing for market-driven alternatives is fundamentally preferable to a regulated reduction in the ways that fees for services can be paid for by investors. We do not consider that the Consultation Paper gives enough credence to the desirability of giving investors choices in how they pay fees for services.

(v) Investment funds give the average retail investor access to a professionally managed pooled vehicle managed by professional money managers and administrators for a comparatively low cost and at low investment thresholds. Investment funds are easily accessed by investors working through thousands of dealing representatives (including as part of a more holistic financial planning exercise) and hundreds of dealer firms. In our view, investment funds are a real Canadian success story, with access to funds being (generally) available in all of the provinces and territories of Canada.

(d) Related to the above-noted comment, with manager-established commission structures – that is, fund managers set the level and type of compensation that will be paid to dealers (and therefore indirectly to advisors) – the parties have more equal negotiating positions than would be the case if investors alone were left to negotiate their fees (on an individual basis) with their advisors and dealer firms. Fund managers have interests that are aligned with investors (including smaller retail investors) – they want investors to invest in their funds, they want their product to be competitively priced vis a vis other financial products (including other funds) and they are required to act in the best interests of the funds. Accordingly, fund managers wish to incent dealers to distribute their funds, while not paying more than is necessary to achieve this objective. Fund managers have much more "clout" and negotiating power than do individuals, particularly smaller retail investors. The CSA should carefully consider the potential for unintended consequences if the current tri-party bargaining relationship is replaced with a two-party model with clearly unequal bargaining power between the parties.

Related again to the two above-noted comments, dealers and fund managers can be said to have a somewhat symbiotic relationship. This relationship feeds the negotiating equality noted above, but also, in our view, led to the growth of the various compensation and incentive models discussed in the Consultation Paper and as regulated by NI 81-105. Because the majority of fund managers generally have no way to distribute their funds to the public (which is more of an operational rather than regulatory issue, given the tremendous operational, compliance and back-office operations that are necessary for a viable dealer network), fund managers must incent dealers to distribute their products, through commissions and other incentives, as well as good management, adoption of best practices and good performance. Similarly, dealers are dependent on fund managers to create and properly manage the funds that can be investment options for their clients. As noted above, the operational aspects that are necessary for a viable dealer network have costs which dealers, understandably, consider should be shared by fund managers through compensation and incentives, given the "sharing" of client relationships between dealers and fund managers. This relationship is a reality – but it is not inherently a negative reality, which is hinted at in the Consultation Paper.

7. Transition Issues Not Discussed in the Consultation Paper

The Consultation Paper does not discuss transition issues in the event that the CSA actually moves to ban embedded compensation. Would the CSA expect that managers will simply stop paying trailing commissions to dealers? Similarly, is the CSA expecting industry to create new series that do not include such embedded compensation and switch investors into that series?

Also, we note that insufficient attention has been paid to the fact that embedded compensation is 'embedded' in management fees -- a fund pays a management fee to its manager, who may then choose to share a part of that management fee with others, including dealers. Banning embedded commissions would not in and of itself change the quantum of the management fee charged by the manager to the fund. To the extent that managers choose to reduce the management fee charged to the fund in light of a ban on embedded compensation, it would not be reasonable to assume that the management fee would be reduced by exactly the amount of the current trailing commission.

Trailing commissions pay for service and advice that representatives and dealers provided to investors – we anticipate that managers may need to provide additional seminars and similar information sessions to assist with, for example, Know-Your-Product obligations because dealers may have less revenue to fund Know-Your-Product research to the extent they do now. Therefore, managers who wish to have a particular fund known to dealers, may need to hold information sessions to a greater extent than they would be required to do currently. Such sessions would need to be funded out of the only source of revenue available to managers – management fees.

Important transitional elements include the systems and operational changes dealers will have to adopt to provide for the ability to charge direct pay or fee-based account level fees. Fund managers will need to reconsider the series of funds they offer to the public. Significant time to allow for such implementation will be necessary.

If the CSA does decide to move forward with a ban on embedded commissions – it will be vital that the CSA carefully – and creatively – consider the transition for funds and industry participants alike. We recommend that the CSA hold a specific consultation on the transition that will be necessary, including recommendations as to modifications of the disclosure regime that today applies to funds, dealers and fund managers. A less prescriptive and inflexible – and more creative - approach to disclosure would be most welcomed.

8. CSA's Next Steps

Before moving ahead or taking any other steps regarding investment fund compensation, we urge the CSA to develop a holistic approach to regulating the industry – and to determine how each regulatory piece fits together at least at a high level. This would include an analysis of the considerable disclosure obligations on investment funds, managers and dealers and how these disclosure obligations fit with dealer and representatives' regulation (SRO and otherwise) and also regulation of conflicts of interest through NI 81-107, NI 31-103, NI 81-105 and NI 81-102, as well as existing securities legislation (Part 21 of the OSA, for instance). We consider that it is important not to focus so purely on the one element outlined in the Consultation Paper, being "embedded compensation through trailer fees and up front commissions" without considering other important matters that may give rise to similar conflicts of interest or important investor protection matters, such as charging of fees generally, operation and distribution of proprietary funds, revenue sharing, distribution of non-securities products (that do are not subject to the same regime as investment funds) etc, none of which are mentioned (other than to say they are not being discussed) in the Consultation Paper.

The Consultation Paper may raise important discussion points, but without understanding the balance of the regulatory regime and a complete picture of the entire industry, unintended consequences and unbalanced regulatory burdens will be created for different segments of the industry.

+++

We hope that our comments will be considered positively by the CSA and as helpful to advance the CSA's considerations of the important matters outlined in the Consultation Paper.

We would also be very pleased to organize a meeting with the lawyers who participated in the preparation of this comment letter to discuss our comments further with interested CSA staff if this would be considered useful.

The following lawyers participated in the development of this comment letter:

Whitney Bell, Jason Brooks, Rebecca Cowdery, Fred Enns, Kathryn Fuller, John Hall, Ron Kosonic, Lynn McGrade, Laura Paglia, Donna Spagnolo and Prema Thiele.

Yours very truly,

Borden Ladner Gervais LLP

(Investment Management and Securities Practice Group Lawyers)

INCLUDES COMMENT LETTERS

The Beep Brief

A response to the CSA CONSULTATION PAPER 81-408
regarding the discontinuation of Embedded Commissions.

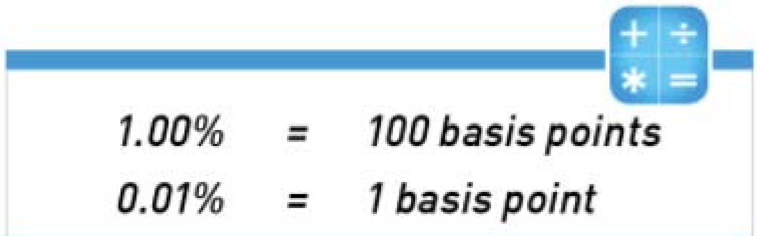
Gerry Gabon
Founder and President
Trusted Wealth Professionals
TWP | TRUSTED WEALTH PROFESSIONALS

Submitted
June 9th 2017

Beeps

Definition of 'Beep'

'Beep' is financial industry jargon for basis point, which is 1/100 of a percentage point in the context of interest rates, bond yields and other debt instruments. The term came into popular usage as an easier way of referring to the basis points as bps. Because basis points express percentages of change, not dollars, they have limited use in quoting stock prices.
http://www.investopedia.com/terms/b/beep.asp



'Beep' Usage

Investment professionals regularly refer to 'basis points' when discussing things like bond yields and mutual funds.

Why does this seemingly tiny unit of measure—one basis point is equal to one one-hundredth of a percentage point—get so much attention? It's pretty simple: Basis points can add up to a lot of money for both individual investors and institutions.
https://www.wsj.com/articles/what-is-a-basis-point-and-why-is-it-so-important-1378324917

Table of Contents

Executive Overview

"The only aspect of investing, that investors' can control, is their Fees"

And what you can't control will erode your Nest-Egg. At present the majority of Canadians' get paid 2 times per month. Yet they pay their mutual fund fees daily; approximately 20 times per month. And they don't know their Total of Embedded Mutual Fund Fees. Nor their Embedded Commissions they are paying as well.

With the rise of low-fee ETFs, CRM2 sharing Fees & Performance (I've coined CRM2 to be CRM ½, explained later), the proliferation of low-fee Robo-Advisors, an overall decline of DB pension plans, upcoming regulations regarding financial industry Titles & Licensing, etc … the 'Billing System' of the Canadian Wealth Industry is being addressed through CSA 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS.

The most lucrative aspect of the Billing System is Basis Points (a.k.a. Beeps); all sales people want Beeps. But Canadian Investors; including seniors and millennials, really want and need Liquidity and Advice. They aren't receiving this, thus, the following 3 statements:

Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.
The Mutual Fund Industry is guilty of Commission Laundering
In 2017, DSC Month, and/or re-DSC Month, will be October.

Within the Beep Brief, you'll find **Solutions** to the Embedded Commission Billing System; including The Beep Ban (Solution2). And proposed Government actions (Solution1).

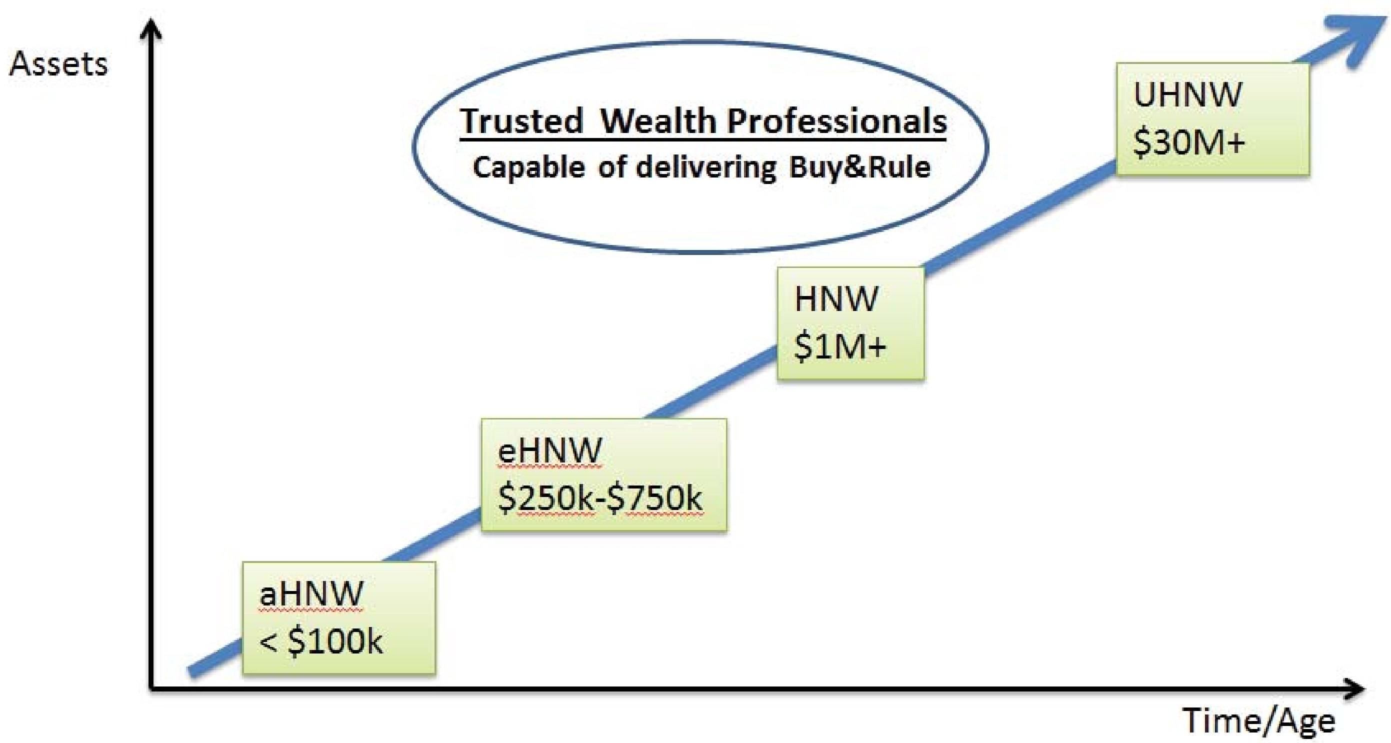
The Beep Brief also provides a look through the **Crystal Ball**; addressing the 'Advice Gap' for aHNW and eHNW. It is expected Robo-Advisors will 'take' the aHNW marketplace. IIROC

Advisors will dominate the eHNW and HNW marketplaces. And the UHNW may chose to move a portion of their assets to Buy&Rule ® as well.

The image below defines:

- aHNW; aspiring High Net Worth
- eHNW; emerging High Net Worth
- HNW; High Net Worth, and
- UHNW; Ultra High Net Worth

The Asset amount delineations are arbitrary, but quite close to actual High Net Worth 'practices' in place today by the Wealth Industry.



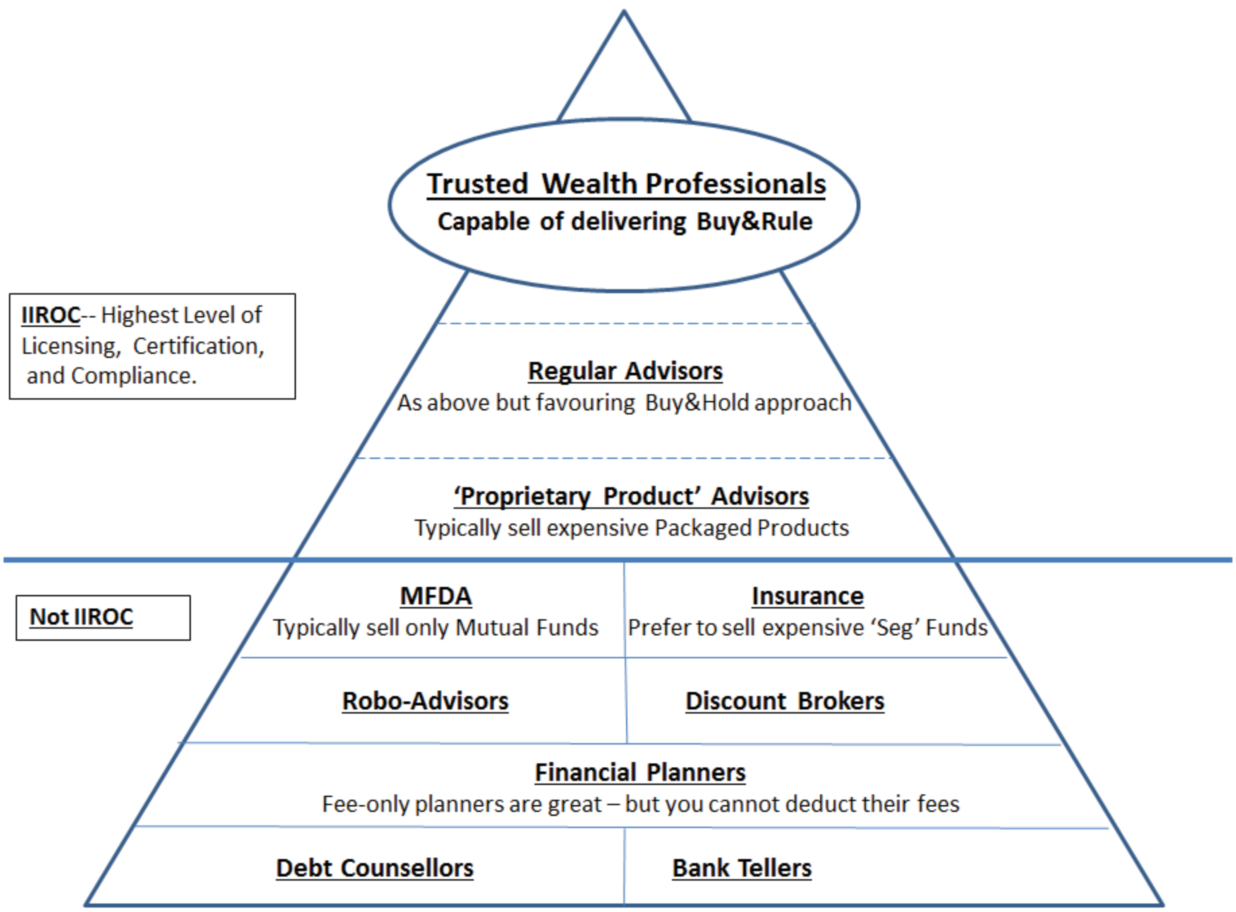
The overall theme of the Beep Brief is that Liquidity provides the Best Outcome, removing Embedded Fees will provide Liquidity to Canadians' and the opportunity to prosper.

Financial Literacy is only part of the solution; Regulators must provide Leadership such that the un-regulated marketing 'spin' of captive assets does not lead to Lesser Outcomes. Removing Embedded Commissions providers the Leadership necessary for overall Canadians' Wealth prosperity.

And there are other actions that Regulators can take; please see the 21 Solutions in the Beep Brief.

But it all boils down to Choice; where can I obtain access to ALL the Investment Styles (ie. Buy&Rule ®), ALL the Investment Products & Fees and ALL the Investment-related Services.

Choice = Liquidity



And IIROC advisors can provide the Choice.

Introduction

To the:

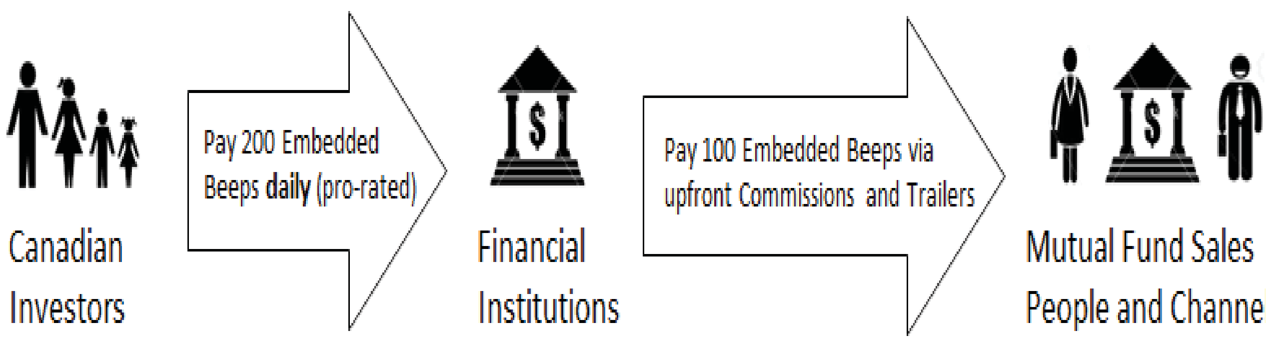
- British Columbia Securities Commission
- Alberta Securities Commission
- Financial and Consumer Affairs Authority of Saskatchewan
- Manitoba Securities Commission
- Ontario Securities Commission
- Autorité des marchés financiers
- Financial and Consumer Services Commission, New Brunswick
- Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
- Nova Scotia Securities Commission
- Securities Commission of Newfoundland and Labrador
- Superintendent of Securities, Northwest Territories
- Superintendent of Securities, Yukon
- Superintendent of Securities, Nunavut

My name is Gerry Gabon and I recently founded an innovative educational platform named Trusted Wealth Professionals. I am a software engineer (UofT - EngSci 8T5) with an MBA specializing in Finance (York - 1991). I have over 30 years of investing experience (direct trading, mutual funds, proprietary product sellers, discount brokers and two different full-service IIROC firms) and several pioneering roles with WealthTech solution providers (IBM, Financial Models, Certicom, SYMCOR, etc …). At Financial Models I sold PAGES; a Financially Intelligent Statement Generation software solution for the HNW Investment Counsellors. At IBM I deployed Broker Workstations for the Brokerage community while also porting Trading Systems. I also recently toured extensively the 'Individual Pension Plan' marketplace for Business Owners and met 100's of Advisors.

I am extremely passionate about connecting the Canadian investors with the trusted professionals they need to maximize their personal Wealth outcomes. And to that end, that is why I founded Trusted Wealth Professionals (www.TrustedWealthProfessionals.com) and why it will become the Trusted Voice of Canadians' Wealth. The Canadian Investors' Source (CIC Course) is on the website, but that is only the first step. Canadians' need to trust their wealth professionals and that mandate is quite too often fraught with many self-serving agendas; namely KYC – Know Your Commissions.

In our current economic environment, Baby-Boomers are aging, markets are experiencing an extended Bull period (with no hint of a Bear), ETFs are rising in AUM, CRM2 is half delivered (my own term is CRM ½), FinTech and Robo's are emerging, regulations and RegTech is evolving rapidly, etc … and it has become apparent that Profiteering is abundant within the Wealth+Financial Services Sector. The Beep Party is raging. Everyone wants Beeps.

Embedded Commissions, is just another form of Beep Sharing. For example, a 2% MER on a Mutual Fund is generally 'split' into two 1% halves. One half, 1%, or 100 basis points, is kept by the Mutual Fund Manufacturer (ie. Financial Institution) and the second half, the other 1%, or 100 basis points, is given to the Seller (the Channel and Sales People). So "100 Beeps for you and 100 Beeps for me". This is the 'Beep Party' a.k.a. Embedded Commissions.



This timely response serves to support the CSA's position that Embedded Commissions can have a negative impact on overall Canadians' Wealth. This submission will include a few diagrams, a couple of new colloquial expressions, and will introduce the following Points:

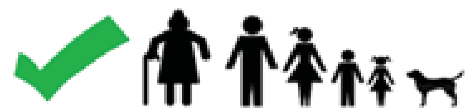
Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.

The Mutual Fund Industry is guilty of Commission Laundering

The underlying preposition of the Beep Brief is that of Liquidity; best understood as non-Liquidity, or Illiquidity. If you are denied Liquidity, because of the underlying instrument, or the Sales Channel, your Outcome is lessened.

The Embedded Commissions within the Mutual Funds fee structure, and similar other Beep-based fees structures, from any/all Wealth industry participants, deny Liquidity to Canadian Investors. And when Liquidity is denied, sub-optimal Outcomes can be achieved. Please note this is only 99% proven via recent ETF vs. MF comparisons and summarizations of HNW clientele's investing approaches, but if you ask Canadians to choose from the Grid below, you'll see the informal results below.

Canadians' Choice for Products & Fees

Products & Fees	Embedded Commissions	Appropriate Transparent Fee for Advice + Service
Illiquid Products		
Financial Securities with Liquidity		

The reason is that you cannot trust self-serving surveys, if you were to explain to Canadians' the truth about their Choices, they choose the Green CheckMark above.
Please note that this submission to the CSA may not be your typical response. But in a professional manner, it is designed to be memorable, and in a free-format manner. And where possible, I provide **Solutions**, to Canadian Investors, Regulators and Industry Participants because I am purposefully not licensed to sell a financial security and that allows me to provide trusted and impactful Leadership.

Of note, I will probably term Banks' Advisors via the term 'Tellers', Mutual Funds sales people, and proprietary product sales people (ie. from Investors Group), interchangeably, as recipients of Embedded Commissions. And I'll probably touch upon why:

In 2017, DSC Month, and/or re-DSC Month, will be October.

Please enjoy the Beep Brief and if you have any questions feel free to contact me. Thank you again for your time and consideration.

Gerry Gabon
Founder and President
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Cell: 416-566-2213

Thought Leadership re: Beeps

As a Canadian, and cognizant of commercial ongoings in North America overall, you are probably well aware that 'Everything is a Billing System'. Not only from my startup efforts and software engineering successes, but from my own personal consumption, nothing is more apparent than '<u>How are they going to charge me?</u>' I can belabor this point, but it is wickedly emphasized that during the Dot-Com Dot-Bomb period of 2000-02, when software companies that 'did nothing' except allow internet providers the ability to customize their billing systems, they were acquired for billions of dollars. Think now to your current cellphone carrier and the myriad of data plan options. Or consider your cable TV plan (if you still have one); look at the bundling and un-bundling options you have. We live in the world of Billing Systems.

And the financial services sector is no different, except the 'Billing System' is generally hidden; especially if you are invested in Mutual Funds. Ask yourself, "How many Beeps did I pay today?", "Did you get my Beeps today?", or "Did you correctly charge me the appropriate Beeps?" Maybe they gave you this T-Shirt as a form of reassurance.

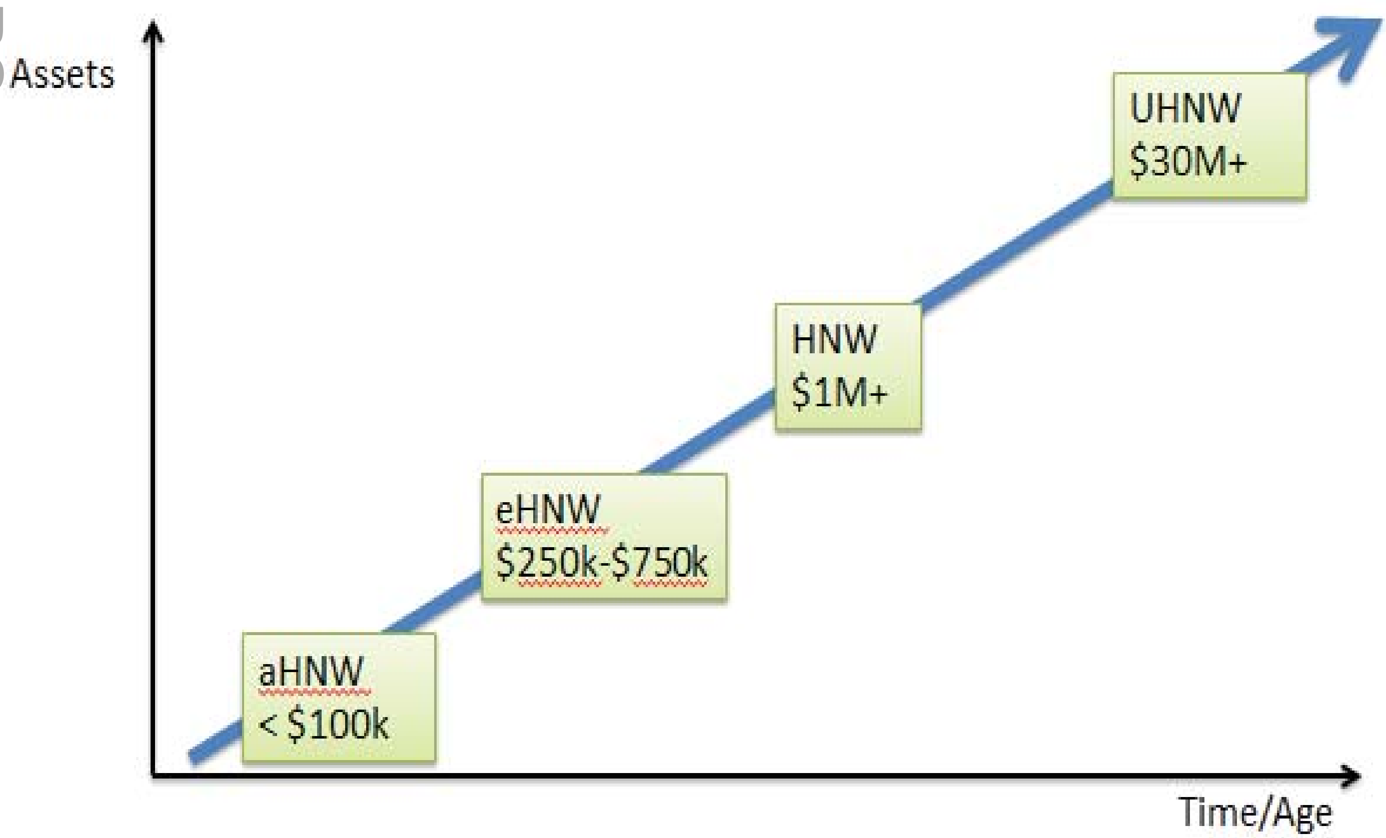
Front

Back

So I honestly can't recall if I learned about the Embedded Commissions response from a colleague, or the OSC's GetSmarterAboutMoney (website or newsletter). But, in either case I felt it was important to dovetail this initiative into the mandate of Trusted Wealth Professionals. Thus, I obtained the 169 page PDF, CSA CONSULTATION PAPER 81-408, starting reading and making notes, and I participated in the associated Webinar. And then I started re-reading, and making more notes, and really appreciating the effort the CSA undertook to produce 81-408.

But as I started to respond, I realized the evidenced-based approach undertaken by the CSA was quite complete, and I don't have the time+resources to commission new studies based on my own unique prepositions.   What stuck in my mind was the comment made on the OSC's webinar is that they, the OSC, are seeking 'Something New'. And when that thought process was woven together with the Embedded Commission Point & Counter-Point that was played out in the media, the Beep Brief was conceived.   This is the opportunity to provide Thought Leadership to Canadians.

The starting point is understanding one of my favourite sayings "How Big Is Your Stack?". It's an analogy from the game of Poker that forces the card holder to 'compare'. And that is critical, the word 'compare'. If you compare yourself to the HNW figure below, a categorization and tiering of High-Net Worth people, you'll see where you stand. The lowercase 'a' is for Aspiring and the 'e' is for Emerging. The capital 'U' has been interchangeably termed 'Ultra' or 'Unicorn'. The start-point and end-point of the individual tiers were chosen by me and purposefully left with gaps such that it is known that 'gapping up' is a discrete step. The 'gaps' set higher targets such that when you have $800k you can say to yourself "I'm not a High Net Worth person yet until I reach $1M". HNW is defined as $1M in net assets, outside of principal residence/home.



It should also be noted that aHNW are just one college/university degree, or one wedding, etc … away from having to start Saving over again. And the tiers I have chosen also tend to coincide with chosen net asset levels by the highest licensed investment professionals; namely the full-service IIROC advisor.

Notwithstanding the stereo-typical objectives of the HNW community, you could express the investing needs of the HNW as per the grid below:

Tiers & Needs	Growth	Growth + Income	Income
aHNW	✓		
eHNW	✓		
HNW		✓	
UHNW			✓

The Financial Services industry is best served by providing advice + counsel via:
1. Fee Transparency; not via Embedded Commissions and certainly not via the initial convoluted CRM ½
2. Liquidity; not constrained by a Billing System, an 'at loss' Commissioned Sales Person or an after-hours settlement process.

Let's now take a closer look at the 2 main points I stated earlier.

Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.

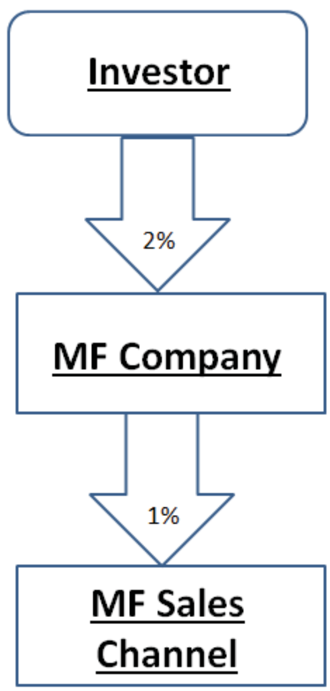
The Mutual Fund Industry is guilty of Commission Laundering

And we'll also consider this bonus point as well

In 2017, DSC Month, or re-DSC Month, will be October

It should also be noted, that just as 'Everything is a Billing System', the sales channel should not be ignored. The 'Sales Channel is Very Powerful' and should always be considered when innovation or disruption is contemplated.

The concept of the Sales Channel that I'll general refer to in the Beep Brief is illustrated below. I've used a few MER percentages, just as examples, but this is in my opinion a high-level view of the CSA's starting point to discontinue Embedded Commissions.



Point # 1 – First Half – "commission-based scheme"

Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.

There are 2 halves to this statement about Mutual Funds

commission-based scheme
semi-liquid asset class

And the connector is the word **masquerade**.

Whether you consider, from an overall perspective Point #1 to be a harsh statement, or an illuminating statement, its origins are actually re-purposed from a similar statement about Hedge Funds. And there is a lot within the 14 words, so let's tackle the 3 main components in order.

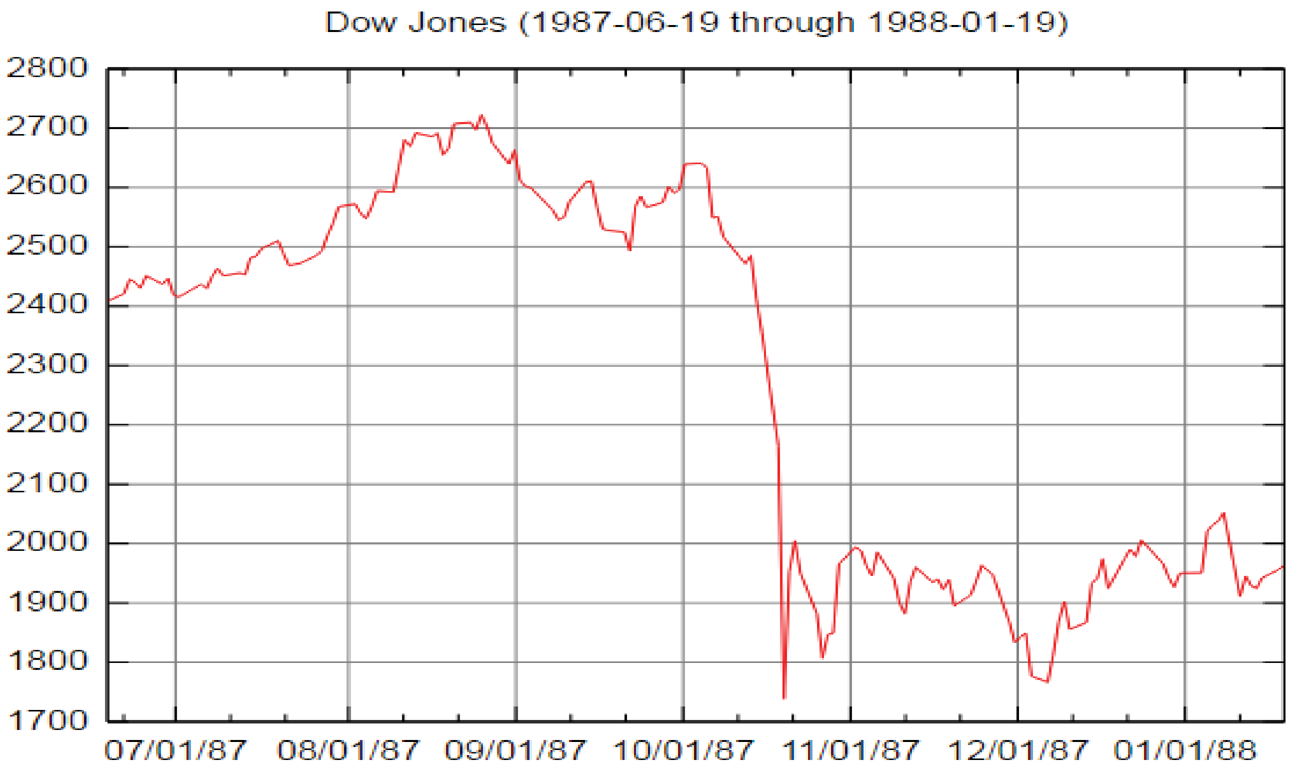
<u>"Commission-based scheme"</u>
Quick Background; and everyone has their own version of these details+facts.

In September 1987, MacKenize Financial brought a new compensation scheme North of the border, DSC's (Deferred Sales Charges); and introduced the DSC's through a new Mutual Fund called Horizons. Mutual Funds were typically sold with a 1-time upfront sales charge. Thus the 'hook' to keep investors buying the new Horizons Mutual Fund products was to pay the Sales Channel the upfront DSC fee, but lock-in the Investor with 5-7 year clause that made them liable for the Sale Channel Fee. So, a double-win was achieved, an easier lucrative sale for the Mutual Fund Sales Channel, and a guarantee to the Mutual Fund manufacturer that they had a recourse against any commission shortfalls (if the investor redeemed their funds).

All the subsequent Billing System terminology such as Front-End loading, no Load, Trailer Fees, etc … are just schemes to incent the Sales Channel to keep selling Mutual Funds.

Now MacKenzie was very fortunate as the Horizon product did not 'sell out' in September 1987, and later, in October of 1987 there was Black Monday, a decline of 22% on the S&P 500.

Afterwards it was a great buying opportunity and Horizons eventually became a flagship offering by MacKenzie. Black Monday is shown in the image below.



But without going into the euphoria of retail investors, many of whom had not seen a crash or a correction, and were struggling with mortgage rates of 14% (or higher), the DSC became the 'juice', the 'drug', the 'pill', for the Mutual Fund sales channel.

This translated into Buy&Hold, the absence of Advice, and made the Mutual Fund manufacturers increasingly more desperate/competitive to maintain+grow their marketshare. So commissions to the MF sales channel became the battle-ground. And the Billing System for Mutual Funds became paramount and the Beep Party started. The 'Scheme' was in full swing.

Plus the entry point into the Beep Party was joining the MFL; Minimal Financial Licensing, in other words, your Mutual Fund Sales Licence. Of note, in the coming months, the MFL will be explained in detail at www.TrustedWealthProfessionals.com.

As a side note, I had the opportunity, while at SYMCOR, to work with the CoreLan founders who built FundServ (no 'e' in FundServ), one of the first (and still in use today I believe) Mutual Fund settlement systems (circa late 1990's). This system essentially takes the daily NAV (Net Asset Value), from another system at 4:01pm (or later) each day, after the market has closed, and ensures the Mutual Fund Buys & Sells are properly administrated. The daily NAV is calculated by the Mutual Fund company first by siphoning their pro-rata amount of the MER before deciding how much is left, per unit, for the Mutual Fund investors.

So I pay daily my mutual fund fees, and we are back to the phrase '**commission-based scheme';** which begs the question "If it isn't a commission, what am I actually getting?" And "Why am I paying daily?" Of note, with a full-service IIROC investment advisor, you pay every 30 or 90 days, in arrears, the average AUM, for the period, and you can pay externally, not from cash within your account or by liquidating holdings. Please note, this external payment rule is changing slightly in 2018 for RRSP and TFSA (Registered plans) but will still remain the same for Taxable or Investment accounts (non-Registered). But it is key to note, that in a Fee-Based account, with an IIROC firm, you are paying once, in arrears, every 30-90 days, versus the possible 60 daily Mutual Fund fee (in a given quarter).

The question still remains, "What is my 100 Beeps to the MF sales channel getting me?" I'll claim it is not advice, because investing advice has two components; namely a Buy and a Sell. You can have a 'Paper Profit', but it is not realized until you sell. And if you Sell, your MF Sales Channel loses Beeps, there is no longer a commission for them (Embedded or otherwise). Do you ever sell a Seg Fund? Or a Target-Date Fund? Probably not, you Hold, so there is no Advice. Again, of interest, with a full-service IIROC investment advisor, you can Sell, and make a real profit. It is a commission to the investment advisor, if you are in a commissioned account, (these accounts are less than 10% of the accounts today). But in a Fee-Based account (more than 90% of the accounts today), you probably have 100, or 150 free trades (maybe more), and the advisor is still compensated if you are sitting in Cash/E (my own term for Cash and/or Equivalents).

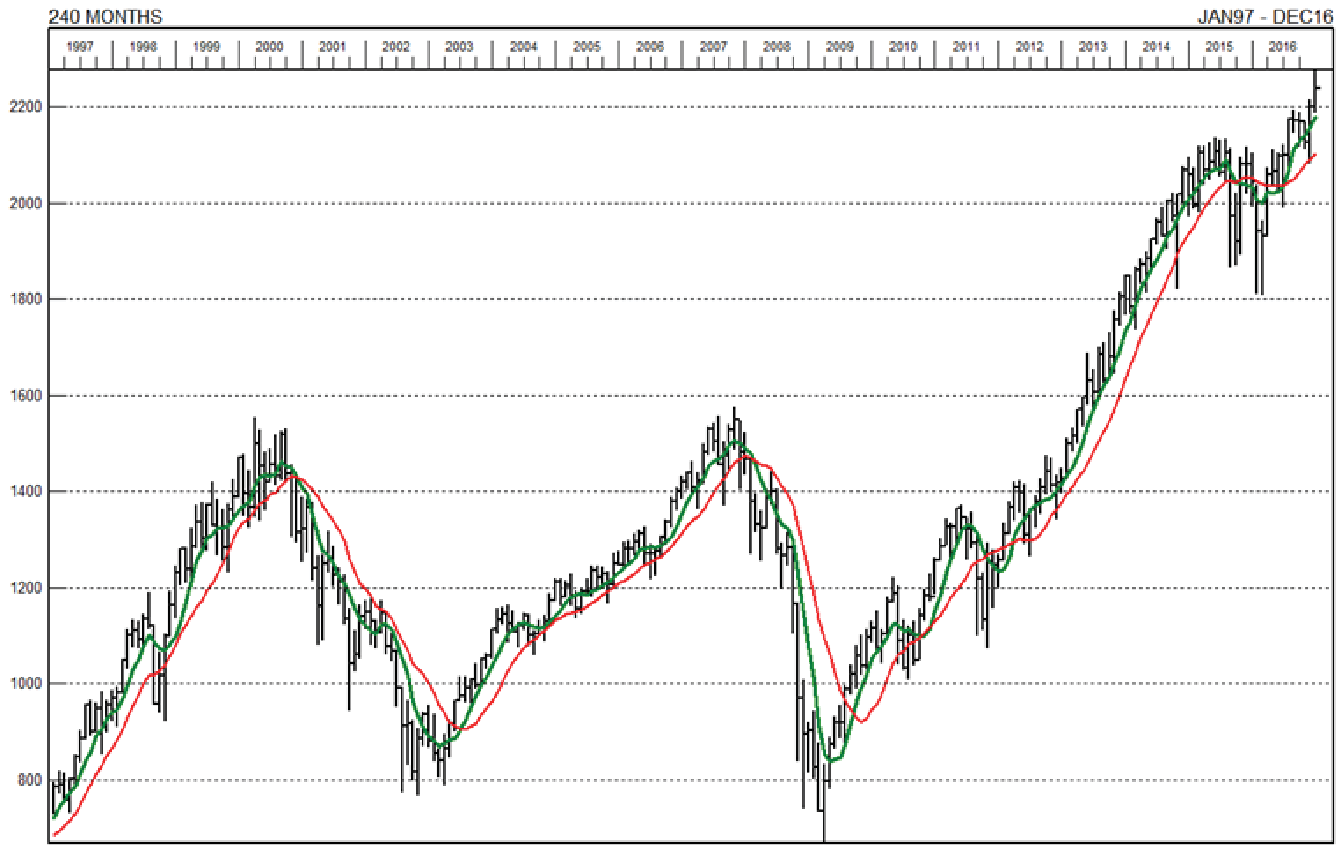
In 2016, there may have been a couple of times to sit in Cash/E. Brexit occurred in Summer of 2016 and in the Fall there was a USA election. And a pertinent FBI investigation. Then there wasn't an FBI investigation. Then the story continues into 2017. There was a FBI investigation. Then then FBI director got fired. Then there was a new FBI investigation. And on Thursday June 8th, we had ex-FBI testimont, and a British Election. All while 5 year Canadian GICs are yielding less than 2% and 'Trade Wars' are coming (ie. autos, lumber, dairy, etc …). Everyone has forgotten Chinese GDP, oil prices, real earnings, etc … but the point is that there may have been a reason to change Mutual Funds, if not Sell outright.

The 5 trading days surrounding Brexit are illustrated below. The market dropped for 2 days, about 900 points and then recovered in the next 3 days. No-one knew that in advance. You could have sat on the sidelines and slept at night. You may have wanted to Sell.

The USA election + Trump's victory was quite similar as well (but more pronounced), there was an overnight low but then an intra-day high that lead to the "march to 20,000" for the DJIA. But the Mutual Fund sales channel does not get compensated if you Sell and chose to stay in Cash/E; they lose Beeps. If you buy a GIC they lose Beeps as well.

If you look at the chart below, the last 20 years of the S&P 500, from 1997 to 2016, there may have been a couple of times to Sell. The last drawn-down, a Bear market between 2007-09, was 54% and took almost 5 years to recover. "Do you want to lose 54% or your current pay cheque?" If not, why lose (potentially) 54% of your retirement pay cheque. But wait, that can't happen now. So then don't look at the earlier drawdown of 2000-02 (a 49% decline I believe).

HNW investors can sleep at night because they have Liquidity. And professional Advice from the highest licensed advisors.. They can Exit & Enter the market, without impacting their Advisor Fee-Based compensation. Mutual Fund investors, aHNW and eHNW cannot achive this Liquidity.



John Grisham’s first book, A Time to Sell, I changed the title a bit to make the point, illustrates that if probably better to Buy&Rule ®, more on this at www.TrustedWealthProfessionals.com in the coming months as well, than to Buy&Keep-Paying-the-Mutual-Fund-Sales-Channel-A-Commission.

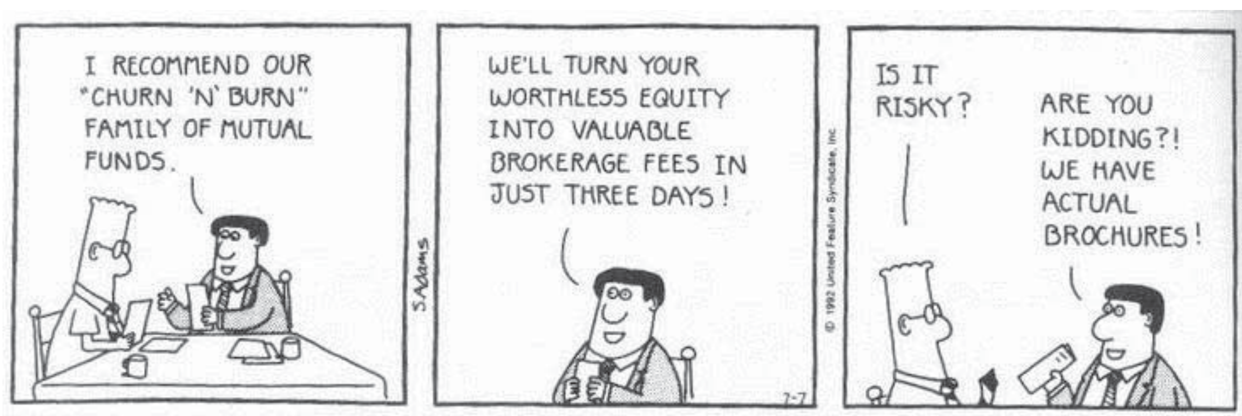
Sidenote: The Beep Brief was coined from another of John Grisham’s books, The Pelican Brief.

And before I’m accused of turning the Beep Brief into a personal commercial, or hate-mongering against the Mutual Funds industry, let’s concentrate on the topic of this subsection. You might need to be an industry participant, or sophisticated investor, to appreciate some of these thoughts, but here is why Mutual Funds are a ‘Commission Based Scheme’:

1. You don’t Sell if and when the professional Rules indicate to do so. What if the market was down 50% and headed down 49% more tomorrow, would you sell? Would you Sell if the market was up 300% and everyone in the world (Jimmy and Warren Buffet included) were screaming “Over-Valued … Get Out Now”?
2. DSC’s prevent you from selling (5-7 year contract). And in fairness to the much maligned Investors Group (and others) it appears that they are easing their DSC and re-DSC policies, but the wording in their latest press release (September 2016) implies if we’ve DSC-ed you before, we’ll keep DSC-ing you again. Known as the re-DSC. Maybe I’m wrong, but I have a friend with a total of $800k at Investors Group and his RRSP holdings

span over 50 separate Mutual Funds, each with a balance of ranging between $6,000 to $28,000. 50 Different Funds? Really? 50 Different Funds? How did this happen? Well, when the 5-7 year DSC clock started expiring on the Mutual Funds, the Investors Group Mutual Fund sales person kept shoving the now commission-free funds into a new Mutual Fund that paid the upfront DSC commission (this is the known as the DSC 'drug', 'pill', or 'juice'; pick your 'poison' for the correct term).

3. Seg funds encourage you to hold for 10 years. Why? They virtually never pay out (the insurance). And if you need Growth, you don't need to annually pay 300 Beeps (or more). And yes I know that some Seg Funds charge less; just ask the 27 year girl who got hustled into a Seg Fund by her company's Benefits provider. She doesn't need any of the Seg Fund insurance benefits when she has 38 more years to go before age 65.
4. Target Date Funds encourage you to hold 'forever'. Why? What do the 100 Beeps for the Sales Channel provide for, Advice? I say NOT.
5. ETF's have no commissions and overall lower product fees, but your MFDA or MFL (Minimal Financial Licensing) sales person cannot sell them to you. And there is no Commission for selling an ETF. Please remember that a MFDA licensed sales person is one of the lowest forms of licensing for financial products sales people; and I'll reiterate, I term this licensing MFL.

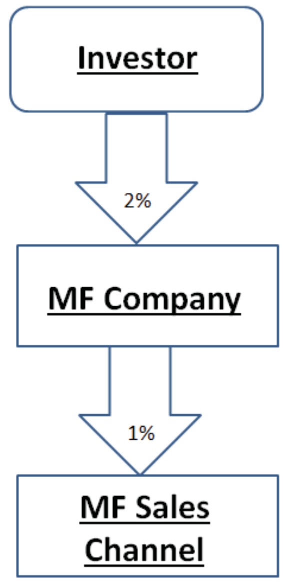


6. And Mutual Funds comprised of ETFs is just another way to keep paying Beeps (this is offered mainly via your bank). I'm astounded that Canadians' pay Beeps for this Fund-of-ETFs scheme. Quite astounded. Please see Solution 15.
7. Did you know your bank keeps an overwhelming proportion of the 100 Beeps typically paid to the Mutual Fund Sales Channel? So the Banks keeps the first 100 Beeps as the Mutual Fund manufacturer, and then the lion's share of the second 100 Beeps (no disrespect to the bank with the Lion-in-their-Logo; all Banks and medium to large Financial Institutions do this). It's known as Beep Hoarding. And it is quite profitable for the banks. That's why their Mutual Fund people turnover every 8 months, they want to sell Mutual Funds to you and get a full Beep Commission.

8. You paid for Beeps today to your mutual fund company when the NAV was calculated, but you don't know how much. You may have purchased the Mutual Fund through a Bank Teller, Mutual Fund Sales person, Insurance Sales Person or perhaps a Discount Broker, it doesn't matter, if the stock market was open today, you paid Mutual Fund Fees today and you don't know how much.
9. Discount Brokers, they prefer to be called Online Brokers, offer A-class, D-class and sometime F-class mutual funds. This may be changing (quite soon) and perhaps it will be enacted one day that D-class funds are not more expensive than F-class funds (sometimes). Better still, there's probably an ETF for your investing needs, that doesn't 'game' you in the highest Beep level; an 'A' class fund looks better to you then an 'F' class fund; think of school 'letter grading' to convince you why an 'A' is better than an 'F' and why this is part of a Scheme.
10. And there is always the nominal total amount of Beeps. Not Beeps a percentage but Beeps as a total dollar amount. CRM ½ only showed me half my Fees. The second half of CRM ½ (on track for 2018) will show me total fees; what the Beeps mean to my overall Wealth. I can't eat a Beep. Or spend a Beep. Everything has to translate back to dollars&cents. And this is a trick that was taught to me by an insurance sales person, human beings are bad at math, especially percentages. You can sell more to them when they don't understand the comparison to a big screen TV, a mortgage payment or a weekly grocery bill. If an investor is about to place $500,000 in a Mutual Fund with a 2% MER, tell them there are paying $10,000/year in total fees (not a 2% MER). Investors know if sales tax goes from 13% to 14% in Ontario, that the increase is 'not good' but they don't understand what difference a MER of 1.8% is versus a MER of 2.2% means; and this is amplified when the equivalent 'Indexing' ETFs is 0.07% to 0.25%. A Scheme is not portraying the Total Fees upfront, when buying the Mutual Funds, you have to wait for an End-of-Year-statement and CRM ½ + CRM ½ to understand what you really paid in total Mutual Fund Fees.
11. Over 30+ years of falling interest rates might mean that old ratios might not hold true in this period of sideways/rising rates (ie. Target Date Funds with Tactical Asset Allocation). The Scheme being that "Say Anything" and introduce new products at the top of a Bull market to keep the Beeps coming. Especially products like Seg Funds and Target Date Funds that lock clients into paying Beeps. Or DSC/re-DSC them at the top of the market. One day there might be a 'cooling off period' for Financial Services product purchases, but until then, Sell Anything will accompany Say Anything.
12. I don't understand why TERs, Trading Expense Ratios, appear to be uncapped. My gut feel says Bond Fund managers are going to have to 'trade' more frequently if interest rates keep rising. This seems to be an area where a blank cheque is issued to the fund manager. TERs = Beeps, but that's kept secret/unknown. The temporal update to this is that the USA mid to long bonds are not rising while Janet Yellen appears to be raising

USA interest rates in June. Possible inverted yield curve? End result, more Bond trading and higher TERs? Uncapped and unknown ETRs.

13. But the perhaps #1 reason why Mutual Funds are really part of a **Commission-Based Scheme**, think of this image below.



Where else in your life do you pay the manufacturer first? What item -- food, hydro, property tax, cellphone, gasoline, insurance, etc – do you pay the Manufacturer first? And then they pay the Sales Channel afterwards? This Scheme infuriates me; where else do you pay the Manufacturer who then pays the Channel (for consumer and commonplace products)?

Think about this. The Mutual Fund sales company has no bad debts, no accounts receivable, no collection agency, no invoices to their clientele, etc … It's all part of an Embedded Scheme. And Commissions are buried within this Embedded Scheme. And they pay themselves daily. Did you get paid today? Do you get paid 238 times a year? That's 250 working days minus a few statutory holidays.

There are 3 Known's in the Investing World:

1. There are Guaranteed Investments (think T-Bills, not Home Capital GICs)
2. There are **non**-Guaranteed Investments; pretty much everything else.
3. But, there are Guaranteed Mutual Fund Fees/Commissions. So much so 'Guaranteed' they're perceived as a form of Entitlement. A Right. If it is a Monday, Tuesday, Wednesday, Thursday or Friday, but not a market-closing holiday, you paid your mutual fund company today. But chances are you get paid bi-weekly, once every 10 business days. Albeit small payments, but you are paying daily your pro-rated Beeps/MER.

That's why it is a Scheme.

Point # 1 – Second Half – "semi-liquid asset class"

Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.

If you have purchased a Labour Sponsored Fund, for the upfront tax break, you might have found that there are only 2 very short windows per year to sell your investment (it is possible the window is only open for a few minutes, I'm not joking). Illiquid.

You might have purchased a top-off-the-market exotic Structured Note, fully well knowing that you need a few phones calls, and possibly a few days, to sell in a Secondary market (probably below market value). Illiquid.

And you've got any stock, bond, or ETF in the world, and the local stock market is open, and you can sell (or even buy more). Liquid.

Those are the definitions of Illiquid vs. full-liquidity. But Mutual Funds are semi-liquid. You can Sell or Buy at 4:01pm EST, after the TSE or NYSE has closed (we're using the common exchanges for reference). You can't Buy or Sell during the trading day, but you don't need to wait Days to transact. Semi-Liquid.

So as I type the Beep Brief, I occasionally glance at the clock, it's 11:33am and then 2:28pm, I just heard that Bombardier is receiving consideration from the Canadian Government. My belief is that there are 10 more years of growth in Bombardier and I can buy the individual shares (BBD.B) or an ETF holding the shares. Right now. Liquid.

But not with a mutual fund. I have to wait until to 4:01pm to get 'filled' (and only then will I know the final price). But that's only the case if place the order online. It's the same scenario if I want to sell BBD.B as well (or the ETF holding BBD.B). I just want to sleep at night. I don't want to even buy GOLD (that's Randgold Resources Limited). Same goes for Nike, TransAlta, Amazon, CIBC, etc … if there's news, or if I have idea that is percolating in my brain, I can buy or sell individual shares, or ETFs, when the market is open, but with a mutual fund I transact when the market is closed (seems 'weird', almost counter-intuitive to the word 'investing'). Semi-Liquid.

And if I'm not online with my Mutual Fund company, if I deal personally with the mutual fund sales person, or her/his company, then I need to pick up the telephone. I want to Sell my Mutual Funds. Let's assume that interest rates are rising and are now at 18% as they were in the mid 1980's and I want to sit in GICs. All my friends are doing this now. Or even more plausible, I just want to have 6% a year as a rate of return, net of fees; pension style investing.

And I want to sleep at night. I've met my objectives for the year, I'm good with stepping out of the market (there is a lot of turmoil at present). So if you want to Sell your mutual funds, the sales process has now reversed, you are going to have to be really persuasive because there is a Loss that is going to occur. A Beep Loss. To the Mutual Fund Sales person. And a Beep Loss Prevention Mechanism now kicks in. You're essentially replacing a non-Guaranteed investment return with yourself (you are the investor) and taking a Guaranteed Commission away from a Sales Person. There is going to be a 'fight' to keep the Mutual Fund Sales Person's Beeps.

But aside from the human interaction, convincing the person who Beeped you, to unBeep you, is an effort that the retail investor is not well enough armed enough to undertake as the Beep Loss Prevention Manual possessed by the Mutual Fund Sales Person is quite extensive.

The bottom line is that Liquidity matters; if the underlying systems don't allow you to transact when you want to, or the Mutual Fund Sales Person doesn't want you to transact (ie. Sell) when you want to, you've been denied liquidity and by then it is too late. Bad Outcomes prevail.

Note1: I have taken it upon myself not to convey portions of the Beep Loss Prevention Manual, other than to say, the best counter starts with Liquidity Paper from yourself. Perhaps a 'play' on Liquid Paper, but your Liquidity Paper starts with a T2033/T2151 for different types of Registered money, or an Account Transfer Form from your new institution (they'll handle it for you). Allow 2-4 weeks and there might be small fees ($150 –ish) along the way. Either way, your investments are not permanently held at any Financial Institution; so your TFSA, RRSP, Pension, Taxable/Investment, RESP, etc … accounts can be moved where necessary. REPEAT – The Beep Loss Prevention Manual is where the Conflict of Interest arises; the Advisor will not prudently 'raise' Cash/E because she/he doesn't get a commission cheque (possibly a Clawback as well; it depends upon the Commission Scheme and Billing System deployed).

Note1 Caveat: You'll soon find out if you have Proprietary products, Deferred Sales Charges (DSC's) or other exorbitant fees within your account holdings+investments. Try to determine if you have 'Fee Creep' when moving your assets as well; that is unknown and increasing Fees that keep Creeping/Popping-Up when you're moving assets. And I've been asked a few times already, "Should I move from Investors Group to a full-service IIROC life-licensed investment advisor, without knowing what my DSC fees will be?" And my answer is that assuming you have a worst case 250 Beep DSC Holdback, you might find that Fee-based full-service IIROC life-licensed investment advisor actually costs you less over a 5 year investment time period, thus justifying the Fees. I won't use Fear to make this point, that Buy&Hold-ing through a 54% market is minor compared to 250 Beep DSC Holdback. Nor the point that full access to all investment Products, Services and Styles trumps the restrictive proprietary offerings. But I'll go out on a limb to that say that if we know 50% of marriages end in divorce, mainly based financial issues, then 50% of financial relationships end because of non-financial emotional issues (ie. Trust or Betrayal; I saw this on Oprah a few years ago). Anyways, you'll know when to issue your Liquidity Papers. Your new Wealth Institution can help you in this regard.

I'm not saying you need to stay invested, or exit the market, or rotate holdings through your portfolio, but if the Embedded Commissions Scheme are affecting your liquidity, either monetarily, procedurally, or psychologically, through word-of-mouth with your Advisor, or not, it ultimately affects Liquidity.

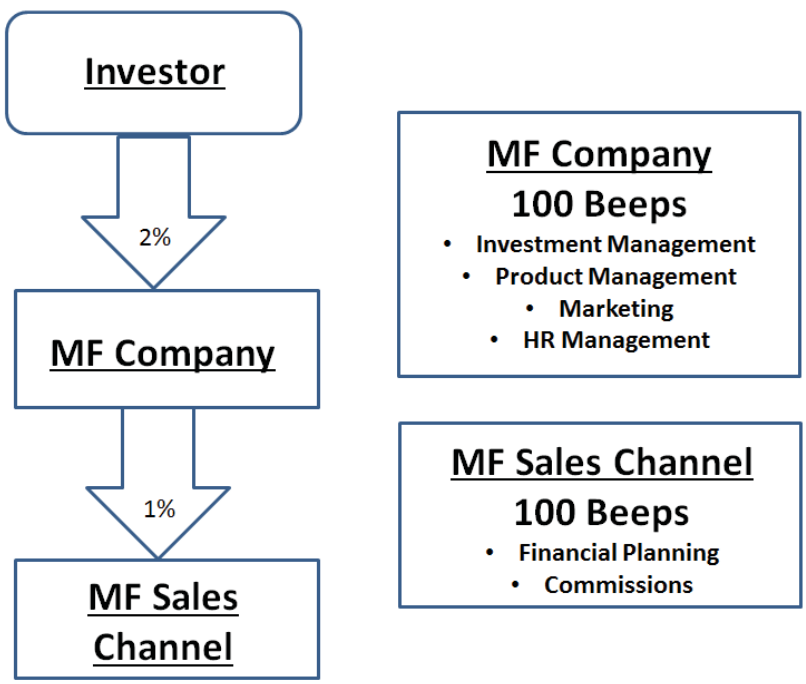
And lack of Liquidity is not good for Investors' Outcomes.

Point # 2 – Commission Laundering

The Mutual Fund Industry is guilty of Commission Laundering

Phew. I came to this conclusion, rightly or wrongly, by Googling and chatting with a variety of financial professionals. There are great articles on the Globe and Mail's website and Advisor.ca that deal with 'deductibility investment management fees'. If you Google that 'string', they will be the first few hits, and feel free to avail yourself of them. But I do think I'm correct in this regard, so here goes.

The background to the Laundering claim is that the entire MER, 200 Beeps, is deductible because it isn't a Commission and it isn't Financial Planning (both non-deductible by the CRA). Thus the entire MER is viewed as Investment Management Fee or Product-related fees. The 100 Beeps for the Mutual Fund company is clearly not Commission, as it is Investment/Product management fees. OK, I hear you, but I don't buy it. So let's look at the Beep Flow.



My thinking is that I have explained in Point 1 that there is no Advice nor Service within the Mutual Fund Sales Channel so the second half of the 200 Beeps paid by the investor, 100 Beeps, should not be deductible. It's a Commission only (and why you would keep paying it annually is criminal).

I know this is upsetting. And I have seen the IFIC breakdown on where the 200 Beeps are spent. And I'm not even concerned about why an ETF can deliver the same 'portfolio' for 4-7 Beeps, but we'll use 30 Beeps as an average (thanks CETFA for this fact).

MF Company

100 Beeps

- **Investment Management**
- **Product Management**
- **Marketing**
- **HR Management**

ETF Company

30 Beeps

- **Investment Management**
- **Product Management**

MF Sales Channel

100 Beeps

- **Financial Planning**
- **Commissions**

I haven't exhaustively surfed every Mutual Fund company's website, just a 'chosen' few, and I've read advertisements in the Globe and Mail (32 years and onward of continued daily reading), but I have noticed the word 'Commissions' with every description of Mutual Fund fees. That alone doesn't make the second 100 Beeps non-deductible; especially if I'm on the Mutual Fund company's website and it is the Sales Channel I'm concerned about.

And it doesn't matter that there is 'wordplay' regarding the words 'Advice' and 'Service'; it seems Commissions are the new 'Service'. Please ignore the spin.

Also, the presence of Mutual Fund Sales Persons T4 slip , or really the T4A, perhaps T5, but mainly T4A, for Commission Income isn't proof enough that the second 100 Beeps are really a Commission.

It boils downs to the fact, that beyond the Financial Planning, Licensing matters. Selling a Mutual Fund, with a Buy&Hold approach, DSC-ed or not, with an accompanying Trailer Fee, is a Commission. Because your Advice is always not to Sell; the second half of investing (Buy-ing first and then Sell-ing second). And that is non-Advice. And also not 'good' Advice.

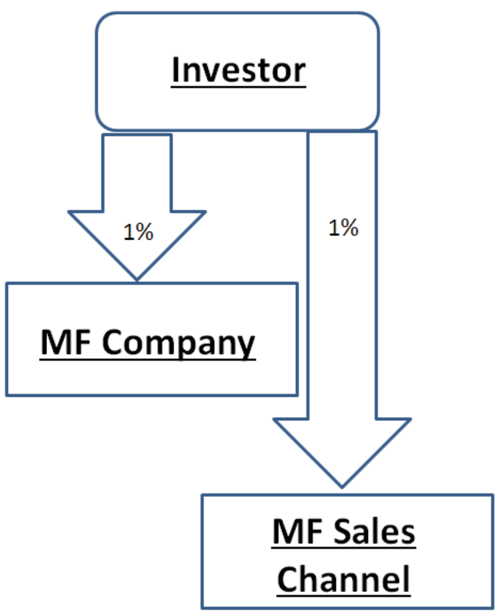
A Full-Service Life-Licensed IIROC advisor, hopefully one who practices Buy&Rule ®, and doesn't suffer from Financial Decidophobia (fear of making financial decisions), actually makes Buy&Sell decisions daily. This includes Portfoliio re-balancing via Buying and Selling, profit-taking by Selling, Buying new issues, Buying and Selling for Tactical Asset Allocation purpose based on KYC's and IPS's. Whether it be within a Discretionary account or not. In a Fee-Based account, this is not Commissions. This is Advice. This is Service. Deserving of Beeps. The full-service IIROC advisor does this daily, it's part of the work they do work clients. Mutual Fund Sales People do none of this, they aren't licensed to do so, they don't do any of this Buying and Selling advice. Sure they perform minimal KYC and IPS efforts, but not deserving of Beeps. Yes they perform some FinPlan work (I'm not sure of their licensing in this regard), but that's non-deductible work anyways.

If you don't have the Licensing, with corresponding Education, where the daily practice of evaluating Buying&Selling decisions exist because it is your job, then the second 100 Beeps is non-deductible. It's a Commission.

And it is Commission Laundering because if the same 100 Beep fee was payable directly the Mutual Fund Sales Channel it would be only Commission.

Buying&Holding a Mutual Fund, let's say 7 years until the DSC wears off, is not Advice; this is ignoring that there could be a 'Time to Sell'. Sending me a statement quarterly telling me the value of my holdings is not Service; it's a necessity, perhaps just to get into the Wealth Industry 'game'. Trying to make the argument that Commissions = Advice = Service because the MER is paid to the Mutual Fund Company, doesn't mean that a Commission is not a Commission.

In the following picture, if the second 100 Beep fee was payable directly the Mutual Fund Sales Channel, the payment would be recorded as a Sale; possibly deserving of a commission.



And if the compensation to the Sales Person was 100% variable, they had no base pay, and was based on Beeps, it would be a Commission for sure.

In the case of the Banks, where they sell their own proprietary Mutual Funds, through their branches, the Banks 'Beep Hoard' and the Teller (they were called Front Line Advisors in a recent CBC investigation), only receives a Bonus. A small bonus what I've learned; the bank Beeps Hoards the majority of the second 100 Beeps. That is why there is incredible turnover at the banks with respect to who is managing your account. The good Tellers get their CSC licence, join an IIROC firm and encourage Follow-Me-Beeps (while referring back to the replacement Teller, who soon has a depleted 'book'). The disgruntled and perhaps OK Tellers get their MFDA/CLU license and cherry pick their 'bank book' by High-Beeping (migrating their HNW clientele and possibly locking them in with Seg Funds or Target-Date-Funds). But all of this is reality only because a Commission, evidence by a Beep payout and lack of Licensing/Advice, is really a Commission. Laundered or not.

Of note, if you can't go to Cash/E because of the Sales Channel compensation scheme, please start completing your Liquidity Papers (transfer to another Wealth firm, perhaps via a Trusted Wealth Professional).

Consider this Compensation grid below. Based on the person serving you (so you can't skirt the rules and have one IIROC person, in a province far far far away, that is the defacto or totem IIROC person in your firm).

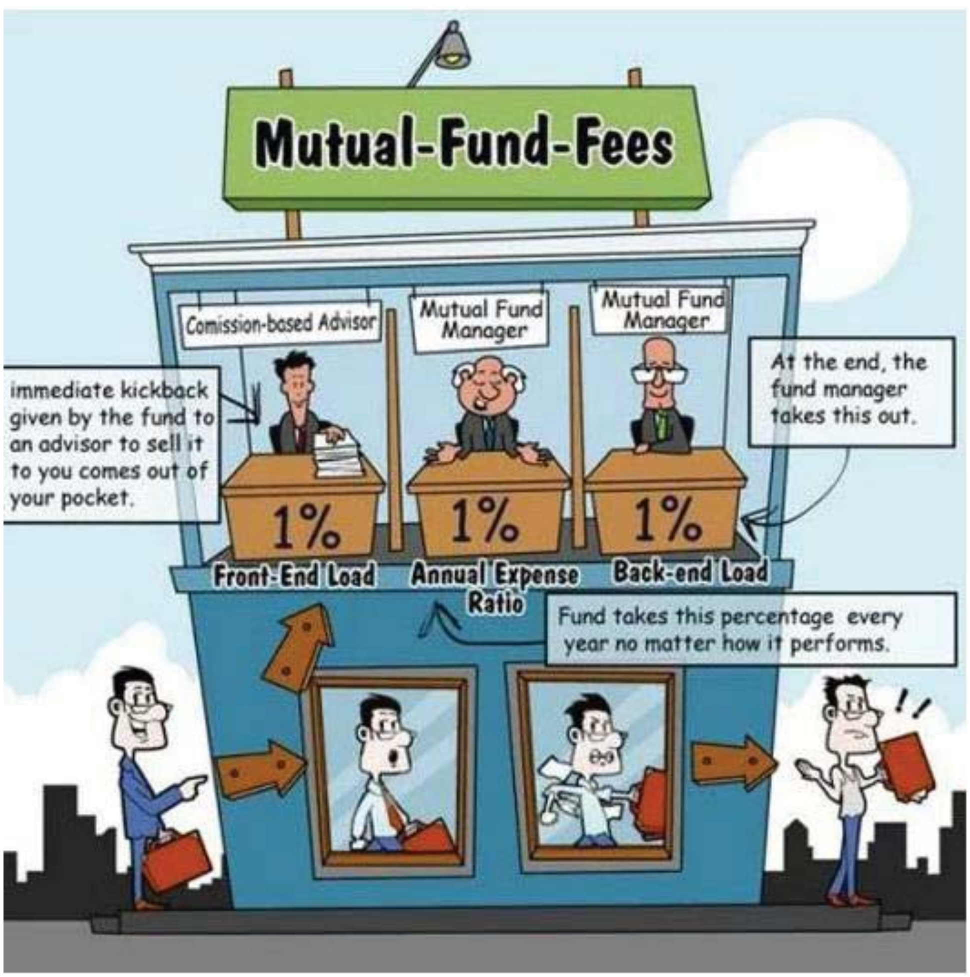
Licensing & Compensation	**Non-IIROC-Licensed** Ie. MFDA, CLU, other	**IIROC Licensed**
Compensation Alternatives	Flat bonus or tiered structured (can't look like a Beep). Can't be Laundered via creativity.	Beeps or other. All options available

There is more to share in the **Solutions** section of the Beep Brief (see Beep Ban; Solution #2), but my viewpoint is that if/when the CSA discontinues Embedded Commissions, the Mutual Fund Manufacturers and Sales Channel will have to get very innovative as they've had the good Beep life for 30+ years. Uber-like disruptive solutions and Robo inspired innovative FinTech platforms are coming; until a Bear market surfaces.

Nothing moves in a straight line. Bulls and Bears are conjoined. And the lack of Advice in a Bear market will be catastrophic as more and more Boomer have invested in the Equity market, and interest rates up/down will affect the Bond market. Canadian's need Advice, and they are not receiving it at present, because if they were, the Asset Mix of Mutual Fund investors would look more and more like that of the HNW at IIROC based firms; where capital preservation is a concern.

But no Mutual Fund Advice means Commissions only, and Commissions Laundering, as the 2nd 100 Beeps would not be deductible if the Mutual Fund Sales Channel had Commission based accounts (vs. Embedded Commission today). Or if you paid the Mutual Fund sales person directly, it then be a Commission.

After-thought. The 'Advice Gap' has been bantered about in the press as a 'hole' where upscaling the Mutual Fund Sales Channel would leave small investors without Advice. Robo's will address this marketplace. The real point is that there won't be free Beeps to the MFDA-licenced Mutual Fund Sales People any more. The small investor (aHNW) will probably be 'moving up' with respect to Advice + Service when they deal with a Robo as there is a Portfolio Manager and Discretionary component to this Beep-based channel as well.



Quick Summary (from an email I typed to a friend), regarding Advice

Oxymoron: Mutual Fund Advice

3Points

Point1. IMHO 'Advice' has to include 'Sell'. If you're not Selling, and only Buying, as in Buy&Hold, then that's a SalesPerson. It's the new KYC – Know Your Commission. Plus 'Selling', perhaps through Rules-Based-Investing (ie. Buy&Rule ®), allows you to take profits and minimize losses. That's why Investing is Buying&Selling. Just Saving, approximated buy Buy&Hold is a Sales-effort, from a Sales-person (proprietary offering or not).

Point2. What is Advice? The definition of Advice? It cannot be FinPlan because we know that is not deductible. So if you had to contrast Advice vs. FinPlan (from a Mutual Fund or Bank Teller's standpoint), I'd think you see that everything is FinPlan or a Sale. Holding a Balanced or Conservative or a Diversified or a Seg Fund or a Target-Date Fund, based on a Pie-Chart, is not Advice. It might be that the Mutual Fund industry is terming 'un-licensed FinPlan advice' as Advice. But it is still non-deductible by the CRA; if it is a FinPlan then it is a FinPlan (whether you have MFDA or CFP designations).

Point3. Licencing matters. We might as well say there is no Advice unless you're CSC-ed and IIROC-ed. Therefore investors via MFDA and other Proprietary Product sellers (ie. Insurance, Bank Tellers, Investor's Group, MD Management, etc …) are getting no Advice unless the person in front of them is CSC and/or IIROC. And the counter-point is that there are IIROC-licensed individuals who are dumbing down their offering, becoming relationship managers, and just acting like MFDA or FinPlan folks. That's a shame as well; 'Bad' IIROC Advisors.

No Advice means Commissions and thus that is Commission Laundering. Sure, the eHNW, HNW and UHNW, who are still in Mutual Funds might feel as if they are getting paid special attention because of their AUM, but it is still not Advice. Perhaps the challenge is to assume everything related to an Embedded Commission is not Advice, and let it be proven otherwise.

Or perhaps unless you can sell all the products, ie. ETFs. Stocks, Bonds, etc … your offering is termed a Commission (that gets Laundered in the current system).

BONUS Point – DSC Month

In 2017, DSC Month, or re-DSC Month, will be October

Usually every month of the year is DSC month. But this October will be extra special as the Mutual Fund managers who feel threatened by the upcoming second half of CRM ½, and a lot of great new Regulations, will be under sales pressure when 3Q17 has completed. So, 270 days will have passed in the 2017 calendar year, sales figures will be calculated, and year end projections plus plus commissions (via T4A) and bonuses will be closer to being envisioned within a Mutual Fund Sales Person's personal bank account.

Or perhaps it will be DSC Month, just for the purpose of keeping your job.

The Mutual Fund sales people will be passing this message along to their Sales Teams. We may have started to return-to-the-norm in the markets, the press will remind us of October's market performance in an odd-numbered year, the Black Swan could be Donald's wife leaving him, USA GDP may be tracking above 3% or below 1%, and European elections in Germany and Italy will be closer (if not passed already). Italian elections might be the next Brexit.

So why will this October will DSC Month, or re-DSC Month? There will be a Social Explosion far worse than French's ketchup being un-shelved. It may not play out in the press, but the sales pressure to lock-in customers will go through a 'last hurrah'.

I'll present a few diagrams of possible industry turmoil and changes in the **Solutions** and the **Crystal Ball** sections of The Beep Brief. But the last chance to get mega Beeps, the biggest commission cheques possible, for the Mutual Fund Sales People (Managers and Teams) will be October (the sales cycle could close in November or December, but it will start in October). Decent weather, a mindset that isn't on Santa Claus, CRM3 possibly to be enacted in the Insurance Industry in early 2018, all will drive the frenzy. The weak Sales Person performers, and the lowest 1 or 2 quartile performers, may find themselves selling Real Estate.

Summer will be slow, but in September the marketing campaigns will start in earnest. ETF fees will be shining a light on Mutual Fund Marketing (and associated HR staff). And door-to- door tactics will be employed; the ability to 'Say Anything' to get Beeps will surface. Insurance has already moved online and underwriting below 55 is no longer required. Lots of multi-channel competition with Robo-Advisors, all based on 3Q17 performance numbers and knowing that 2018's RRSP season is right around the corner.

The Beep Battle will be on center stage. This might be the last year of Easy Beeps. 'Say Anything' to 'Sell Anything' and lock-in Beeps will be the marching orders. And DSC's offer the best payout Commission payout (to the chagrin of the Canadian Investor).

"I'M HAVING TROUBLE SLEEPING, ROB. DO YOU THINK YOU COULD EXPLAIN, ONE MORE TIME, HOW YOU PICKED OUR MUTUAL FUNDS?"

Summary (before Solutions are presented)

Stop the Construction.

It's actually Destruction … to Canadians Wealth.

Ending Embedded Commissions will reduce Titles and move assets to Robo-advisors. Please see the **Crystal Ball** section after **Solutions**. You still solve a ton of problems in the industry including Best Interests and Titles. And Seniors can still have Commissioned based accounts, make 5 trades/year, and get GICs, T-Bills, Rate-Reset Preferred Shares, etc … from IIROC-based advisors.

The investment Style practiced by the Mutual Fund industry is Buy&Hold. But this is really Buy&Keep-paying-me-my-Commissions. Investing is about Buying and Selling, Buying good quality assets when they are undervalued and Selling them when they are overvalued (in general). But in the Mutual Fund arena there is no Selling and it isn't their limited licensing (MFL – Minimal Financial Licensing) that encourages them to turn a blind eye to Selling, or their lack of product availability/choice, it's their Commission plan, the Beeps, that encourages Mutual Fund Sales People to sell the Most Expensive Fund with the Highest Margin (proprietary products) with the Highest Commission. Embedded Beeps, with DSC's, rule the day.

'Say Anything' to 'Sell Anything' with High Beeps is the mantra.But the overall thesis of the Beep Brief is these 2 main Points:

Mutual Funds are a commission-based scheme masquerading as a semi-liquid asset class.

The Mutual Fund Industry is guilty of Commission Laundering

And this Bonus Point

In 2017, DSC Month, or re-DSC Month, will be October

I applaud the CSA for this undertaking regarding discontinuing of Embedded Commissions. They have done their home in CONSULTATION PAPER 81-408. There are many facts and a ton of details in the 169 page document.

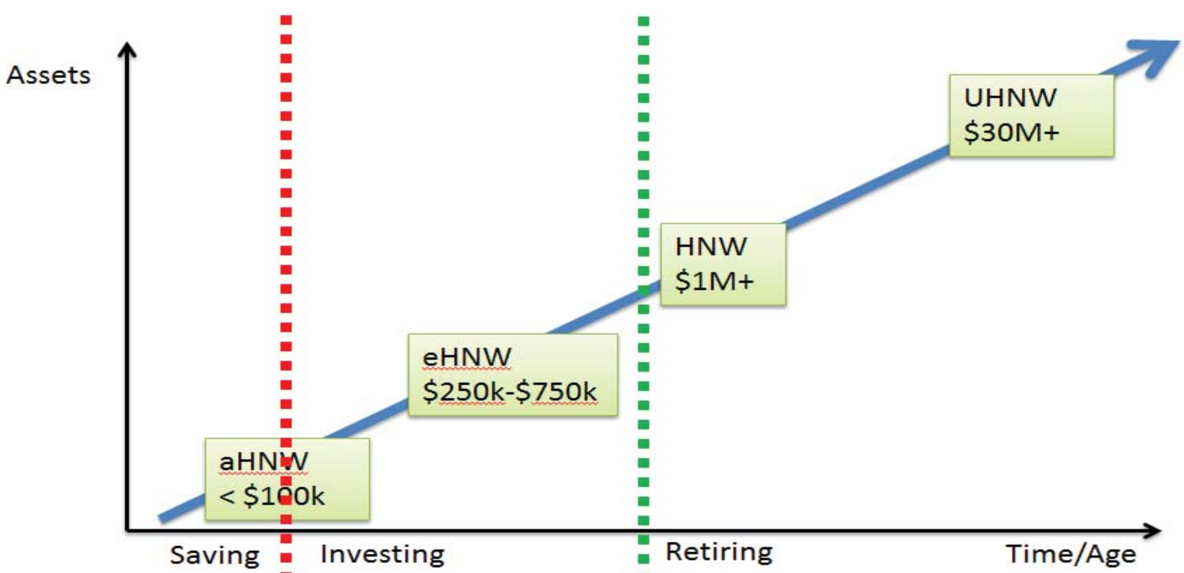
Removing of Embedded Commission enhances the Canadian Investors' Liquidity. And Liquidity is good for Best Outcomes.

I know it is scary for the Mutual Fund industry to accept the removal of Embedded Commissions, change always is.

And that reminds me of this visual.

Do you know what this chart is? To me, it looks like nothing moves in a straight line and within the up-sloping Trendline there are Ups & Downs along the way. I'll give you a hint, it's almost a 20 year period, of an Index, that is near and dear to Canadians' hearts ♥. It shows there are times to Buy and times to Sell, and there was also a 10 year flat period as well. And this is on the Home Page of www.TrustedWealthProfessionals.com as well. Do you know the Index?

There have been ill-advised wording changes recently by the Mutual Fund industry, one of them is 'Investment Funds' replacing 'Mutual Funds' (it really means Beep-generating Funds). It reminds me of conversations I've had in the Pension marketplace about people who will 'Say Anything' to get Beeps for AUM (Assets Under Management). At some point Canadian's will transition from Saving to Investing. And then at a later point, they'll move from Investing to Retiring. As they traverse these 3 stages, they'll need Growth, Growth+Income and finally Income from their assets. I've arbitrarily depicted this below, in the HNW Spectrum graph I portrayed earlier in The Beep Brief.



And Canadians' can't keep losing Beeps to the Sales Channel. Beep Preservation is paramount as Canadians will need to keep in mind these 2 emerging facts:

1. The Government cannot look after you, to your current standard of living.
2. You'll need more money/assets than you think. Whether it is because you're living longer, or inflation, or whatever. You'll need more money/assets.

So the opportunity exists now to Rule Your Wealth.

And I don't agree in its entirety with the argument that Canadians need to become savvier with respect to their financial choices. The Wealth industry has to be presented to Canadian investors in such a way that the correct Choices, and Best Outcomes, are the default settings.

If you consider a food supermarket, any one of the larger chains will do. You walk in with cash (or a debit card) but no credit card, and in any aisle there are all the products side-by-side, with Nutrition labels (albeit still confusing). Your health choices have now been narrowed down for you. So have your spending limitations. Gasoline prices are generally 'displayed' so as to be seen from a distance. Store flyers, online or in a newspaper, are everywhere; there are specials, there are sales. But in the Financial Services sector, the overall Wealth industry, there still is mystery, hidden costs/fees, a non-transparent Embeddedness, that does not serve the Canadian consumer/investor. This leads to Beep Profiteering. And it creates sub-optimal outcomes for Canadians overall.

Canadians' need Investing Liquidity. They need Fair Choice. They can't deal with all the Schemes and Billing Systems. They need Advice, real proper Advice. Without Conflicts of Interest. At present, en mass, Canadians have the Wild Wild West of Products & Fees, with no real Service or Advice defined. The last I heard was 23,000 Advisors, with over 20,000 securities, creates a mind boggling array of investing Permutations and Combinations. Note: I just saw 120,000 'Advisors' mentioned in a CBC article on Sales Practices at Big Banks.

Ironically, the CSA has an opportunity to provide Leadership to this plethora of Choice + Customization by making the default option the Best Possible Outcome (see Solution #1).

But as an industry-whole, the Mutual Fund Fees can be formulized to be:

No investment Advice
+ Various levels of Service/Statements
+ Embedded Fees/Commissions
+ None-to-Great levels of FinPlan (Financial Planning)
+ MFL (Minimal Financial Licensing)
= Commissions Scheme

Don’t let the Advice BS (Big Story) fool you, Embedded Commissions, in the overall Wealth industry, Financial Industry, the Insurance Industry, etc … are not in the Canadian investor’s best interest. Embedded Commissions affect Liquidity, and the denial of Liquidity affects overall Best Outcomes; evidenced by Wealth/Asset performance. Embedded Commissions does not equate to Advice.

Thank you again for your time and consideration when reading this Beep Brief. I do have enough material for the second phase of the Beep Brief, but that is for another day.

I'll get on to the Solutions now.

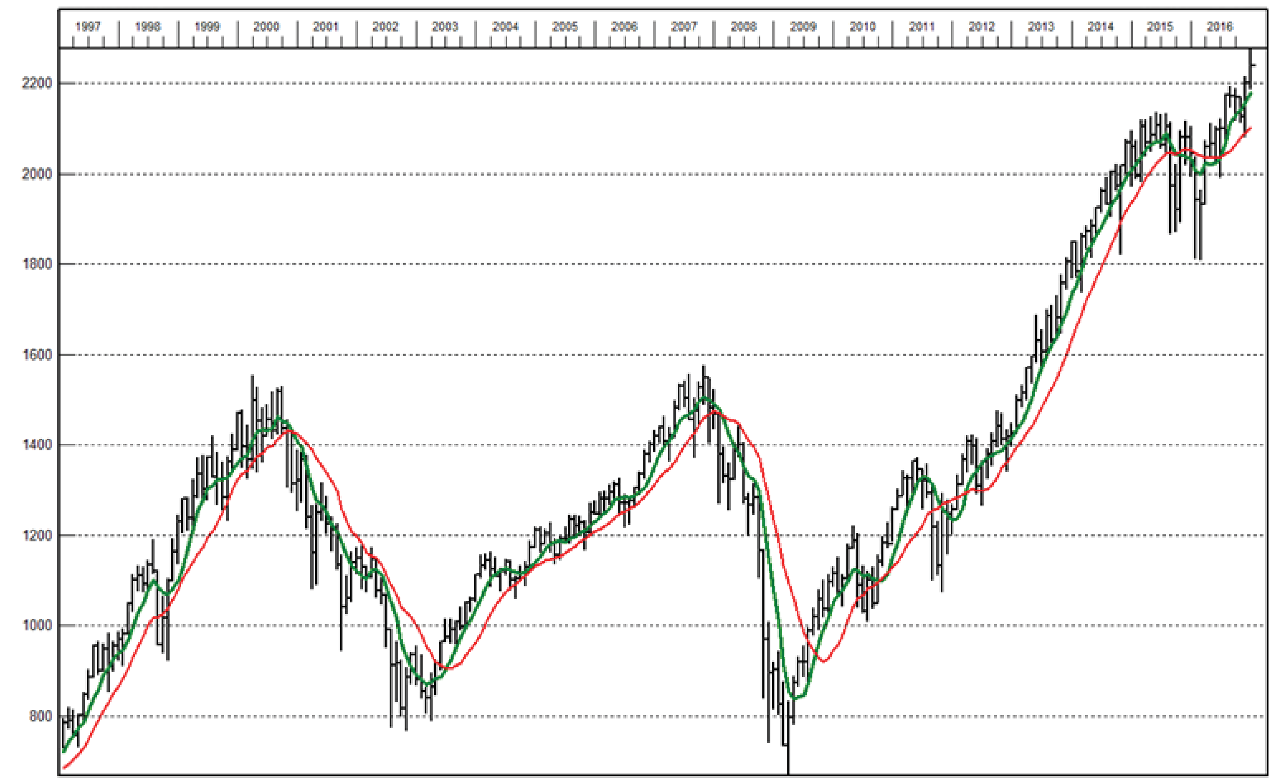
And thank you again for your time.

Solutions – Before the Crystal Ball

Solution 1 – Must see IIROC Advisor in order to receive CPP and/or OAS

One Bear market, will diminish Canadians Wealth drastically. And stress all levels of Government. The quasi-Bear market could be a return to the 'norm' slowly over the next 5-10 years; that's stagflation. And again, stress levels of Government.

Was the Mutual Funds Sales Person's Advice, or Mutual Fund company's Advice, ever to get out of the market? Do they really want Canadians to participate fully in a 54% decline; last evidenced between 2007-09? Or a Dot-Com rise into a decline of 49% during the Dot-Bomb?

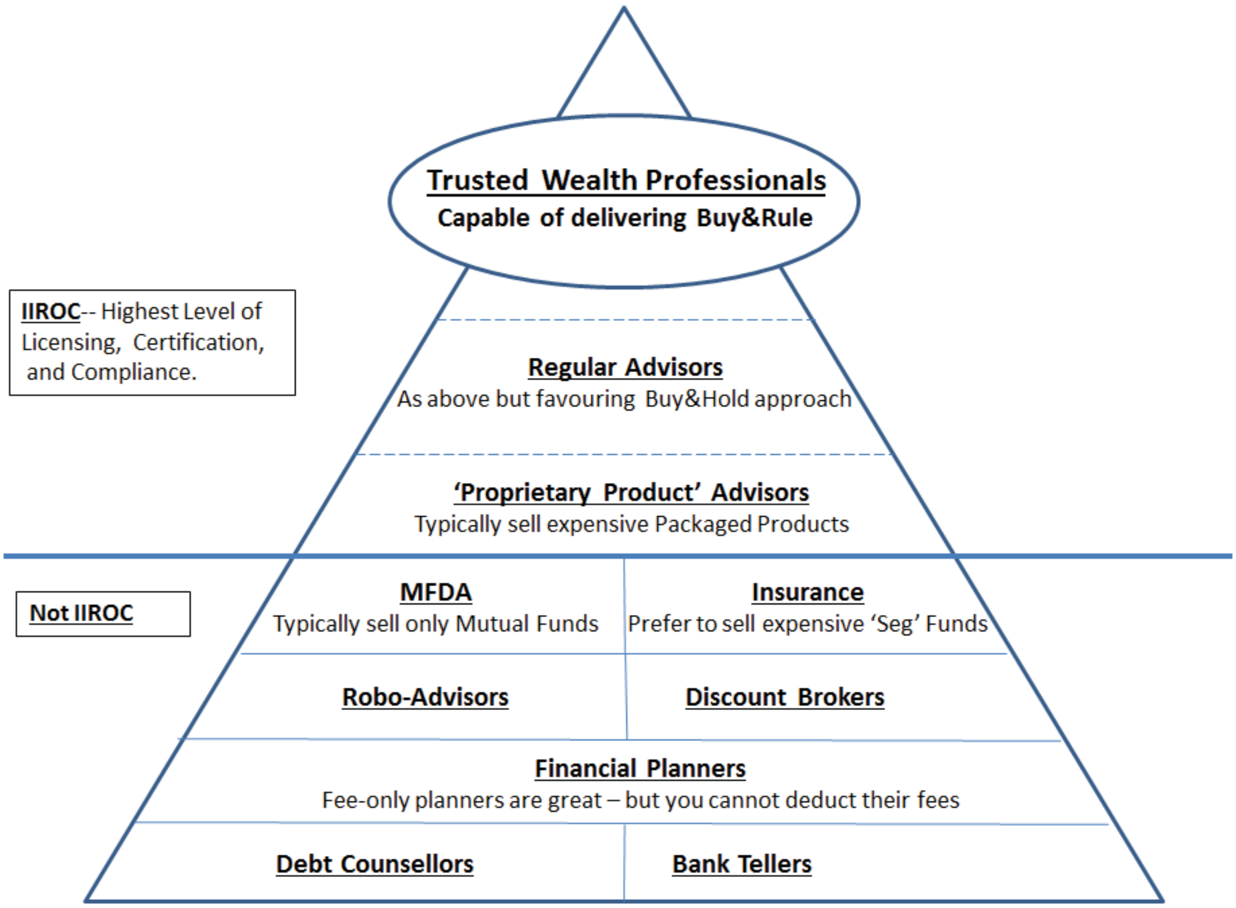


I'm not fear mongering, I'm just illustrating history. In the chart above, over the last 20 years, there have been two major Bear markets. The market moves in Bulls and Bears. It goes up and down. It doesn't move in straight lines.

A new law/regulation is coming. Mandated by the Government.

If you're entitled, and you want your CPP, and OAS, you must go see a full-service IIROC life-licenced non-proprietary investment advisor. Every 2 years. Starting at age 55, maybe age 45, or when your investible assets (across all accounts), surpasses $100,000.

Note: Average 'book' for an IIROC advisor is $150M across 150 'families', so $1M per account. This is the type of advice/service that we want to connect with Canadian investors.



Note: TWP Triangle explained in Solution2

OK, bold and new and innovative thinking, Yes. Scary to a lot of industry participants at present, YES. But if you have an emissions check on your car every 2 years, and a principal residence designation now on your tax return, etc ... it's an easy extension. The government, so that is Justin, Bill and Stephen on a Federal level and Kathleen plus Charles on the Ontario Provincial level, mandate that you must signoff on a bonafide visit/consultation with someone that can open your eyes to all the investment products and services. And perhaps all the investment styles. And Fees aussi.

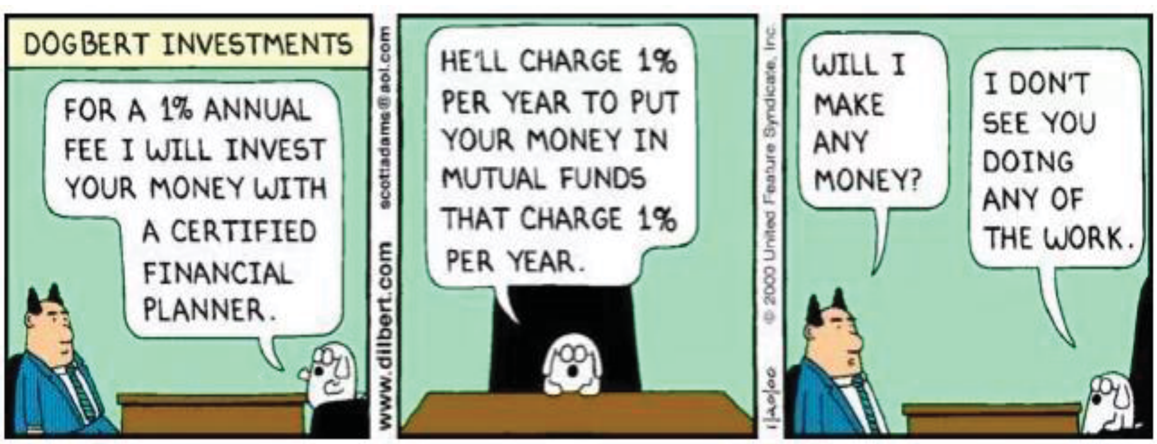
Re-Cap: If you want/need your CPP + OAS go see a Trusted Wealth Professional (TWP). A full-service IIROC life-licensed investment advisor. Not MFDA. Not insurance. Not a Financial planner. Not a Debt Counsellor. And not anyone from your bank (ie. Teller).. And not a wannabe 'bad' Full-Service advisor (who jiggles or trades on Mutual Funds based on the sway of a free lunch from a Mutual Fund company). But rather a true TWP who can practice capital preservation and understands the usage of Tactical Asset Allocation. A true TWP who can go 100% cash (or equivalents, termed 'Cash/E') if the investments + market dictate so. I can sit in

100% cash/E in my accounts – can you? The next best option is to slide to the safety-end of your IPS ranges (ie. 10% equity if the range is 10% to 60%). An Investment style of Buy&Rule ® inherently includes the needed 'flexibility' and appropriate Licensing.

Why? We are increasingly every day so much more dependent upon the government to look after us. It's astounding. And despite a few great ideas I have to change this dependency, I can't cut this umbilical cord. But the Government, at all levels, needs to make sure that we Canadians grow up and can look after ourselves. And we can't do it ourselves with the Up-Selling, Cross-Selling, Locked-In Products (proprietary or not), and Beep-based schemes within the overall Wealth/Financial sectors.

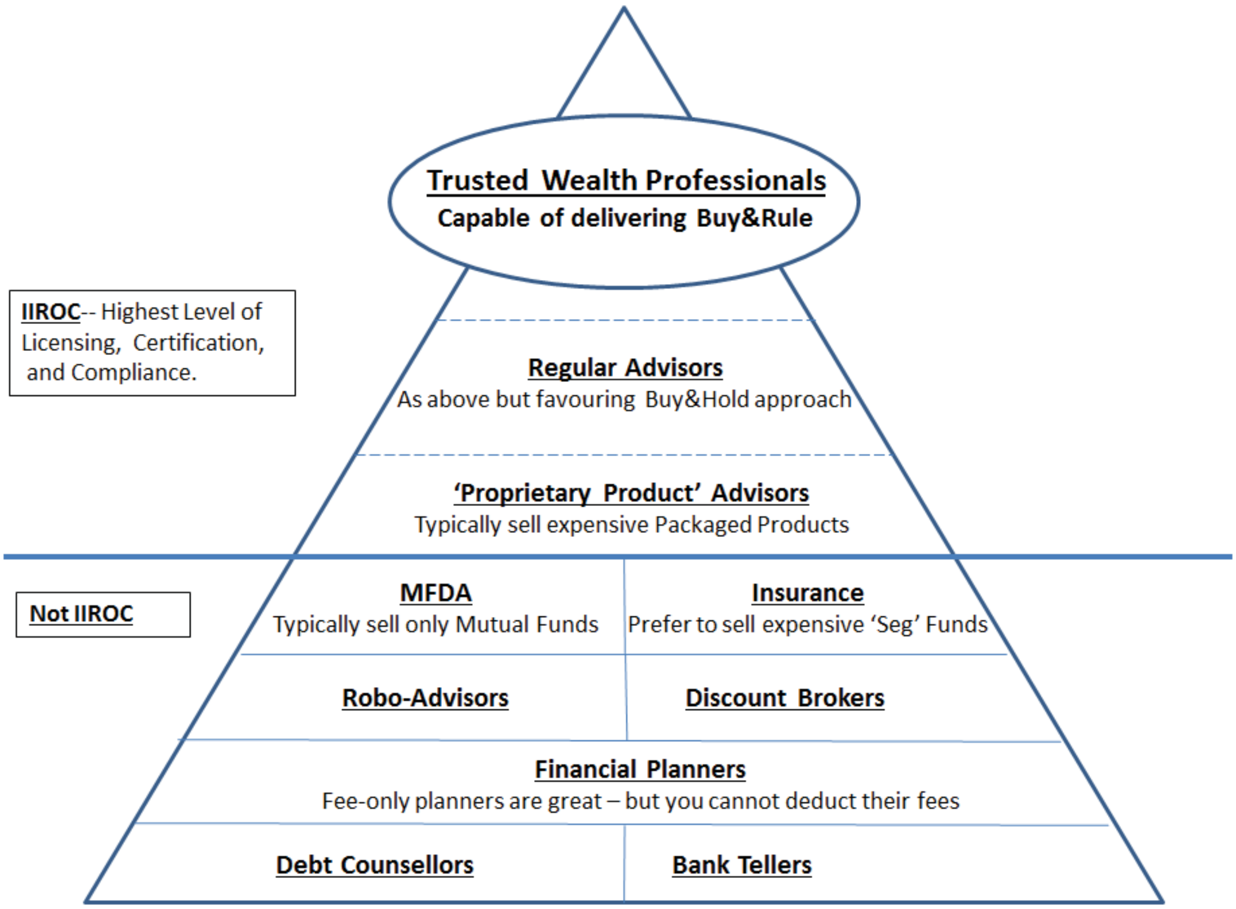
If a bank owns a full service brokerage firm, then minimums should be set for mandatory in-house referrals; from the banks themselves, their insurance arms, bank-owned discount brokers, Robo's they own, etc … to full-service brokerage IIROC-licensed firm they own. As an aside, I've been told by the smaller IIROC firms, that this is where they 'pick off' the majority of their clients/assets. Banks with Tellers are far from well versed to deal with a small independent IIROC professional firm. Holding AUM at the bank branch is a short-term asset-grab as the bank will lose the AUM to their small IIROC firm competition (eventually).

Solution1a: if you don't meet the criteria for Solution 1 above, then you probably should visit with a Debt Counsellor, if appropriate, and also stop financial institutions from growing the Canadian individual's debt levels as well. Why give a new credit card, or HELOC, to someone who already can't make monthly payments, or is within $200/month from declaring bankruptcy.



Solution2 – Beep Ban

Just in case your eyes move towards the diagram below, I'll say it again, ban Beeps for non-IIROC licensed Sales Channels (or similar regulations). And this is a direct Sales Person connection, not one IIROC licensed person in your firm, in a city far far away, and/or a non-IIROC Sales Person dealing with the Canadian investor.



The diagram above is self-serving for Trusted Wealth Professionals. I know there are many other categorizations of 'Advisors', but from the Canadian investors standpoint, from those that have $10,000 (aHNW, aspiring High Net Worth), and through to the $250,000 level (eHNW, emerging High Net Worth), this is a sufficient distinction. The HNW already know who a trusted wealth professional is.

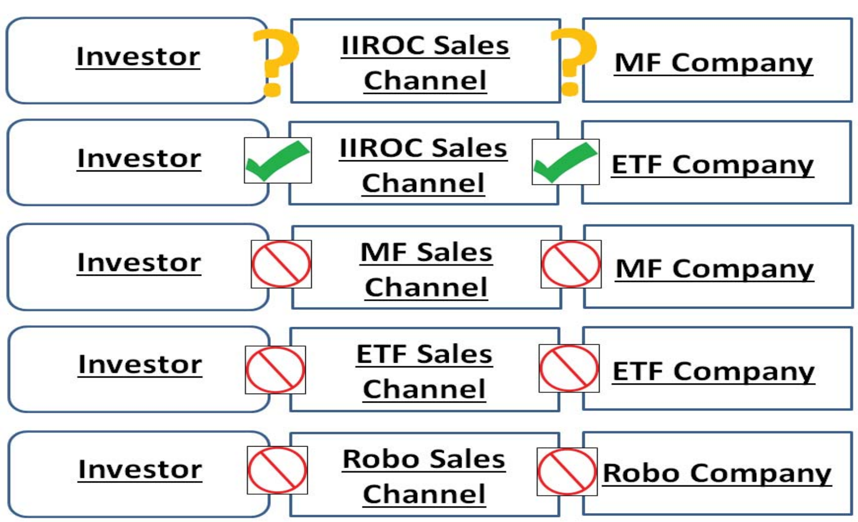
And perhaps with an admittance of the overuse of the word 'Beep' in the Beep Brief, I'll admit that, but the Embedded Beep Scheme has led to greater scrutiny of the Mutual Fund Sales Practices.

So, what would a Beep Ban look like? Essentially, you can't share Beeps amongst multiple parties and you need to do 'work' for your Beeps. You can term 'work' as Advice or Service, but I'll re-mention that your 'work' must be that of an IIROC advisors. And yes, there are IIROC advisors who only do the 'work' of the MFDA Mutual Fund-licensed Sales Person (but I can't provide that detail in this Beep Brief, but it is sad that there are 'Bad' IIROC Advisors).

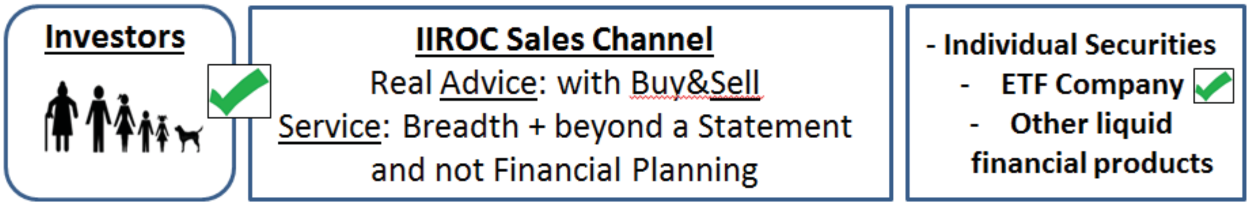
Beep Ban

1. Don't allow Beep pricing for non-IIROC advisors. Ban Beeps for the MFL; Minimal Financial Licensing (ie. MFDA, Insurance, etc …).
2. Don't allow Beep pricing for Insurance wrapped investments.
3. Don't allow Beep pricing for any entity/advisor that doesn't Buy&Sell themselves. If they are just a middle-person, flat bonus compensation systems will suffice.
4. Ban Beeps for any type of Sales Channel and Ban Beeps for WealthCo's where Accountants, Actuaries, Lawyers, Fee-Only Planners, etc … try and receive Beeps from the HNW clientele. There will be emerging Wealth Companies (WealthCo's) that will create pricing structures to extract the most amount of money from their clientele, and some of this will avoid the Fee scrutiny of CRM ½ . The first instance of this is Financial Planners (including Fee-Only) and Accountants, referring HNW clients to mutual fund firms and participating in the Mutual Fund Beeps. And this is starting to emerge in the Robo marketplace as well. The same referral arrangement exists in the Insurance marketplace (but you need certain licensing for legitimate referrals).
5. Only 1 Beep-biller per aHNW, eHNW, HNW and UHNW unless you have the requisite Licensing/Service/Advice. And any Beep sharing must be disclosed in writing (Beep referrals, Beep splits, etc …) and additional waivers signed showcasing the nominal and percentage amounts per annum.

Just a simple way of illustrating the Beep Ban is portrayed below. But let's not forget about the Canadian investor and the Investments + Liquidity.



It might be better to look at 'OK Beeps' with this diagram



Advisors who flip Mutual Funds, or Advisors who charge more mutual funds in a Fee-based account, should would be excluded from receiving Beeps. Please see Addendum 1; the beginnings of a Bad Advisor Blog.

"The weakest kind of referral, of course, is the lead capture"

You shouldn't be receiving Beeps for passing along someone's name. Or a similar weak effort.

<u>Solution3 – No Insurance + Investment mixing/wrapping</u>

Don't allow the mixing of Insurance with Investments (ie. Seg funds). Don't allow insurance 'wrappers' around Robo's offerings or offerings from other investment companies (for the purpose of minimizing regulation). Or delaying the removal of Embedded Fees until the second half of CRM ½, or CRM3 for the insurance industry in 2018-19, is delivered.

<u>Solution3a</u> – Seg Fund's have an 'advantage' as Investments bypass Probate tax. If the CRA and related interested parties (Justin, Bill, Stephen, Kathleen, Charles) care about tax revenue, they'll address the arbitrage advantage of Seg Funds, and the $15 tax per $1000 assets (please do not use 1.5%, people can't do 'percentage' math). Take away the Advantage, so you can't wrap Investments with insurance, and purposely avoid paying tax. This could be a great revenue source for the CRA. Keep in mind that Canadians are living longer, so more fees are generated by these Seg Funds and greater Nest-Egg's are accumulated. Why allow an investment to bypass Probate?

<u>Solution3b</u> – Make Seg Funds, for those Canadian investors' that really need them, based on ETFs only (no manager turnover, cheaper, etc …). So you'd have Seg ETFs. Possibly look at Target-Date ETFs as well (no holding underlying mutual funds).

It might be easier to discontinue Seg Funds.

Solution4 – Benefit Plans
Corporate Benefit Plans ie. For example, your employer matches your 3% with 3% of their own. No more Mutual Funds; need go to ETFs. Separate the investing via RRSP/Retirement-Plan, from your Dental/Vision plan (generally offered by an Insurance Company). And provide Liquidity by being able to transfer (perhaps 1x/year, or 2x/year, automatic (?), to a Full-Service IIROC, Discount, or Robo). Make it easy for this to happen, perhaps mandatory.

Solution5 – Define Advice (in a clear and differentiated manner)
This is a joke I thought of:

KNOCK KNOCK
"Who's there?"
"Mutual Fund Sales Person"
"I thought you guys only KNOCKed once a year… when it was RRSP season?

The sad thing is that most Mutual Fund Sales People only call 1x/year, about mid-February timeframe, to ask for more RRSP dollars. And they call this Service/Advice. ☹

The opportunity exits to define Advice. And Advice Tiering. Plus define Service.   Advice is not a Financial Plan. There has to be an aspect of a 'Sell' (IMHO; in my humble opinion). And transacted themselves by the 'Advisor'. Buy&Hold is not Advice, nor Service. And this needs to be Standardized across the entire industry. Plus approved by the CSA/OSC and the CRA. It may be that non-IIROC companies/Advisors will never be providing Advice.

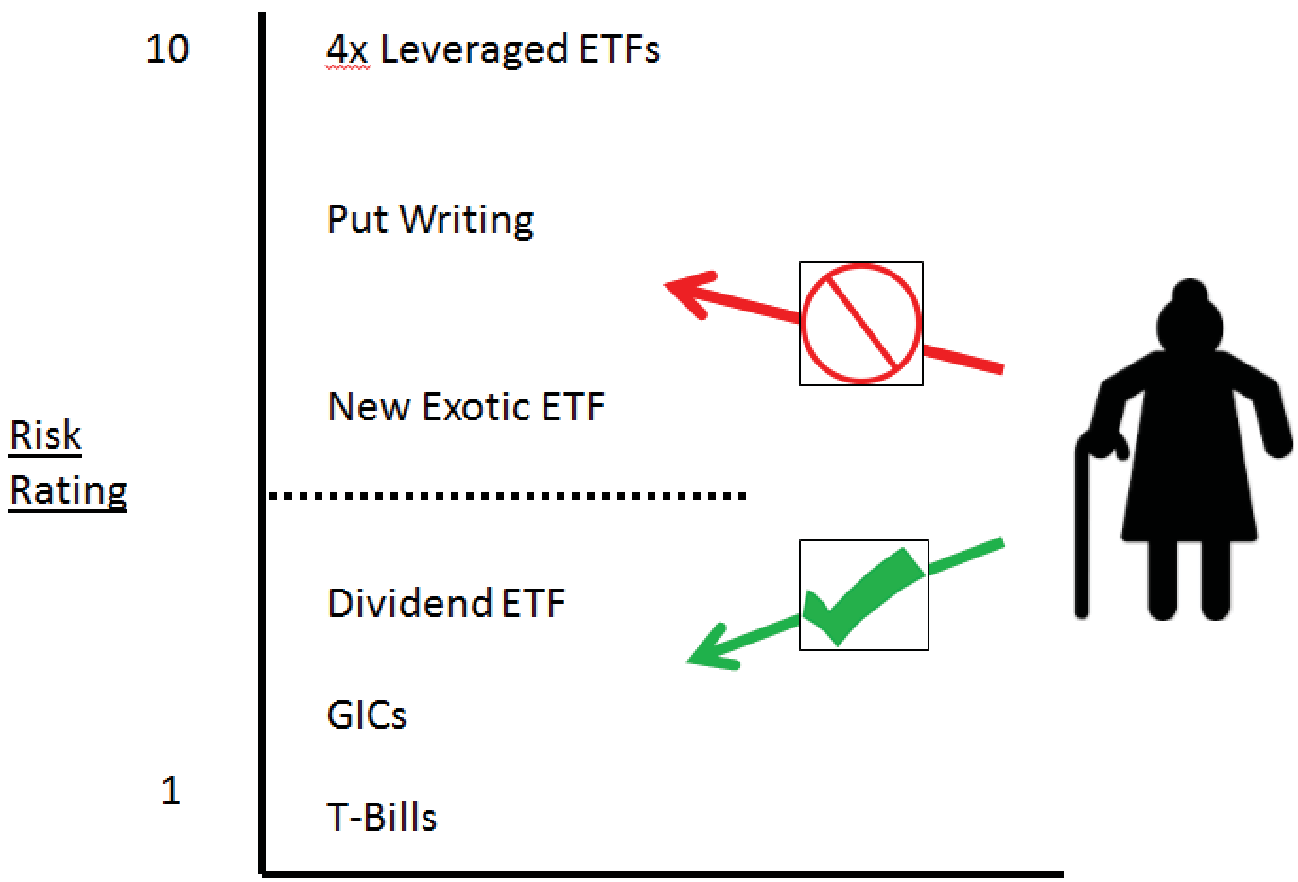
	FinPlan$ & Description (nondeduct)	Commission$ & Description (nondeduct)	Service$ & Description (CSA apprv.)	Advice$ & Description (CSA apprv.)	Other$& Description (CSA apprv.)
$0 to $10,000					
$10,001 to $50,000					
$50,001 to $100,000					
$100,001 to $250,000					
$250,001 to $500,000					
$500,000 to $1,000,000					

Solution6 – Security/Product Risk Ratings

There should be Tiered Risk Ratings for Products. And for Tiered Risk ratings for Seniors, you can't cross the line (see image below). And if you can't BackTest the product through an entire market cycle (so Mid-2007 was last Peak), and if it didn't exist through this time period either, then it is too risky (high risk rating or non-rated; sign an additional waiver if you want this).

If the Mutual Fund doesn't create an 'S' class fund for Seniors, and an 'M' class for Millennials, then they might as well be in invested in ETFs. Actually I don't think either of these will occur (maybe I'm wrong), so perhaps you should just invest in ETFs regardless.

But I read a good point that Seniors that shouldn't be in Mutual Funds because they've already paid high fees their entire investing life. So, if no 'S'-class Mutual Funds, go to ETFs.



If you happen to examine the Judgements from the Complaint process, that are in the press, you'll often understand that Canadian Investors' being placed into an inappropriate/risky product is prevalent more than 50% of the time.

Solution7 – Standardized AUM Grid

Need standardized industry-wide GRID for AUM-levels – so, $0-$250k, $251k-$500k, etc … Or whatever levels are chosen to discern smaller accounts and then larger accounts. This is just an example below. Every financial institution has to use the exact same ranges.

$0 to $10,000
$10,001 to $50,000
$50,001 to $100,000
$100,001 to $250,000
$250,001 to $500,000
$500,000 to $1,000,000

Solution8 – Standardized Investor Fee Interface

I don't think the Regulators should get into the 'bedroom' of Sales Management. Me: I've been on the Sales side of Hi-Tech solutions for 30+ years. I've been a quota-bearing sales representative for over 10 years and also consulted in this regard for the last 15 years. The complexity within the compensation plans at major hi-tech firms (e. Nortel, Oracle, Microsoft, etc ...) would astound you. Especially with their compensation plans for their different channel structures. Complicated and convoluted. I think the Regulators should stay out of this area, but please keep in mind that everything the Canadian investor sees as a Billing System means that there is a synonymous Compensation System for the Sales Person/Channel. This gives rise to KYCP; Know Your Comp Plan (aka. "Where do my Beeps come from"?).

But there should be an IFI, IPI or ICI – Investor Fee Interface, Investor Pricing Interface or Investor Commission Interface, just like a GUI (graphical users interface) or UI (User Interface) or UX (User Xperience). Focus here, not inside the company, but external between the Investor and the Company. Just like 13% HST in Ontario, your cost is known, it is clear and it is

1-time. And it is standardized across all retailers. What is and what isn't taxed (necessities) is known, the Mutual Fund industry thrives on the 'not known' (ie. Embedded Beeps).

Solution8a
Need consumer acceptance of **ALL** new pricing schemes; through public + industry consultation.

Solution8b
Need consumer acceptance of **ALL** new products; again through public + industry consultation. It's too difficult for the Investor to learn KYP; Know Your Product. Or, KTPWJMU; Know The Product We Just Made Up.

Solution9 – Lower Price is the Law
Test annually (or semi-annually) the total cost of Fee-Based vs. Commission accounts. If lower in Commission accounts, possibly move Investor to a Commission account. Or sign waiver (and state 'Why' you aren't switching). There are Pro's and Con's to this as different IIROC Advisors may not be capable of managing Commission based accounts (ie. the 'Bad' Advisor).

Solution10 – Can I have a graph please of my Asset's Performance
My personal #1 priority is the industry need graphs in statements; visuals. Robo's are winning in this regard. Ironically at Financial Models, 17 years ago, we could show a pie-chart, or any chart type, of your assets, holdings, etc … The software was Financially Intelligent. This should become mandatory as 85% (or more) of the population processes visually.

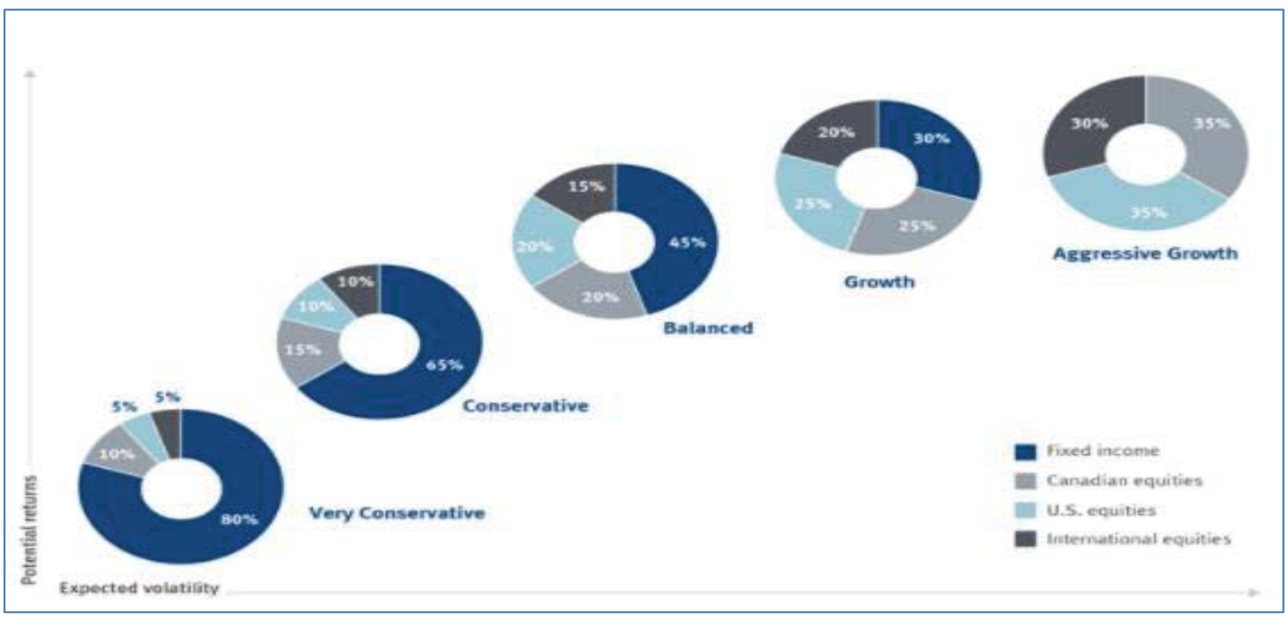
Solution11 – Risk Profiling needs a complete overall

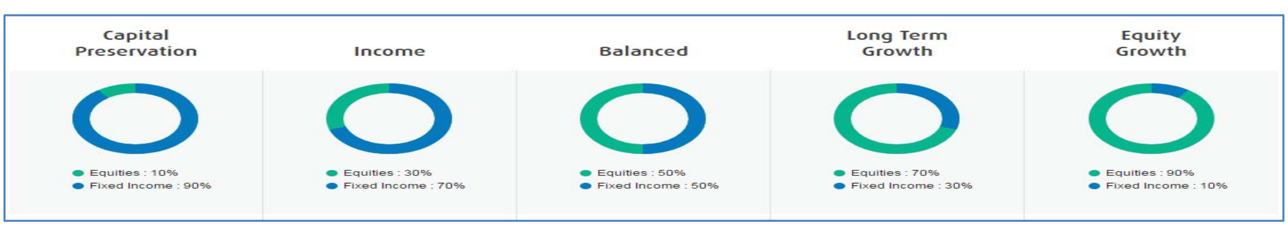
Risk Profiling in KYC's and IPS's is horrendous IMHO (in my humble opinion). There is a great need to have actual market examples. And proposed securities/investments as well in the Risk Profiling. The KYC and IPS is done in absentia of investing ☹. And please use standardized terms.

Did I tell you about my own Mystery Shopping experience? I planned on booking 'investment' conversations with 5 of the major banks. The idea, just walk into a bank branch and tell them I want to invest. I literally said that I was investing directly already but wanted to see how the branches programs with portray me and classify me with respect to 'risk'; I was after the proverbial pie-chart. I wanted to go through their Risk Profiling questionnaire.

I only actually went to 2 of banks. Both turned out to be 'product sales'. I'm OK with that, I actually expected that. The 'sadness' of the experience was that at one of the banks, their 'top' Teller, a salesperson, with a planner designation (CFP I think), asked me two times to change my 'risk answers', and actually did present to me the option that she was quite familiar with (the one question where she wanted me to change my answer). I was honestly flabbergasted, the lady tried to have me change my answer, and it made me think she didn't know the talk track to the other options. It was the question somewhat worded "If you invested $100,000 and it dropped to $90,000, what do you do?" Then there were 4 multiple choice options; A, B, C and D. I picked option C but she only knew the answer to option B ☹

<u>Solution11a</u>
The Pie-Charts need to be standardized for Canadian retail investors. There are three Pie-Chart series presented below; all with different order and naming conventions.





And actual market investment 'visuals' matter. The Primer below is an example of poorly communicating 'risk' and 'reward'; borrowed from a CIBC website. Read the words.

A Primer to Market Downturns

Be the first to write a review

All market slumps are not the same. Here is how to recognize different types, and what they mean.

If you're like many Canadians, you've been getting nervous about your investments because of the rapid up-and-down swings of the stock markets. To help you understand and cope with these market swings, let's take a look at the different types of downturns.

Declines

A decline - usually lasting a few weeks to a few months - is a short-lived sell-off by investors in reaction to some unexpected bad news. An example was the 554-point drop (a 7.2% decline) in the Dow Jones Industrial Average, one of the most closely watched indexes, in October 1997. Fears about how the weak Asian economies would affect earnings expectations in North America resulted in significant "knee-jerk" selling. Soon, however, the Dow adjusted itself, and it ended the year higher than it had started.

Corrections

When a decline approaches the 10% level over a short period of time, such as a few days, it's usually considered a correction. Corrections can be caused by significant increases in interest rates, reductions in overall economic activity, or perceived overvaluations of stocks. A severe correction can occur as a result of a particularly negative political event. For instance, the Dow fell 21.2% over a three-month period after Iraq invaded Kuwait in August 1990. Interestingly, in a study of the Dow's movement since 1900, Ned Davis Research, a financial research company, found that severe corrections are followed by "bear" markets 58% of the time.

Bear markets

A bear market is a prolonged period of declining stock values that can last a year or longer. The market is considered "bear" when stock prices fall about 20% or more and stay down. Broad economic factors, such as unfavourable interest rates and an economic slowdown, trigger a self-perpetuating spiral of selling. This is in contrast to a "bull" market, which is a prolonged period of rising stock value.

Crashes

Much less common than the above is a crash, when stock prices drop more than 10% in one or two days, resulting in severe sell-offs by scared investors. Only two crashes occurred in the last century: The first was on October 29, 1929, and the second on October 19, 1987. Usually, a crash is caused by a dramatic reversal of basic market assumptions. Although not a "crash," the financial crisis of 2008 caused the Dow's worst-ever week: Starting October 6 of that year, the index fell 18.1%.

Whether it's a brief decline or an extended bear market, you can use some simple strategies to see a downturn through. A long-term focus, combined with a well-diversified portfolio, will ensure that the bumps along the way don't derail your plan.

Read the 'spin' in the Primer above. Contrast the longevity terms; days, weeks, months, etc … Read the actual numbers and 'example' numbers. And keep in mind that 85% of people process visually.

As unfair as this will seem, but do any of the Marketing personnel have degrees/certification in financial services. Better still, are they Licensed? And I'll go one step further and say that the Compliance department approved this. ☹

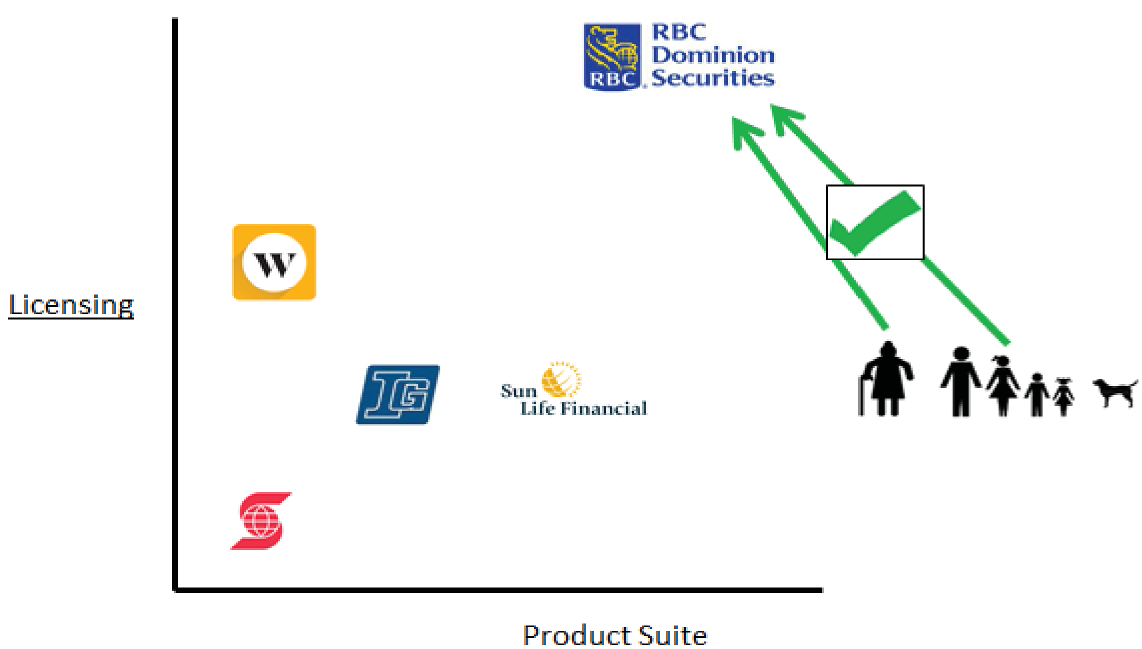
Solution12 – Make the default case the correct case.
Discount brokers selling Mutual Funds; A-Class and F-class. Possibly limit to D-class or just remove Mutual Funds from their offerings. Curtail their Product Suite offering to only ETFs. I think Discount Brokers will start branding themselves now as Ethical Compensation brokers; at present they are not doing themselves a service by collecting A-class or other Trailer fees

Solution13 – Rate the Advisors
Advisors should have a Risk Rating. 100% Yes. My Advisor makes a difference, does yours? Investment Style matters as well. Just off the top of my head:

- Your tenure in the business, in years, or your Mentor team's tenure in the Investment busines? Note: Investors Group, 4 years of experience is not 'Senior' advisor.
- Have you experienced a complete market cycle? Started pre-2007. Have you seen a period of rising interest rates. Started pre-1985?
- Can you handle a Commission based Account? Really? Even if it means less compensation to you?
- **Licensing matters**, where are you on the Licensing Ladder, at the bottom? Are you part of the MFL?

And there are a few other 'choice' questions I have to determine if an Advisor can be Trusted or not. But the Investor should also sign off on the fact that they've seen the Advisor's Report (on IIROC's website, or any other official Regulatory website).

Solution14 – Industry GRID
Should be an industry product GRID that distinguishes limited product sellers and proprietary product sellers. And it will be Cross-referenced with licensing. The starting point will be Product Suite vs. Licensing. Investor's must signoff on this.



This will show who has Minimal Financial Licensed (MFL) representatives (ie. major Canadian banks). You could also explicitly show Cross-Referencing of Licensing with Proprietary Products. Maybe there should be an Open 'Book Look' to see what Products the Wealth Companies are actually selling; in other words, make it easy for the public to identify you as a Proprietary Product Seller. It be great also to cross reference this with performance over a complete market cycle. Hmmmm.

True Story – I actually heard my bank branch representative tell a client that the Brokerage firm "charges commissions". It was delivered in a Do-Not-Visit-Them tone. Sad ☹.

Sessions 8 and 9 of the Canadian Investors' Course on the Trusted Wealth Professionals website are as impartial and fact-based as can possible be. But it may be that Canadians need a bit of Leadership. And yes, this will come across as extremely self-serving, but in today's society where we are so enamoured by the Wealthy Celebrity, sports player, music artist, etc … why not showcase the Advisors that serve the wealthy?

TWP | Trusted Wealth Professionals

CIC

See **Crystal Ball** in the following section on how this can be addressed.

Solution14a
There should be a Menu of Products, for any particular category, a product GRID per se. This GRID would show all products with their total cost (total cost, not partial cost like CRM ½ or how the Banks are portraying their Services these – see Solution 15). Like a restaurant menu; you should see low priced entrees, medium priced entrees and the most expensive entrees. And/Or it should be signed-off on by the firm's management. Note: the GRID could look a paint-chip-strip as well.

<u>Maybe 3 Investment Options always need to be presented</u>; Low, Medium and High Priced.

Why? There are almost 3000 stocks on the NYSE, and 22,000 mutual funds (OK, there are a lot of duplicates, with A-Class, F-Class, D-Class, etc ..)

Horizons S&P/TSX 60 Index ETF charges 0.03% at present; 0.07% after September. Vanguard and Blackrock have similar priced ETF products that equate to Closet-Indexed Canadian Equity Funds (which charge a lot more). The Globe&Mail's website indicates there are over 1000 securities to participate in the Canadian Equity marketplace (way too many IMHO); 1237 to be exact at the date of me generating the following image.

Solution15 – Funds of ETF is not the same as buying ETFs

Please disallow Mutual Funds, primarily holding ETF's, and sold as 'ETFs.'; mainly by bank branches. These are really Mutual Funds, generally proprietary, with a new fee structure, the 2-Fee-Structure ☹. Innovative yes, I'm OK with that. But no-one at the bank branch has an IIROC license. Packaging 'securities', so they can be sold by Minimal Financially Licensed 'Tellers' is not in the Best Interest of Canadians.

And you need to do math + calculations to put MER + Advisory-Fee together.

*"All ETFs have management fees and expenses (calculated as management expense ratio - MER) which are in addition to the **annual advisory fee**. The MER is embedded within the pricing of the ETFs themselves and will not appear as an expense item on your account statement(s). The MER of the ETFs held within your portfolio are anticipated to be a weighted average of 0.20% to 0.35% of the value of your SmartFolio account."*

Note: Advisory-Fee does not mean Advice.

Our fees explained

Our commitment to you
Our goal is to provide clients with full disclosure with respect to the fees and interest rates they pay for certain accounts and transactions. This page outlines the range of charges you may incur, depending on the types of accounts you hold and the transactions that occur within these accounts. Any fees charged to your accounts will be detailed on your client statements. If you require any additional information regarding your fees, please contact one of our dedicated representatives at 1-844-895-3721

In general
- Fees are charged per account unless otherwise stated
- Accounts can be grouped by household to benefit from lower pricing at higher asset balances
- Fees are subject to change
- You will receive 60 days' notice for any new or amended fee
- No commissions charges on trades

BMO SmartFolio advisory fee:
Pay one advisory fee which is calculated as a percentage of your total assets in your BMO SmartFolio account(s). The advisory fee is charged quarterly in arrears and is based on average total assets in your BMO SmartFolio account(s) during the calendar quarter.

The advisory fee covers:
- Professional portfolio management including monitoring and rebalancing
- Support from a team of dedicated representatives as you need it

The advisory fee follows a tiered-pricing schedule based on the value of your BMO SmartFolio account(s).

Minimum Quarterly Advisory Fee $15

Asset value	Annual Rate
First $100,000	0.70%
Next $150,000	0.60%
Next $250,000	0.50%
Above $500,000	0.40%

The minimum quarterly advisory fee of $15 will be waived if you deposit $250 or greater in your account during that calendar quarter. If the minimum fee is waived, the tiered advisory fee schedule above will apply.

All ETFs have management fees and expenses (calculated as management expense ratio - MER) which are in addition to the annual advisory fee.

The MER is embedded within the pricing of the ETFs themselves and will not appear as an expense item on your account statement(s). The MER of the ETFs held within your portfolio are anticipated to be a weighted average of 0.20% to 0.35% of the value of your SmartFolio account.

For more information about the management fees paid by the ETFs in each ETF portfolio, please speak to one of our representatives at 1-844-895-3721.

Other account fees
Other fees apply for the administrative requests detailed below:

- Transfer-out of a Non-Registered or Registered Account, Full and partial: $135 per account
- Partial withdrawal of a Registered Account (excluding TFSA): $25 per request
- Full Deregistration of a Registered Account (excluding TFSA): $100 per account
- Cheque requests: $10 per request
- Paper statement requests: $5 per statement

Interest rates
Interest on a credit balance in your account is subject to change without notice, may vary according to the size of the balance and may be subject to minimums, as described more fully in the BMO SmartFolio Investment Management Agreement. Interest is not paid if the amount accrued is less than $5 per month. BMO Nesbitt Burns may earn revenue from the use of cash credit balances.

Foreign currency conversion
BMO Nesbitt Burns will act as principal for foreign currency conversions in your account unless otherwise disclosed. When a transaction requires the conversion of currency, BMO Nesbitt Burns will convert the currency at rates established or determined by BMO Nesbitt Burns or related parties. Exchange rates are subject to change without notice and may vary according to the market, type of currency in which the trade is transacted, and the value of the gross amount of the trade. In addition to the commission or other fees applicable to the transaction, BMO SmartFolio or parties related to us will earn spread revenue up to 1.5% from a foreign currency conversion.

Closing fees
You will be required to pay any accrued unpaid advisory fees up to the date of closing. These fees are subject to GST, QST, and/or HST where applicable.

You will be charged for any sales, use, goods and services, harmonized sales, value added, and transaction taxes which are incurred by or that may be charged to either you, BMO Nesbitt Burns or both (whether jointly or severally) by any governmental authority in any jurisdiction as a result of transactions in your account.

Try and add these two Fees together

The MER of the ETFs held within your portfolio are anticipated to be a weighted average of 0.20% to 0.35% of the value of your SmartFolio account."

Asset value	Annual Rate
First $100,000	0.70%
Next $150,000	0.60%
Next $250,000	0.50%
Above $500,000	0.40%

I know the Jeopardy champions can't do it; have you noticed they always 'miss' the math questions?

Solution16 – Transparency
Transparency of MF's/ETF's. Maybe not so much ETFs, but what are Mutual Fund's holding for 89 days before they 'window dress' their portfolios at quarter? Are they holding Valeant for 89 days to see if it pops? If we're dealing with Embedded Commissions, I think we'll soon be dealing with Embedded Securities and Positions. It might be high TERs (Trading Expense Ratios) that shines light on this 'dark' area.

Solution16a
There should be a 'PP' designation on Proprietary Funds/ETFs/Products. Meaning that the investor understands this may ultimately deny liquidity; or hurt returns if sold/transferred. But I know this will get 'spun' into a 'positive', that's OK. In essence, start disclosing the reason 'why' proprietary products are more appropriate to the client's objectives, constraints, risk profile than products from other third parties (available from the advisor). Or ensure the investor has 3 or 4 choices (across a price range and possibly Proprietary).

Solution17 – Wealth Industry Marketing
Limited Financial Services + Wealth Marketing. I read an article once, that described it was useless for banks to market as the 5-6% churn was unavoidable, and inevitable, and the only new business was immigrants. It was a study, as part of an advertisement, from a Big Consulting firm (could have been Deloitte or Accenture or KPMG or IBM), published in the Globe&Mail or National Post. It might have been a Big Data story. I just can't find it now (and I've tried) but I fullly acknowledge that the other side of the coin is that FinTech startups are the real threat, so 'Big Bank' and 'Big Insurance' Marketing, as bloated as it seems, might actually be effective to holding churn at 5-6%. But if we experience a Bear market, watch out for Regulation in this area. Wealth Industry marketing will start to track that of the Cigarette industry; Embedded Commissions are bad for Your Health. And too much Wealth Marketing will be scrutinized.

Solution19 – Mutual Fund Fees
Personally I'd love to see an indepth review of Mutual Fund fees; specifically, are they correct? Are they shown in conjunction with the TERs? Perhaps reported more frequently (daily on a website, maybe detailing the NAV calculation). I could be wrong, but the multiplicative and accumulative aspects of withdrawing 1/250th of a fee daily still makes me wonder if Mutual Fund investors are paying too much (ie. Is the Mutual Fund industry displaying linear math … but Mutual Fund investors are paying accumulative math?!?!).

Afterall, you don't get a receipt when the MER is deducted from your Investments everyday ☹.

Note: This may be a repeat, but with my trusted wealth professional, full-service IIROC, I pay every 90 days for my Taxable, RRSP and TFSA accounts. It is based on average asset value and this is the last calendar year I'll be able to pay for my TFSA and RRSP externally. But I pay every 90 days. In arrears. And I get a statement. And I can see my accounts online and I can talk to someone about it (my Trusted Wealth Professional).

Solution20 – 'Lower Fees Should be the Law'
(A quasi Repeat of Solution 9). Fee-Based Accounts with IIROC advisors shouldn't be higher than if you invested in Mutual Funds directly, so the Total Account Fee, that includes an F-Class fund should be examined in context of the A-class Mutual Fund fee. If you're paying more in Total overall Fees, although it could be for an exotic Mutual Fund, you should signoff on a separate waiver. Or just get an ETF. Better still, buy the individual securities. There are multiple ways to expose your portfolio to International and Emerging markets as well as new/niche sectors. Many many ways. Or maybe get a Trusted Wealth Professional.

Solution21 – Account Fees
My Trusted Wealth Professional has 2 different types of Fee-Based accounts; one for Growth and one primarily geared towards Income. The Income account has a restriction on Equities. This might be pervasive across the IIROC industry, I'm not sure. But there is merit here.

Solution21a – Volume Discounts
As your assets increase in value, at an IIROC-based firm, the Total overall Fee decreases. Every firm has their own discount schedule, but I'm in favour of standardization across the industry.

Solution Summary
Basically I'm advocating that the Advisor demonstrate their value; through Licensing, Service and Advice. Earn your Beeps. Do work for your clients, real Work. Stop fooling unknowledgeable Canadian Investors. I'd start with the Beep Ban and hope there isn't a social Fee revolt during the next Bear market. The Government can't afford to maintain our current lifestyle because we paid too much in Fees, or in Embedded Commissions.

The Crystal Ball -- An Epilogue and Foreshadowing

The Mutual Fund industry as a whole should look at adding new services and offerings, based on increasing their licensing and technology. I'd personally love to see a graph in my monthly statement, and access a graph online as well. And I'm OK if there are 100-1000 new IIROC firms.

But let's come back to the cries of 'Advice Gap' by the Mutual Fund industry; this is their own problem (IMHO). MFL (Minimal Financial Licensing), limited+proprietary products, and an Embedded Commissions first sales approach have created an 'Advice Gap' already. The Mutual fund industry is literally stating that, at present, they don't deliver Advice to their clientele.

Oxymoron: Mutual Fund Advice

Like Hidden/Embedded Commissions, Hidden/Embedded Advice is really Non-Existent Advice. Transparency of Advice and Service does not exist as there is no Advice + Service. See thoughts in the preceding Point #2

As in every sales based culture, the Mutual Fund Sales Channel is 'Whale Hunting', they are looking for a Mega Beeps client.

Yes, if you have \$1M or \$2M AUM, you're getting good/great Service and maybe Advice, but I always wonder what will happen if the market declines by 54% again. Even a 20% decline, or an average Bear market decline of 38%, will not be welcome by anyone in the Boomer age group. You can't re-gain Time, that is why you need to look at Buy&Rule ® as a method of capital preservation.

It is time for the MF industry to grow up. Their 'gravy train', a.k.a. Embedded Commissions only serves them, not their clients.

There are lots of '5 Forces' methods, Michael Porter's 5 methdology, of looking at the future of Mutual Fund industry.

1. Mutual Funds could be 'dissolved' entirely, unless Specialty Funds, otherwise Canadian Investor's will gravitate towards Robo's/Discount-Brokers and buy/utilize ETFs
2. Mutual Fund Manufacturers acquire Mutual Fund Channel (ie. GWL just bought FHG)
3. Mutual Fund Channel(s) acquire Mutual Fund Manufacturer(s); not likely
4. Investor pays directly to the Channel a full 2%; not likely to happen.

But my gut feel is that structurally, nothing will change, it is too difficult to transact M&A, but the Manufacturers' have already thrown the Sales Channel under the proverbial bus when CRM ½ required the Mutual Fund Channel's fees be shown first (while hiding their own portion of the MER for another year).

The Mutual Fund Channel is going to 'lose' in the present regulatory + consumer environment, so it needs to re-invent itself with Licensing, their own Robo's, and Service (ie. Graphs on statement). They need to go into full Beep Protection model. As there is quite a bit of 'direct' selling these days as well.

Note: I submitted a letter today to Liberal MP Wayne Easter, Chair of the Finance Committee, regarding the Hearings into the Sales practices of Canada's Big Banks. Sales Practices Canada-wide are going to be examine closely in the coming years; Insurance and Real Estate will be examined as well, anywhere the Beep Hunt is prevalent, there will be scrutiny and regulation.

And if the industry is already bloated with Sales Channel headcount (compared to UK + AUS), then not to worry; rightsizing will be welcome.

Fees, in the absence of definable Advice + Service will continually find a lower and lower point for the Sales Channel.

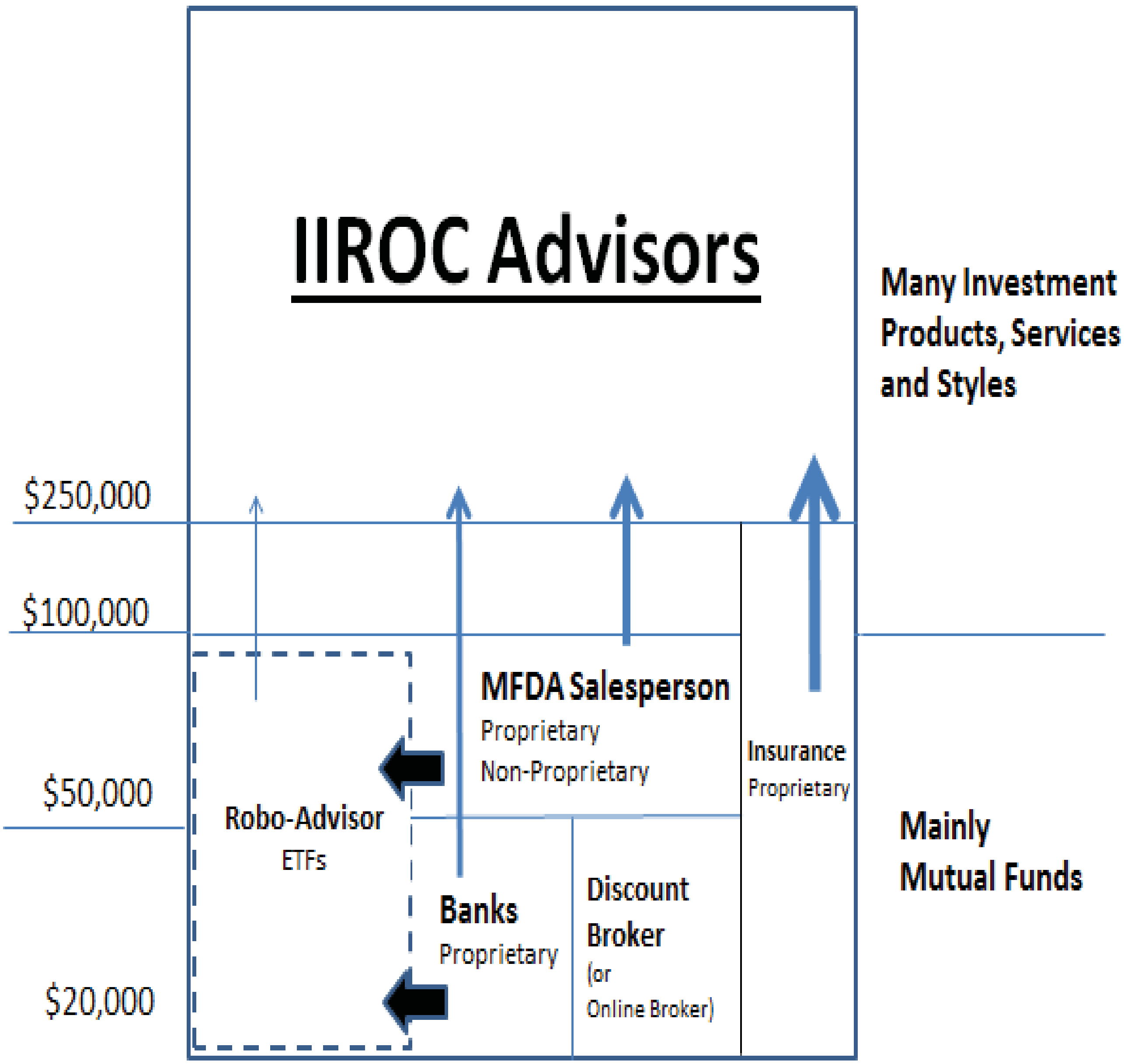
So thinking about:

1. CRM2, Fee and Performance disclosure.
2. the rise of cheaper ETFs,
3. discontinuation of Embedded Commissions,

there is a grim picture painted for the Mutual Fund industry.

And if that jab-hook-jab combination doesn't knockout the weak providers, then a Bear market will be the uppercut that finishes the job.

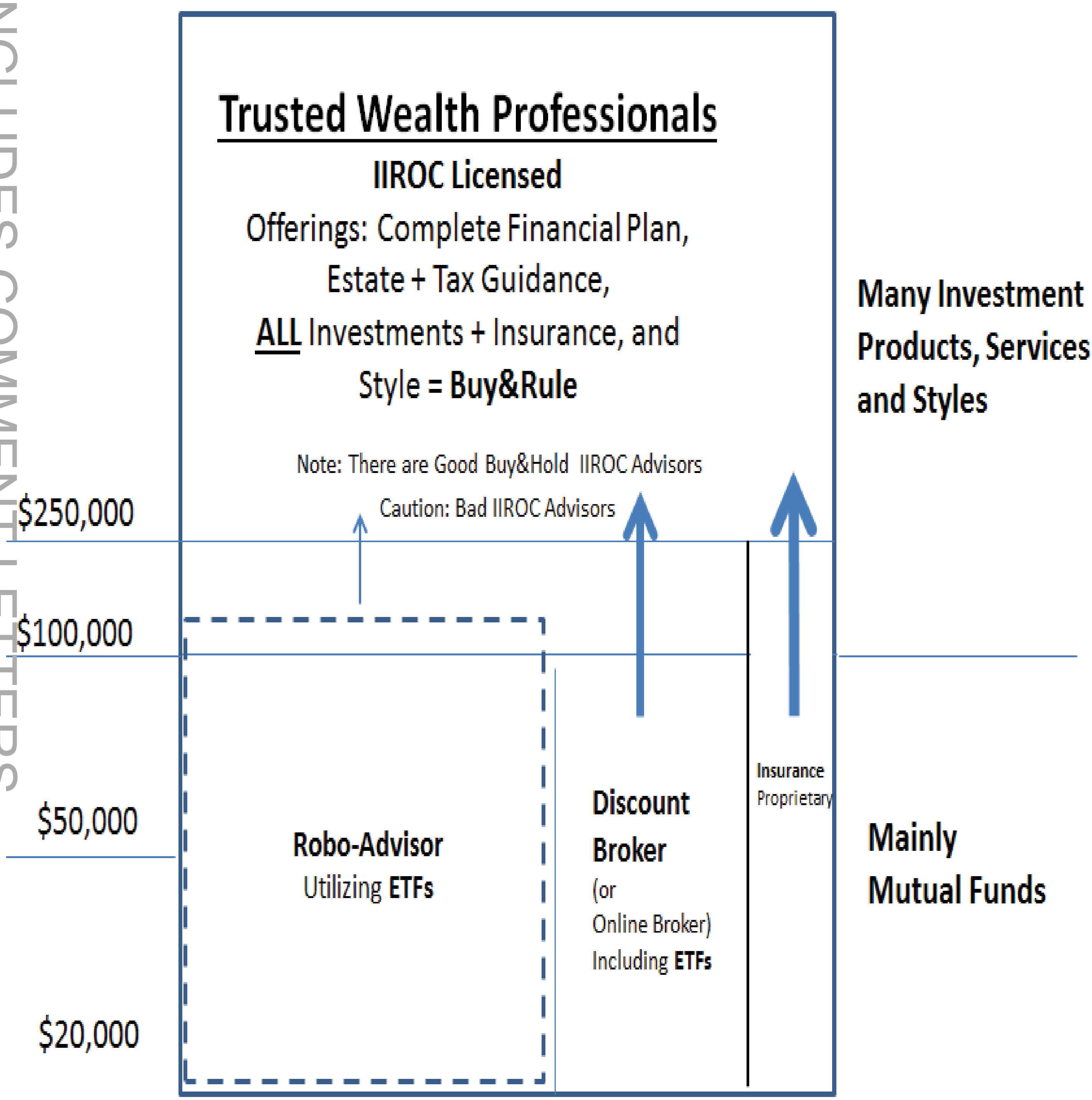
The MF industry needs to re-invent itself. The starting point is the Who Are The Players and Where are Assets flowing diagram below. The arrows show the 'theoretical' flows that are occurring today; think and thin arrows denote volume of flows.



Theoretically, the small accounts will migrate to Robo-Advisors. Large accounts will be gobbled up easily by the IIROC Trusted Wealth Professionals. Discount Brokers and the Insurance Channel will have eroded Asset Bases. Banks and Mutual Fund Sales Channel will lose heavily. Again, this is only theory.

But maybe it is reality.

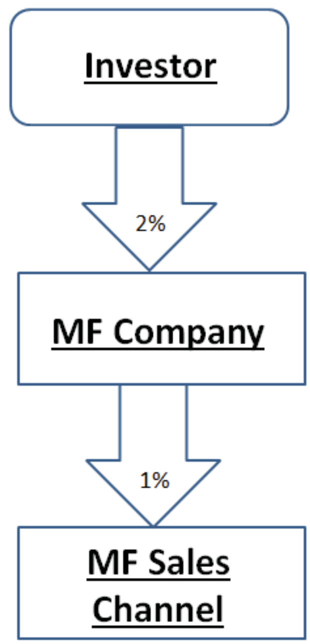
So the 'new' Wealth Industry Players and Assets are as follows:

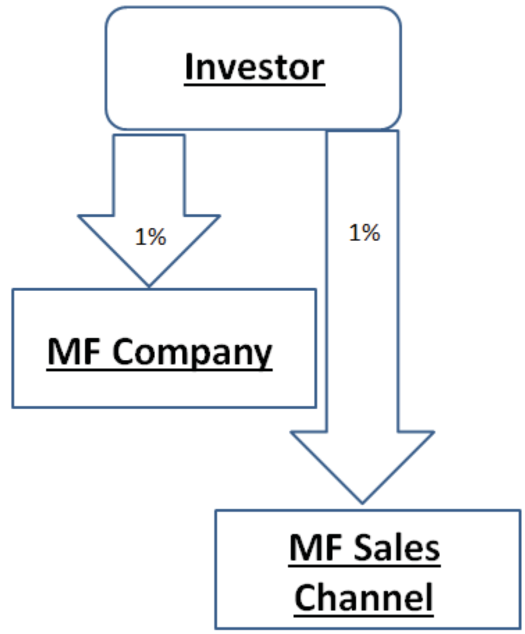


And maybe I'm wrong. Maybe not. But obviously biased. ☺

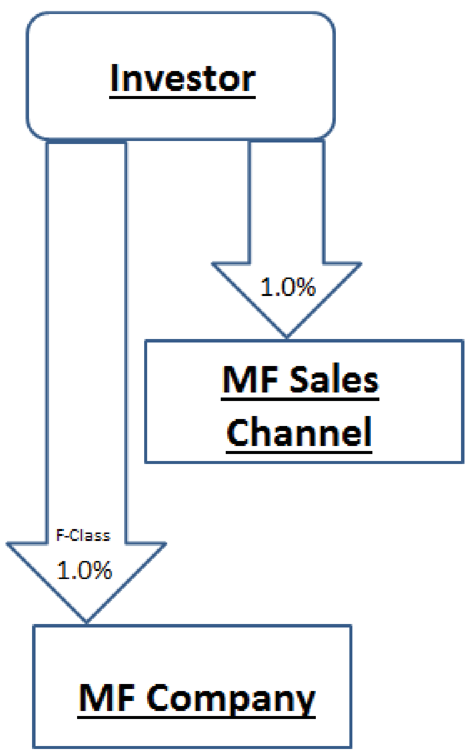
But the days of $1M accounts being unconsciously invested with a Robo, during a Bear market, are light years away.

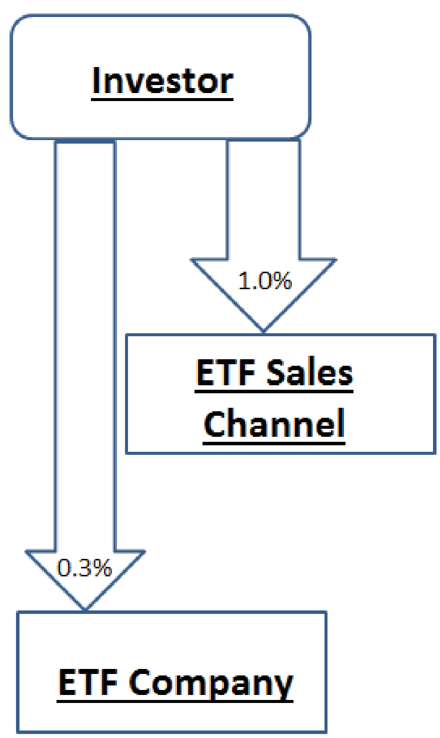
So the starting point, is how does the Sales Channel convince the investor to remain with the Mutual Fund Sales Channel, possibly through this dual Fee option (see 'right' image below).



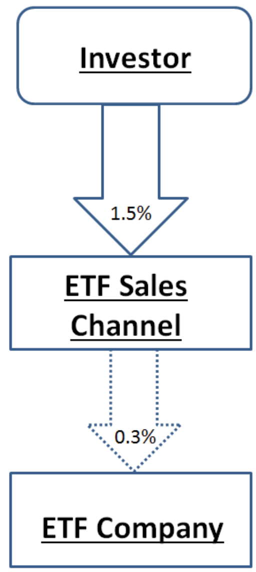


The Investor would essentially 'write' two cheques in that model. Even if the Funds were now F-class, or cheaper ETFs were used. But if the Mutual Fund Sales Channel up-licenced themselves to IIROC, and started sell ETFs, we'll see this switch occur.

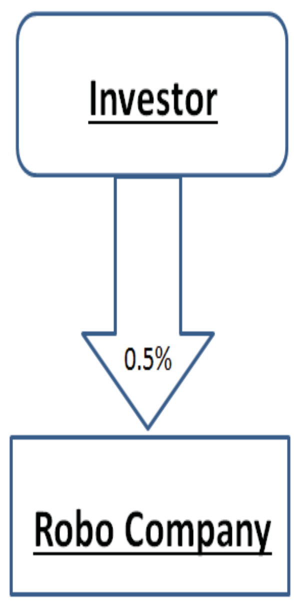




But it will probably appear as:



More expensive to the Canadian investor, but the long term threat is this model:



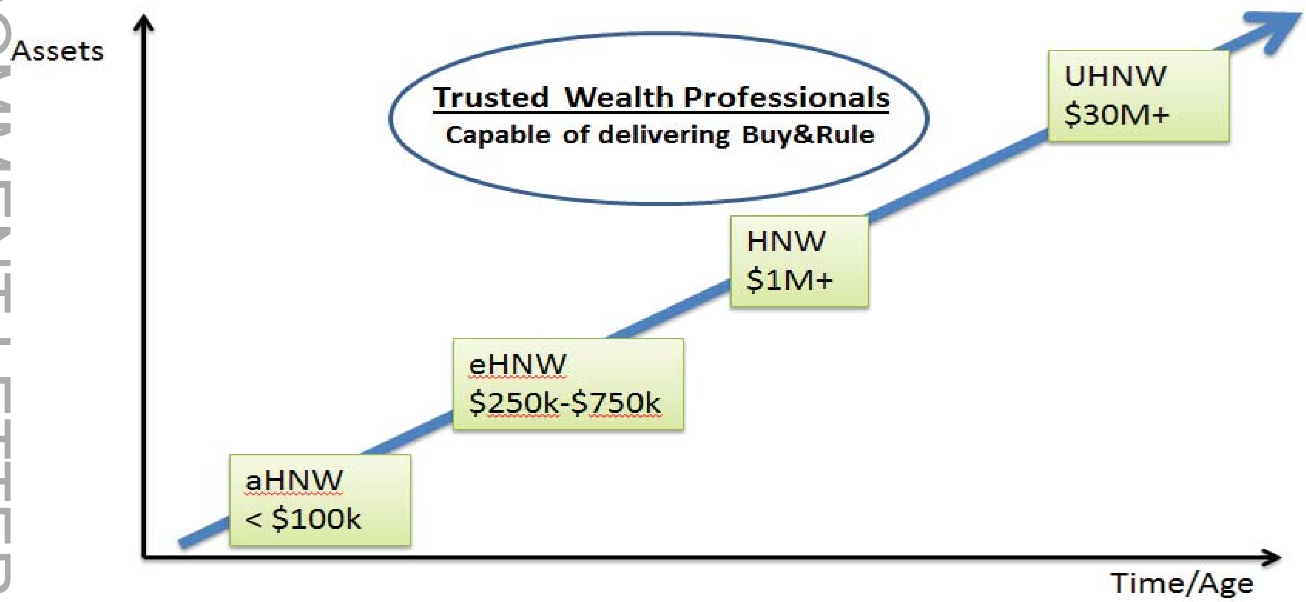
The point being, licensing matters. And if you have more+higher licensing, you can do more work for your clients, and charge higher fees.

Personally I think the Brokerage firms should lower their minimums and create Platinum, Gold, Silver and Bronze levels of Advice+Service. And start picking off the aHNW to eHNW marketplace; between $50k to $250k. If you start treating this niche, similar to the Service+Advice delivered to the full HNW client, you might end up with the most AUM ☺

The simple logic for the Crystal Ball is that the:

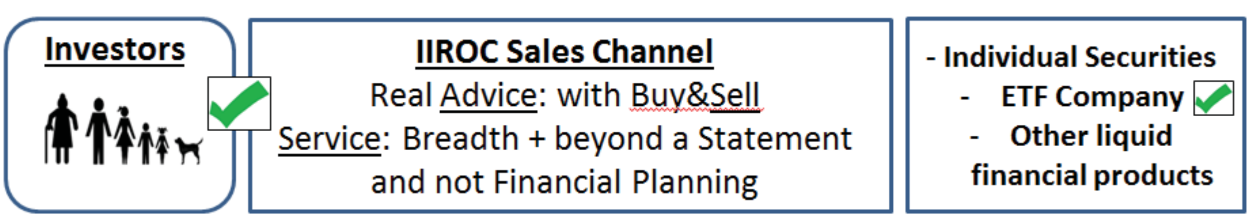
1. Highest licensed,
2. Full access to all Products and Services (a form of Liquidity),
3. Complete Tax, Accounting, Estate, etc … counsel, and
4. Practicing all Investment Styles, including Buy&Rule ®

will be the IIROC Life-Licensed Investment Advisor. All the Canadian investors want this Advice+Service offering; who wants an Advisor with lower licensing? Less Products + Services?



As mentioned above I believe that the IIROC licensed firms, will start to encroach into the aHNW marketplace as well; lowering their limits. This will be a strategic preemptive move against the Robo's. A Bear market will help in this regard. Just watch out for the 'bad' IIROC advisor. And I also wonder how many Robo's will survive the next Bear; there are going to be common acronyms, such as CDIC and CIPF, shared with

So, as Wealth Increases, as the rungs of the HNW Ladder are climbed, Canadian Investors will flock to the IIROC Sales Channel. The Wealthy, the HNW, know where to obtain Advice+Service.

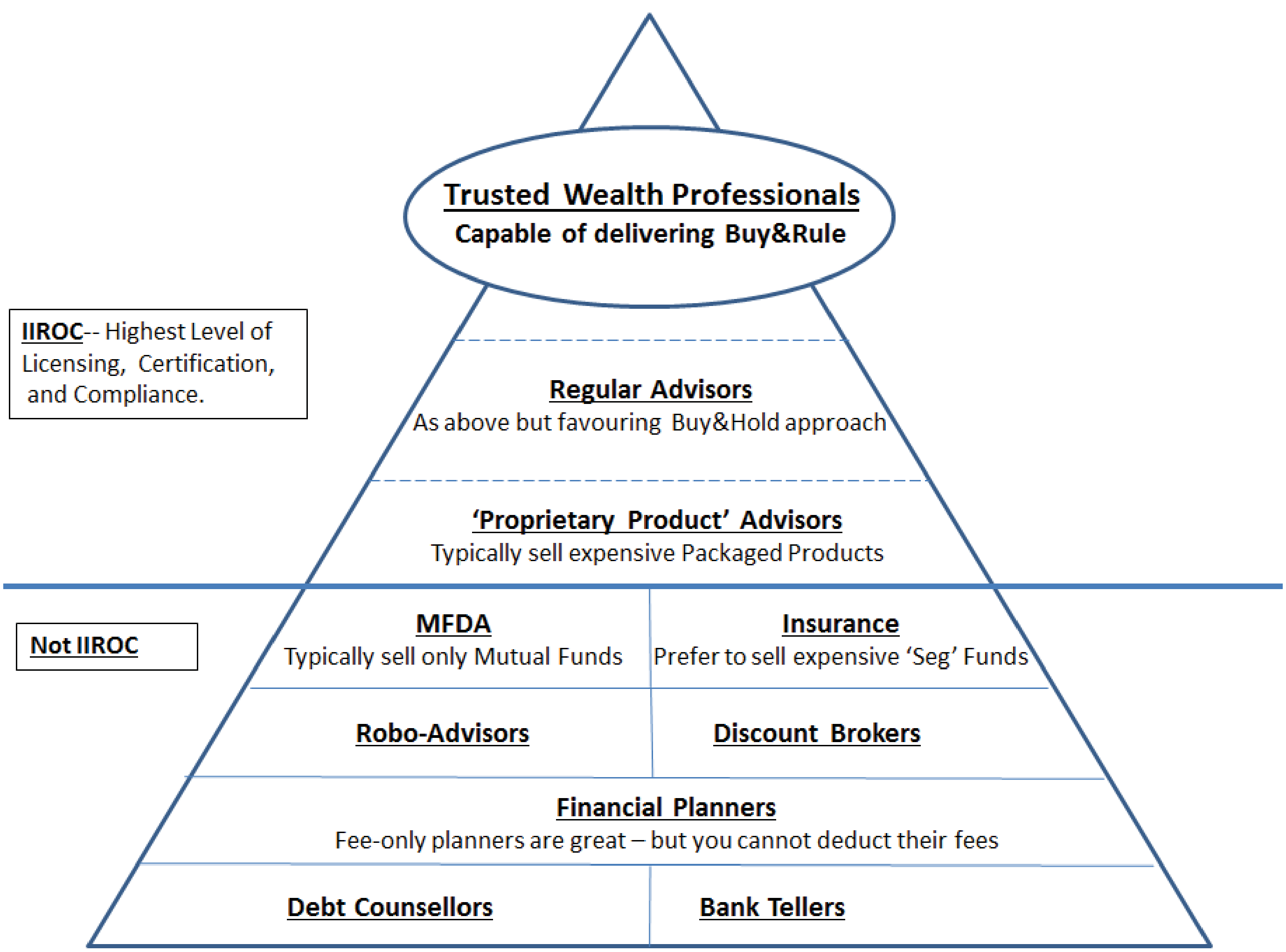


It may be the opportunity of a life-time, that as our current over-heated Bull market, returns to a Norm, via a:

1. Crash
2. Correction
3. Trickle-Down
4. Sideways Slide
5. Trickle-Up (but with lower growth than Inflation)

that the Investment Style Buy&Rule ® becomes the ideal haven.

The next Bear could be Gentle, or a ferocious Grizzly, but given a choice, I'd like to miss the most of it. That's why I have a Trusted Wealth Professional and don't use Mutual Funds. Capital Preservation and Liquidity are two components of the Advice that has been shared with me; reflected in my investment initiatives.



Addendum 1: The 'Bad Advisor' Blog may start

Up-Beeping is something that the 'Bad Advisors' are great at. If you left your MFDA sales person and transferred your assets to a full-service IIROC broker who has Financial Decidophobia (fear of making financial decisions), but they are a great relationship person, and they love the free lunches that mutual fund companies provide along with baseball tickets, luxury cruises, spa outings, Sonoma wine tasting 'junkets', etc … you may just find that your total Beeps now are greater than your Beeps you paid when transacting directly at your Mutual Fund company.

So you owned A-class mutual funds previously and now you own the F-class, but your total fees are higher. The average UpBeep is from about 200 Beeps to 225 Beeps.

And keep in mind your overall Wealth performance as well as some of these 'Financial Decidophobia' & 'Relationship-type' advisors are often swayed by the Mutual Fund sponsor of their latest Lunch&Learn or XMAS party. This is when Up-Beeping becomes Beep Churn (with not often positive results). But if you move from A-class to F-class, for the same Fund, and your total fees have gone up, this is bad news. You probably need lower priced no-commissioned ETFs (unless utilizing a specialty Mutual Fund).

Or you need to leave your Bad Advisor.

Addendum 2: Fee & Advice After-thoughts

Let's think about this example. Buying/Owning/Selling a home. Using round numbers as an example, you bought a home for $1M and paid 3%+3%=6% as a commission to Real Estate Agents. So that's $60,000 in Commissions. You pay your property tax, your utilities and upkeep. And now your Agent comes by and offers you a Valuation Service priced at 0.00365% to tell you what your house is worth; that's just $10/day. Do you buy it? It's made easy for you; automatically deducted from your bank account. And only $3650 per year? It could show you comparables in your neighbourhood? Perhaps via Monthly reports!

But you think that you don't need it, it's free online, or it doesn't matter now (you're busy and exhausted from commuting). You think it's a Scheme, it's a redundant, often free and value-less service. You can find out the value of your home, to the same degree of error+accuracy online now.

Please don't get charmed into thinking that a statement (online or not), or an annual phone call to inquire about a possible RRSP donation, is actually considered Advice or Service. IFIC's own statement shows that the average Canadian Mutual Fund investor has $46,000 at the end of 2015. So if we add a bit to that, and call it $50,000 now, there is no set standard level of Service or Advice that applies to a Mutual Fund investor. Hence it's all Commissions and Financial Planning, both of which are not deductible as ruled by the CRA. Note: I think the Fund Manager is doing all the work (if they aren't Closet Indexing).

Anyways, how do you feel about these 3 Advice+Service+Fee scenarios?

1. An 88-year old man had $2M in Mutual Funds at an Orangeville bank branch. He thought he only paid $100 a year in fees; that's what the Teller at the Bank told him. He recently passed away. Fee Shock was not the cause of his death.

2. A 55-year old recent divorcee, and first-time ever+anything investor, was convinced by a mutual fund sales person to invest her 2015 settlement proceeds of $600k in 'safe' mutual funds. Her first statement of 2016 showed her Oil based holdings were worth less than $500k. It did get worse, before it got better, but it still hasn't recovered. She's still alive. And single.

3. A 75-year old Grannie was convinced at the bank branch to switch her life-savings of $700k from GICs into a Bond fund just before the USA election. The Mutual fund sales person had never seen a period of rising interest rates; evidenced in November + December of 2016. Grannie now has $600k, pays about 100 Beeps per year in Fees,

and is worried about rising hydro rates. And property tax. And the cost of food. Grannie is counting her days, but not solely because the Bank is now wealthier. And I'm not sure if the Teller is still at the Bank.

Nothing moves in a straight line. The graph below is the last 10 years of the TSX. It is almost flat. And the market doesn't always go up. That's why Advice matters and why it is non-existent in the Mutual Fund Sales Channel. There's a Time to Sell. And a Time to Buy.

It's fair to say though, that if you have substantially more than $250,000, maybe $500,000, you do receive preferential treatment and service levels from your Mutual Fund Sales Person/Company. I don't disagree with that. But I'd love to debate how the Mutual Fund Services are defined; I know it isn't Advice.

Note: Adding to a position with an annual RRSP or TFSA contribution is not Advice. Most Mutual Fund Sales People just 'add' to the Pie-Chart; Balanced, Conservative, Growth, Income, etc … fund that you are already holding.

Addendum 3: Musings regarding Mutual Funds Commission-based Scheme

Commission-based Scheme - Summarization

1. Commission Laundering; Sales Channel Fee is non-deductible if paid directly to Sales Channel, and it's non-deductible if there is no Advice or Service beyond Financial Plan (non-deductible); see Point2 in the main section of the Beep Brief. No other consumer product is setup like this; none that I can think of, but that may change as well.
2. Mutual Fund companies pay themselves Daily, before calculating NAV. And it's an unknown amount and unknown communicated amount. "How much did I pay today?" "Or this year?" You don't know. You don't get a receipt. You don't know how much was taken. It's as close as you can get to an unauthorized withdrawal from your bank account And it is approximately 250 times per year. You get paid 2x/month, so 24 times a year, but you pay Mutual Fund fees 250 per year (with Embedded Commissions).
3. Embedded Fees, Canadian Investors don't see the Fees in total amount or percent amount until CRM ½ is shared on a statement at the end of the year. This denies the Liquidity by contrasting performance versus other instruments; ie. Bond Fund vs. 5-year GIC rate. All the Front-End Load, No-Load, DSC's, etc … bury the Fees such that the total Embedded Fee is roughly ½ Embedded Product Costs and ½ Embedded Commissions.
4. Trading Expense Ratios, TERs, are essentially a blank cheque (and they could be higher than some ETF Fees; 0.03% and 0.04% are ETF Equity fees that are in the public domain).
5. IIROC Advisor Fees decline when AUM increase (Fee-based account). I'm still perplexed; **there are no volume discounts on Mutual Funds?** Do they exist within the Sales Channel? Perhaps via rebates? If you had $1M or $2M in AUM, you probably would have a 1% (or 100 Beeps) Fee, or Less, via an IIROC advisor (OK, not via the 'Bad' IIROC advisor who 'gouges' their clients). But combine that with ETFs that charge 0.04 or 0.25, and you're better off with Advice and Liquidity from the full-service life-licensed IIROC advisor.

And yet we're still not talking about the Investments. And does anybody care about the Risk of the investments? And their Performance? Or if I made any money? Keep up with inflation? Beat a Benchmark? Retired early? Found Freedom at age 55?

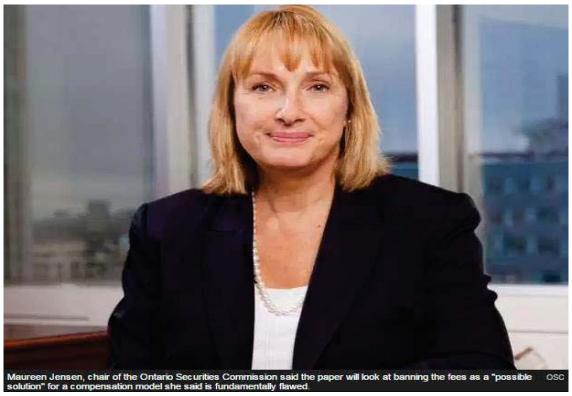
Nope.

Mutual Fund Sales Person got their Beeps. They DSC-ed you (potentially) and they have their Beep Loss Prevention Manual in case you try to Sell and go to Cash/E, or move your assets.

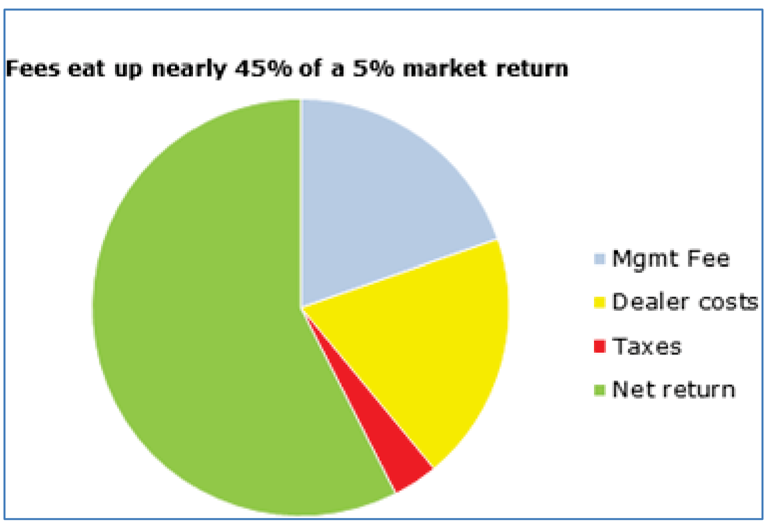
Back Matter

I've created a Beep Brief Back Matter over the past few months. It contains many pertinent articles; with the article title, the original article itself and source links, for my background reading when I was compiling Notes for myself.

It is available in softcopy and will accompany the Beep Brief Submission.



Maureen Jensen, chair of the Ontario Securities Commission said the paper will look at banning the fees as a "possible solution" for a compensation model she said is fundamentally flawed.



Thanks and Apologies

To my confidants, and my proof readers, many thanks. Especially for the stories about Profiteering via Embedded Commissions. And you've already received my apologies for enduring the Out-Takes and the Extracts from this Brief. Evidenced by the fantastic Spell-O's that are created when you've got no RAM left for Auto-Correct to run on your laptop ☹

Also there still might be a correction or two required in the Beep Brief, and I apologize for that in advance.

Plus, thanks and apologies to any of the creators of the non-watermarked images+cartoons I've snipped from the web. I've left an audit trail, where possible, to show the original sourcing.

INCLUDES COMMENT LETTERS

The Beep Brief

A response to the CSA CONSULTATION PAPER 81-408
regarding the discontinuing of Embedded Commissions.

Back Matter

Gerry Gabon
Founder and President
Trusted Wealth Professionals

TWP | TRUSTED WEALTH PROFESSIONALS

Submitted
June 9th 2017

http://business.financialpost.com/news/fp-street/canadas-market-watchdogs-look-at-fundamentally-flawed-embedded-fees-on-investment-funds

Canada's market watchdogs assessing impact of ban on 'fundamentally flawed' embedded fund fee model

BARBARA SHECTER | September 27, 2016 6:23 PM ET

Maureen Jensen, chair of the Ontario Securities Commission said the paper will look at banning the fees as a "possible solution" for a compensation model she said is fundamentally flawed. OSC

Ontario Securities Commission chair Maureen Jensen says Canada's compensation model for mutual funds is fundamentally flawed and that regulators are looking at an outright ban on embedded fund fees as a "possible solution."

"The current compensation model consists of fees set by the fund manager to incent sales," Jensen said Tuesday in her first major address since taking the helm of the country's largest market watchdog. "This does not put the investor's interest first, and that's a fundamental flaw that needs to be addressed."

Following the luncheon speech at the Toronto Board of Trade, Jensen told media it is up to the investment industry to come up with a viable alternative to a ban.

She said some suggested alternatives, such as capping the embedded fees, do not go far enough because they don't eliminate conflicts of interest at the heart of the current system.

"We know this would be a major change for investors and the industry," she told the business crowd during her speech. "That's why input from all of our stakeholders is necessary throughout this process."

The Canadian Securities Administrators, an umbrella organization for provincial commissions, will publish a consultation paper by the end of the year that looks at the potential impacts of an outright ban on embedded fees for investment funds, including mutual funds. It is the culmination of an examination that has been under way for more than three years.

The investment industry has fought strongly against curtailing embedded mutual fund fees, which have been banned in other jurisdictions such as the United Kingdom. Industry groups argue that banning the embedded fees in favour of a set annual fee for advice would squeeze some investors out of the investment game because they either cannot afford, or would chose not to pay the upfront fee.

Industry representatives have also argued that new rules requiring greater disclosure of fund fees will improve outcomes for investors by giving them a better understanding of what and how they pay for advice.

Jensen called these "critically important" changes, but said "disclosure alone is not enough."

In her speech, she cited research from the National Bureau of Economic Research that she said suggests a combination of embedded fees and unsuitable portfolio construction has caused the investment returns of advised clients to lag passive market benchmarks by two to three per cent a year.

"The impact of these fees on investor returns is significant," she said. "Investors experiencing this kind of outcome on a consistent basis would never break even and would, in fact, be worse off."

Jensen, who took the helm at the OSC in February, also used the speech to announce that the regulator will be the first in Canada to launch a hub to work directly with fintech companies. The official unveiling of LaunchPad is to take place in a few weeks, and the plan is to help the upstart financial technology firms navigate — and even potentially tailor — the regulatory framework.

The upstarts, which use technology and data to compete in traditional financial services business lines from lending to investment advice, don't fit "neatly" into current regulations, Jensen said, acknowledging that some requirements "might not make sense" for the new business models.

"Based on our experience so far, many Fintech companies 'don't know what they don't know' about operating in a regulated industry, and that can threaten their ability to do business," she said. The idea behind LaunchPad is to help "tailor regulation and oversight to their unique business models, as long as investor protections are in place."

Forty fintech firms have sought registration over the past couple of years, Jensen said, adding that these include online advisers, peer-to-peer lenders, and crowdfunding platforms.

She said another recent OSC initiative, a paid whistleblower program with rewards of up to $5 million for tips that lead to successful cases against those who breach securities laws, has already proven "fruitful." It has generated 30 tips since the launch in July, some of which involve alleged malfeasance on accounting statements and disclosure violations.

There are suggestions of "serious potential offenses" among the tips received, Jensen said, adding that tipsters are coming forward to reveal alleged activity and behaviour that would have been very difficult for the commission to unearth on its own.

"I am encouraged by these early results," she said. "New enforcement tools like this will help us resolve cases more quickly and effectively."

Financial Post

http://www.theglobeandmail.com/globe-investor/funds-and-etfs/etfs/mutual-funds-arent-looking-for-a-fee-fight/article18231785/

PORTFOLIO STRATEGY

Lower-cost mutual funds? Dream on

ROB CARRICK
The Globe and Mail

Published Friday, Apr. 25, 2014 6:09PM EDT

Exchange-traded fund companies have been slashing their fees lately in a display of macho one-upmanship that you never see in the mutual fund business.

Mutual fund fees are the black hole of Canadian investing. We know from work done by the independent analysis firm Morningstar that our fund fees are among the world's highest. But the fund industry's reluctance to talk about fees makes it hard to tell whether they're falling or not.

So let's dig into the numbers. As a proxy for the fund industry, we'll look at 12 popular mutual funds with combined assets of close to $100-billion. Three of the funds had lower fees in late 2013 than they did five years ago, while nine were charging more.

The past five years were a period when fund companies had to deal with the introduction of the harmonized sales tax in some provinces. A key competitive consideration for the fund industry: Eat the extra costs of the HST, or pass them along? Other business pressures over the past five years included the rise of the ETF sector, which is much smaller than the mutual fund industry but faster growing, and the lingering shock to investor confidence caused by the market crash of 2008-09.

As shown by the group of 12 widely held funds, the overwhelming preference in the fund business over the past five years was to let fees float higher. Where fees did rise, the total increase was typically 0.1 of a percentage point or less. While such increases would have had a modest effect on investor returns, they're still highly symbolic. They suggest that investors should give up on the idea that mutual fund fees in Canada will ever meaningfully decline on an industry-wide basis.

This sort of decline has long been anticipated, in part because our fees are high on a global basis. Fee competition from the ETF business, a direct competitor to mutual funds, would also suggest lower fund costs ahead. The final argument for lower fees is based on economies of scale – the idea that funds become more efficient to run when their fixed costs are applied against rising assets.

On our list of 12 popular funds, there is one that has become significantly cheaper in the past five years. It's Investors Dividend, which went from a management expense ratio (MER) of 2.68 per cent in 2009 for its Series A version to 2.39 per cent in 2013. Investors Group announced a year ago that it was cutting fees to make its comparatively expensive products more competitive, and here is one tangible result.

Fees also declined for Dynamic Strategic Yield and Beutel Goodman Canadian Equity over the past five years, though not so dramatically. The latter fund's decline was notable because the fee was already near the low end for Canadian equity mutual funds.

The nine funds with rising fees over the past five years show a pattern of multiple small increases. The $17.5-billion RBC Canadian Dividend Fund – it's the country's largest mutual fund, according to Globeinvestor.com – has had the MER for its Series A version rise from 1.7 per cent in 2009 to 1.79 per cent in 2013.

A spokesman for RBC Global Asset Management said the rising MER is due entirely to the HST. He also noted that the administration costs built into the MER were cut by 0.02 of a percentage point at the beginning of 2014, while the administration fee for RBC Balanced fell 0.04 of a percentage point. "Overall, over 90 per cent of RBC GAM mutual funds have MERs that are below the category average," he wrote in an e-mail.

It's worth noting that every bank-run mutual fund on the list of 12 popular funds is more expensive to own than it was five years ago. This is admittedly a small sample, but the banks do seem intent on squeezing more fee revenue from their mutual funds.

Rising fees may seem inconsequential for a fund like RBC Canadian Dividend, which has regularly outperformed both the average return for its peers in the Canadian dividend and income equity category and the S&P/TSX composite total return index.

BMO Bond is a different story – returns have been consistently below average over the past five years. Scotia Canadian Dividend made 13 per cent annually for the five years to March 31, while its peers averaged 14 per cent and the index averaged 13.7 per cent.

How common is it for investors to pay fees – maybe even rising fees – for indifferent or worse returns? “Out of all the mutual funds I cover, I would say 25 per cent are pretty decent,” said analyst Dave Paterson of D.A. Paterson & Associates. “You’ve got another 50 per cent that are acceptable, but you might as well be in an ETF, and 25 per cent that probably shouldn’t be sold.”

ETFs have tiny MERs because they’re robotic index-trackers for the most part, whereas mutual funds must bear the cost of analysts and portfolio managers who select individual stocks and bonds. Fund fees also include commissions paid by fund companies to the advisers and dealers who sell their products, whereas ETFs typically do not.

A fair-and-square comparison of ETFs and mutual funds would add a percentage point to ETF fees to cover the cost of investment advice and financial planning that is baked into most fund fees. But thanks to the latest round of fee cuts, you can combine ETFs and fee-based advice and still pay much less than you would with mutual funds.

The iShares S&P/TSX Capped Composite Index ETF (XIC) has an estimated MER of 0.05 per cent today, down from 0.27 per cent a year ago. The iShares people cut the cost of this fund in response to a fee reduction made a while back in a competing product, the BMO S&P/TSX Capped Composite Index ETF (ZCN). BMO’s response came this week – a further fee cut in ZCN to match iShares.

The back story here is that ETFs had a disappointing 2013, sales-wise. While global stock markets soared, the flow of money into equity ETFs was offset to some extent by money pouring out of bond ETFs. Add a growing number of competing ETF providers to this picture and you end up with recent fee cuts announced by iShares and BMO.

The mutual fund industry had quite a decent year in 2013 and now sits on roughly $1-trillion in assets, compared to $66-billion for ETFs. Do not expect a mutual fund fee war any time soon.

Follow me on Twitter: @rcarrick

http://www.advisor.ca/my-practice/give-clients-a-real-choice-11665

GIVE CLIENTS A REAL CHOICE

John J. De Goey / January 4, 2011

Advisors generally do a good job in helping their clients make smart decisions with their money. Most try to help clients obtain a meaningful understanding of capital markets. Most try to make reasonably suitable recommendations. These advisors will diversify between equity and income, value and growth, small cap, large cap and a number of other ways, too.

What I see less of though is a diversification between active and passive products and strategies. This, of course, could be an all or nothing proposition or a mix and match (core and satellite) combination.

Most financial advisors recommend an all active approach all the time. These same advisors insist they have no bias at all and that they go out of their way to help their clients make informed decisions about the products and strategies being pursued.

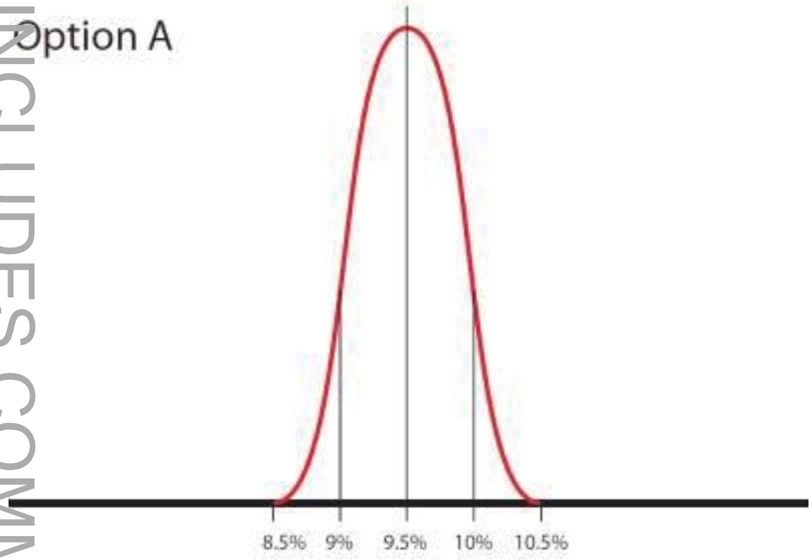
I beg to differ.

My sense is there are advisors who are deliberately silent on the matter of cost impacts when discussing options with their clients.

Here's a simple example. Why not show clients both options? Don't direct them one way or another to start. Simply explain that both options are on the table and that over the course of their lifetime, both would likely be reasonable depictions of their overall investment experience.

For anyone who wants a credible bit of background and rationale regarding what follows, please read William F. Sharpe's "The Arithmetic of Active Management". If you can't locate a copy, you can get it here.
Sharpe's paper provides a simple way of combining the notions of risk, return and cost. It shows that both historically and logically, an average investor's expected return is the return of the asset class minus the cost of the product used to get exposure to that asset class- plus or minus a degree of variance.

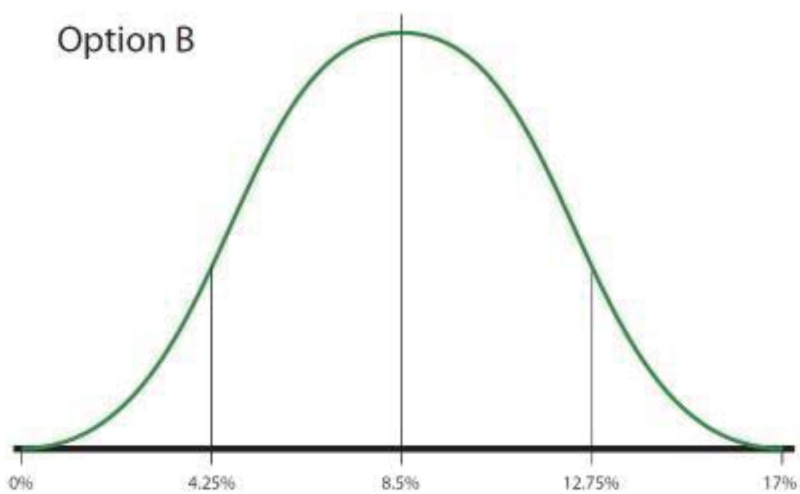
In my illustrations, Option A features a 9.5% average expected return with a relatively modest variance (tracking error), while Option B features an 8.5% average expected return, but with a fair bit of additional variance (positive or negative "alpha").



Since the differences are due to product cost and the likely dispersion of returns, we're left with Option A hugging a benchmark minus a lower cost, +/- a tracking error and Option B costing more and having a greater variance of possible return outcomes due to security selection.

One would reasonably expect modest tracking error for the passive option and a much higher variance for the active option. If markets return 10% and the passive option costs 0.5%, while the active one (featuring no advisor compensation) costs 1.5%, then the long-term difference is 1% per annum- forever.

Is it worth a certain 1% cost increase if that choice is most likely to involve a similar reduction in long term returns with a wider dispersion of outcomes? Remember that for every person on the right side of the centre line in either option, there's another on the left side. There are pros and cons to both approaches, but which option is a typical investor more likely to choose if asked? Both options have a constituency.



Considering the choices available according to Sharpe's paper, investors should clearly understand their two options. Here's a value proposition that you may wish to consider taking to them. Ask "If I could show you how to save tens or even hundreds of thousands of dollars over the course of your lifetime by simply replacing your current investment products with products that have a similar expected pre-cost risk and return profile, but which cost 1% less and have less expected volatility, is that something that would interest you"?

All I know is that every time I ask that question, I get a resounding...Yes.

In fact, the only people I've ever met who don't give such a response are the people who would never asked the question in the first place.

John J. De Goey, CFP, is the vice president of Burgeonvest Bick Securities Limited (BBSL) and author of The Professional Financial Advisor II. The views expressed are not necessarily shared by BBSL. You can learn more about John at his Web site: www.johndegoey.com.

http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=760407&culture=en-CA

How much are your mutual funds really costing you?

New fund industry trade group infographic understates long-term effect of fund fees.

By Christopher Davis | 20/07/16

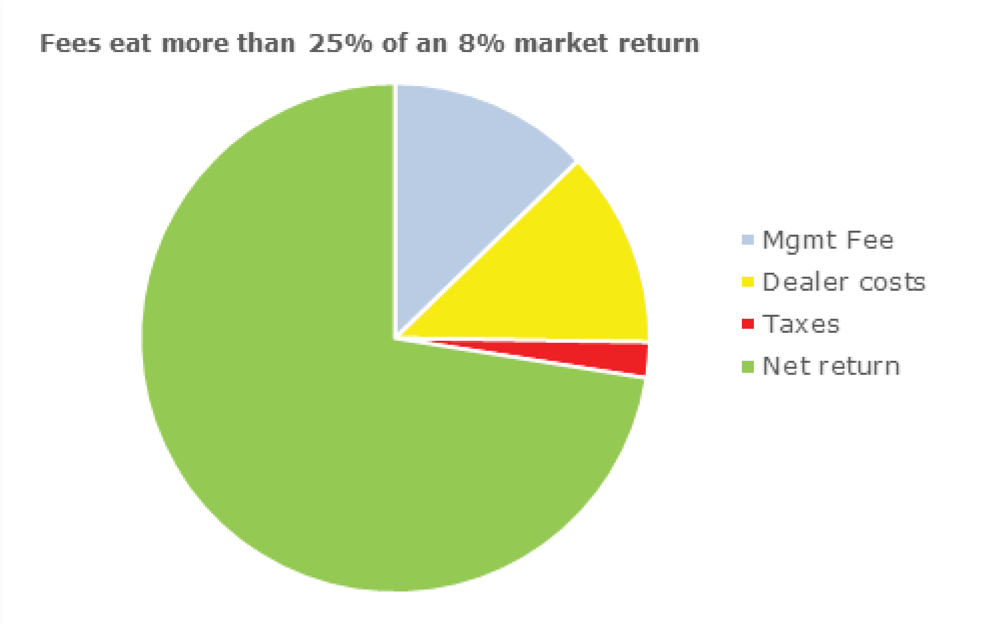
What Scottish poet Andrew Lang said of politicians--that they "use statistics in the same way that a drunk uses lampposts"--could also be said of the Investment Funds Institute of Canada's (IFIC) recent effort to illustrate the value investors receive from paying mutual fund fees.

Christopher Davis is Director of Morningstar Research at Morningstar Canada. In this role, he oversees Morningstar's Canada active fund research analyst team and sits on the Canadian Morningstar Analyst Ratings Committee. He is Morningstar Canada's lead analyst for the Fidelity and Sentry fund families. He also represents Morningstar on the Canadian Investment Funds Standards Committee. Prior to assuming his current role in 2012, he was a senior fund analyst in Morningstar's U.S. office. During his tenure, he led Morningstar's coverage of Fidelity Investments and was the editor of the Fidelity Funds Newsletter. He also served as the lead analyst on several other asset managers including the Baron, FPA, Columbia Acorn, Ariel, and T. Rowe Price fund familes, as well as for the health-care category. His specialties included behavioral finance, income oriented, and tax-managed fund. He also oversaw Morningstar's target-date fund coverage of the Fidelity and TIAA-CREF series. Davis joined Morningstar in 1999 as a data analyst and became a fund analyst in 2000. Davis holds a bachelor's degree in economics and political science from the University of Illinois Urbana-Champaign

The industry trade group says its recently released infographic on the topic, which coincides with new regulatory requirements under the Client-Relationship Model – phase 2 (CRM2) mandating dollar-value disclosure of advisory fees, is designed to illustrate the impact of fund management, distribution and tax costs on investor accounts.

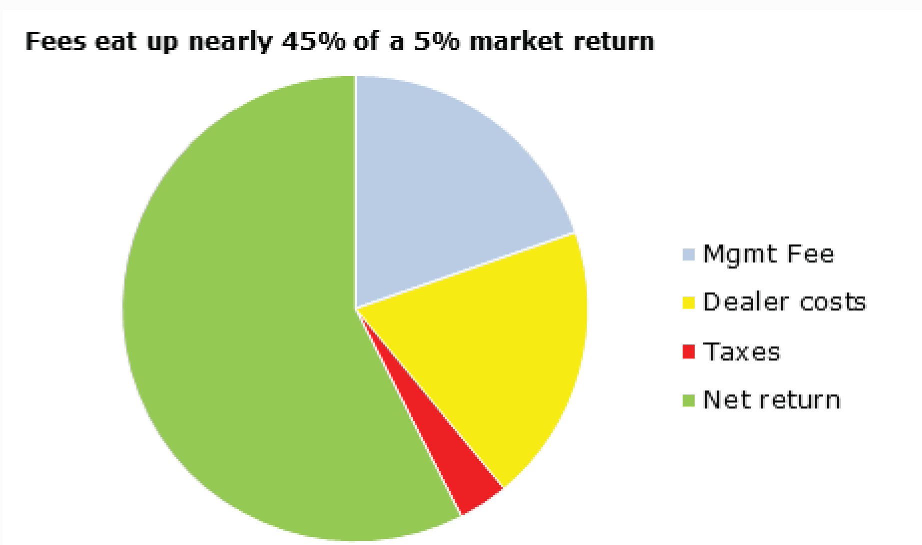
Given its source, the message to investors isn't too surprising: You're getting a great deal! If a fund's management-expense ratio (MER) is 2.2%--which an IFIC-funded study says is the average asset-weighted cost of funds sold through advice-based channels--just 2.2 cents of every dollar invested gets you professional money management and investment advice. All but a tiny slice of the pie grows along with your investment.

IFIC gets the basic arithmetic of fund expenses right, but it doesn't put them into the proper context. What sounds like a trifling sum in comparison to the size of your overall investment appears quite substantial as a proportion of your investment's returns. Let's say your 60% stock/40% bond portfolio closely matches the 8.4% pre-expense return[1] this asset mix has averaged over the past 30 years. An 8% return before fees turns into 5.8% after subtracting the 2.2% MER. What IFIC calls a great value will have eaten more than 25% of your investment returns for the year, as the chart below demonstrates.



Source: Morningstar. Chart assumes 8% gross annual return and 2.2% in annual expenses.

Market returns mean fund expenses chew up an even larger piece of the pie. This is a reality investors may confront in coming years. While it was plausible to expect 8% gains from a 60/40 portfolio over the prior three decades, investors should expect more subdued long-term returns going forward. With the FTSE TMX Canada Universe Bond Index--the bellwether for the investment-grade bond market--yielding a skimpy 1.8%, it's all but impossible to match the 9% annualized gain it notched over the 30-year period. It's not beyond the realm of possibility a 60/40 portfolio returns 5% instead of 8%. Instead of swallowing 25% of pre-expense returns, the MER would gobble nearly 45%.



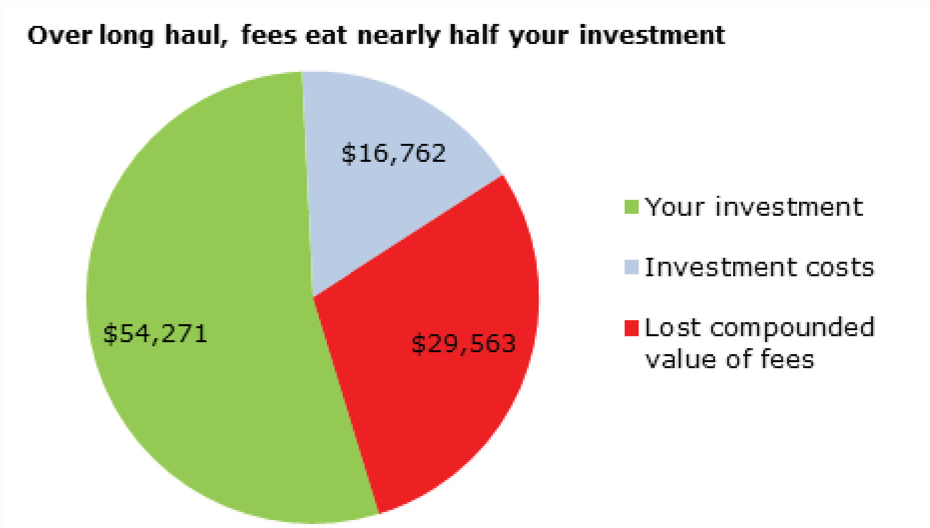
Source: Morningstar. Chart assumes 5% gross annual return and 2.2% in annual expenses.

Thanks to miniscule yields, bond investors will feel the expense pinch the most. The median MER for commission-based core domestic bond funds clocks in at 1.59%, consuming nearly all of the investment grade market's 1.8% yield. Yield typically makes up the better part of bond returns, but that's especially the case these days. The bond market has benefited mightily from the boost it's gotten from three decades of declining interest rates--bond prices and rates move in opposite directions--but with yields at already-low levels, there's not much room for them to fall further. (And if they rise, you're likely to earn negative returns, adding insult to the injury of a yield-swallowing MER.)

The ugly math of fund costs: Where compounding works against you

The harm done by fund fees worsens over time for the same reason your investments grow. If you've shelled out 2.2 cents on the dollar in fees, the 97.8 cents put to work grows exponentially thanks to the magic of compounding. But so does the value of the 2.2 cents paid in fees.

As an example, let's get back to the 60/40 portfolio averaging 8% annual returns before fees with a 2.2% MER. Over a 30-year period, a $10,000 investment will grow to about $54,300 after fees. Over that stretch, the investor will rack up almost $16,800 in investment expenses. However, the opportunity cost is a lot higher. Without fees, $10,000 would rise to about $100,600 over 30 years. The difference between the before- and after-fee balance--more than $46,000--is almost three times what the investor paid in fees. The cost to the investor isn't just $16,700 but also the more than $29,500 in foregone gains. While the MER will have consumed about a quarter of the investment returns on average in a single year, the combined explicit (investment fees) and implicit (compounded value of investment fees) costs will have devoured 45% over a three-decade span.



Source: Data generated using Savii Financial Concepts MER Calculator.

Beware of termites

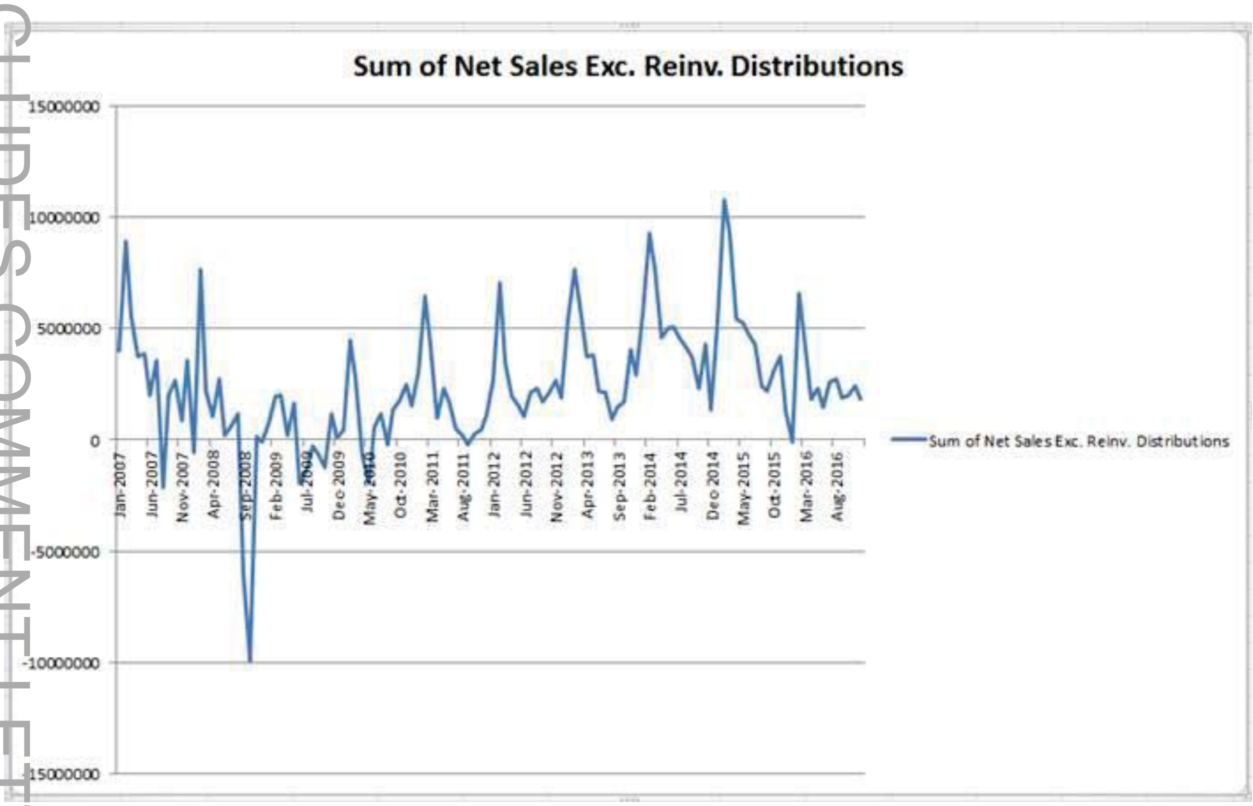
Of course, there's no world where you can invest without fees. Investment managers don't work for free, though low-cost ETFs now offer something not far from it. Paying for financial advice, whether as part of or separate from the MER, chips away at returns on one end, but a capable advisor can more than make up for it on the other by minimizing investment and tax costs, managing asset allocation, and ensuring clients save enough and stick to their financial plan when the going gets rough.

The question, though, isn't whether investment providers should be paid but how much. Because the price you pay comes directly out of your investment returns, less is always better. Even seemingly small costs add up over time. As John Oliver, the host of HBO's *Last Week Tonight*, more colourfully noted, fees are like termites: They may be small and barely noticeable, but they'll eat your future.

Note

[1] Our pre-expense return calculation uses 30-year annualized returns of the S&P/TSX Composite Index and the FTSE TMX Universe Index as of June 30, 2016.

Graph from Spreadsheet of Mutual Fund Net Sales (source IFIC below)



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https://www.ific.ca/wp-content/uploads/2016/07/Infographic-Value-for-Your-Mutual-Fund-Fees.pdf/14577/

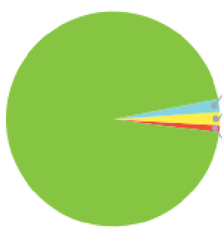
IFIC.CA

VALUE FOR YOUR MUTUAL FUND FEES

Your fees pay for services provided by:

- **Your fund manager** – the company that manages the mutual funds that you buy.
- **Your dealer** – the firm where your financial advisor is registered. Some dealers charge an additional fee to you directly.

...and for taxes to federal and provincial governments.



These three types of costs are reflected in the fund's Management Expense Ratio (MER).

- Your Money – Invested to Grow
- Fund Manager Fees
- Dealer Fees
- Taxes

FUND MANAGER SERVICES

- Sets the **strategy and goals** for a fund
- Keeps **records** for the fund and for all clients, including tax reporting
- Chooses and monitors **experts who buy and sell** investments to match the fund's goals
- Provides or arranges for **legal, accounting, audit and custodial services**, and ensures the fund meets regulatory requirements

DEALER SERVICES

Your dealer firm provides these services to you directly or through your advisor, and works to ensure your advisor meets government rules and regulations:

- Understands and reviews **your financial needs** and **how much risk** you are willing and able to handle
- **Keeps detailed records** about your account
- Delivers **account statements** and other information to you
- **Guides you** to build and maintain your financial plan
- Provides you with **information and access** to your account online
- **Buys/sells units** of a fund for you, based on your needs and your ability to handle risk
- Is a member of **investor protection funds** and **regulatory organizations**

TAXES

GST and HST are charged on fees and services

IFIC THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA http://insurance-journal.ca/article/fee-based-compensation-could-take-a-huge-toll-on-mgas/

Fee-based compensation could take a huge toll on MGAs

by Alain Thériault Feb. 28, 2017 07:00 a.m.

The newly minted obligation to disclose mutual fund fees will probably spread to segregated funds. If the regulators also ban embedded commissions and MGAs are forced to implement fee-based compensation only, it may cost them $200 million, a recent study finds.

The consultation by the **Canadian Securities Administrators** (CSA) on the possibility of eliminating embedded commissions in mutual funds is troubling MGAs. They worry that this ban will spread to segregated funds, just as disclosure has.

Disclosure of segregated fund commissions would affect MGAs' economic model because of their structure. This finding was stated in an *Insurance Advisory Service* report on MGAs published in August 2016, produced by **Strategic Insight**.

An excerpt of this report obtained by *The Insurance and Investment Journal* states that the segregated fund compensation model will continue to be largely skewed towards deferred sales charges (DSC). This compensation structure accounted for 40% of gross seg fund sales in 2015, compared to 20% for mutual funds during the same period. The smaller proportion of DSC for mutual funds is due to the fact that CRM2 disclosure requirements already apply to them.

"Based on MGA gross sales and the estimated DSC share in 2015, DSC point-of-sale commissions alone had an annual economic impact on MGAs and their advisors of approximately $200 million," the report confirms. Strategic Insight thinks that DSC will have a greater on impact MGAs than on mutual fund dealers.

Hub Financial President **Terri Botosan** is optimistic despite these regulatory issues. "It's a very exciting time for the MGAs: we must participate in discussion with the regulators, and make sure that every party considering these decisions understands what that might mean for the customers," she says.

We know that disclosure is imminent for segregated funds, **James McMahon,** president of **Financial Horizons Group** – Quebec. "Regulatory changes are accelerating in the industry, and we have to spin on a dime, which is getting more and more expensive. We have a back-office system for mutual funds and segregated funds, with a staff of over 50 people. If the advisors all go to fee-based compensation tomorrow morning, it would take me four to five years to absorb the shock," he says.

The **Canadian Association of Independent Life Brokerage Agencies** (CAILBA) and the insurance industry overall have clearly expressed their support for embedded commissions in segregated funds to the **Canadian Council of Insurance Regulators** (CCIR), says **Michael Williams** a **BridgeForce Financial Group** (BFG) partner who is also president of CAILBA. "Agents are not afraid of disclosing and stating at the point of sale with the client that they have a choice as to how they pay for advice. I hope the regulators heard the message. Even if mutual funds embedded commissions are banned, we believe we can still support embedded commissions on seg funds with success," he adds.

Six of one…

James McMahon thinks that by banning commissions, regulators will create a bigger problem than the one they wanted to solve. "Take a couple who saves $25 or $50 per month and over the years manages to accumulate substantial assets. Who will take care of them, who will help them? The regulators haven't answered that question yet!"

Michel Kirouac, vice-president and general manager of **Groupe Cloutier**, does not understand why the CSA is leaning toward one model rather than another. He views them as equivalent. "I don't really see a difference between charging the customer fees and selling funds with embedded commissions. In the industry, 90% of funds foresee compensation for the advisor of about 1%," he explains.

Compensation still hovers around this mark, Kirouac adds. A fund with embedded commissions whose management expense ratio (MER) is 3% will pay the advisor a trailing commission of 1%. The rest will go to the manufacturer. If this fund exists in an F series, the MER will be 2% and the advisor can adjust his or her trailing commission. "For example, we see an average trailing commission of 0.6% to 1% in F series funds," Kirouac says.

In the fee-based model, customers pay the manufacturer fees of 2%, and the advisor negotiates the fees directly with the customer. "This is the model that the regulators are heading toward. If the fee-based model is imposed, this may affect the value of investment fund blocks of business," Kirouac points out.

Michel Kirouac is not a fervent believer in the single fee-based model. "100% transparency is a fine principle, but what will the banks put on their statements? This reform will confuse people for nothing, in addition to affecting advisors who manage large asset volumes. We are not against disclosure, and it's already required by law. But eliminating trailing commissions would be quite a shock, and we would have to learn to live with it," Kirouac adds.

Groupe Cloutier is poised to submit a brief as part of the CSA consultation on the possibility of banning embedded commissions in mutual funds.

http://www.wealthprofessional.ca/news/etfs/more-mutual-funds-jumping-on-the-etf-bandwagon-224363.aspx

More mutual funds jumping on the ETF bandwagon

by Leo Almazora20 Apr 2017

With ETFs gaining traction among investors worldwide, mutual fund managers would have every reason to dislike their low-cost competition. But there's evidence that, for some, it's a love-hate relationship.

Citing data from independent investment research firm Morningstar, Marketwatch reports that more mutual fund managers are including ETFs in their portfolio.

In 2016, 1,222 mutual funds had an ETF among their holdings, accounting for a median value of 4.5% of the mutual fund's total assets under management.

Compare that to 2006, when there were only 595 ETF-holding mutual funds, with a median of 1.2% of the fund's assets placed in an ETF.

Such mutual funds are still the minority, however: a 2016 fact book released by the Investment Company Institute, an association of US funds, reported that there were more than 9,000 US mutual funds in 2015, holding US$15.7 in assets.

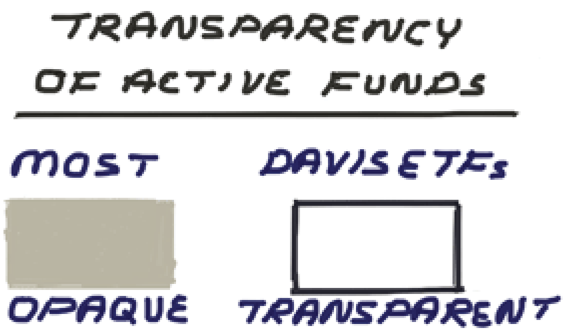
The top ETFs for mutual funds were equity-based, with the most popular being the SPDR S&P 500 ETF Trust — the largest ETF on the market with US$232 billion in assets. Six of the most widely held were bond ETFs, among which were two "junk bond" funds.

Morningstar didn't list which mutual funds used which ETFs, but it's possible that mutual fund managers use fixed-income ETFs to easily obtain broad exposure to the bond market, especially less liquid areas like emerging-market debt.

http://www.aaii.com/files/investorupdate/20170112.html?a=updatenm20170112

A Simple Solution to Offering an Active ETF

Thursday, January 12, 2017



Three new exchange-traded funds began trading today: Davis Select U.S. Equity (DUSA), Davis Select Financial (DFNL) and Davis Select Worldwide (DWLD). Normally such an event is not particularly noteworthy from our viewpoint. The launches of these funds are, however. They are actively managed equity ETFs based on strategies used for Davis Advisors' mutual funds, separately managed accounts and institutional funds. More importantly, they will follow the disclosure rules long used by index ETFs.

A bit of context is needed to understand why the launch of these funds is raising eyebrows. Actively managed ETFs remain relatively few in number. Most mutual fund companies have refrained from offering actively managed exchange-traded funds—particularly ETF versions of their equity-focused strategies. One particular hurdle has oft been attributed as the reason: transparency. Index (passive) ETFs disclose their holdings daily. Most mutual funds do not.

Attempts to provide a hybrid approach, meaning ETFs with reduced transparency, have generally not been successful. One platform that did pass the Securities and Exchange Commission's muster is Eaton Vance's NextShares. NextShares' exchange-traded managed funds provide limited transparency. Vanguard has its own platform and has filed to created ETF share classes for some of its actively managed funds. Last year, the SEC approved petitions from Bats Global Markets and the New York Stock Exchange for a streamlined process for listing actively managed ETFs. This was viewed as a positive for the industry, but it's not clear that the approval resolved the transparency hurdle.

Mutual fund provider Davis Advisors has settled on a simple solution for dealing with the issue of transparency. In registration statements filed earlier this month, the company wrote: "On each day that the Trust is open for business… the names and amounts of Deposit Securities to be included in the current Fund Deposit for each Fund will be published." Restating this in layman's terms, the ETFs' holdings will be disclosed daily. No lag. No complicated structure. Davis' actively managed ETFs will follow the same rules for disclosing their portfolios as index ETFs have done since the first exchange-traded fund (SPDR S&P 500 (SPY)) was launched in 1993.

Full, daily disclosure among actively managed ETFs is not a new concept. PIMCO provides it, as does Doubleline. The difference is that these companies offer bond ETFs. Since an issuer can have many bond issues outstanding and because the trading volume in each specific bond varies, there is less concern about active traders trying to jump ahead of a bond fund manager making portfolio changes then there is for a stock fund manager making portfolio changes. There are some actively managed equity ETFs offering daily disclosure [e.g., AdvisorShares Wilshire Buyback ETF (NYSE Arca: TTFS)], but they are relatively few in number and small in size. The four largest actively managed bond ETFs alone accounted for more than $2 out of every $5 invested in the 176 actively managed ETFs in existence as of December 31, 2016, based on data from Morningstar.

Davis Advisors is better positioned than other actively managed mutual fund providers to provide daily transparency because its mutual funds have below-average turnover ratios for their respective categories. The firm intends to follow a similar approach with its ETFs. Barron's quoted chairman Chris Davis as saying "it would be very strange if [the ETFs] ended up with a different kind of portfolio" than Davis Advisors' mutual funds. As such, it will be interesting to see if Davis Advisors turns out to be a trailblazer or more of an exception. The headlines and trends I've seen so far suggest that Davis will be an exception—unless these new ETFs turn out to be quite successful.

We've excluded the Davis funds from our mutual fund guide (which will be updated next month) because of the loads and expenses associated with the share classes most available to individual investors. Morningstar shows the Davis New York Venture (NYVTX), Davis International (DILAX) and Davis Financial (RPFGX) mutual funds as outperforming their category benchmarks. This potentially bodes well for the ETFs, but—as is the case with any brand new financial product—it would be prudent to monitor how they perform before making a decision on whether or not to invest in them.

https://www.theglobeandmail.com/report-on-business/rob-commentary/why-wed-celebrate-a-ban-on-embedded-commissions-for-advisers/article30987923/

DAVID O'LEARY

Why we'd celebrate a ban on embedded commissions for advisers

DAVID O'LEARY
Special to The Globe and Mail
Published Wednesday, Jul. 20, 2016 5:00AM EDT

David O'Leary, CFA, MBA is managing partner at Eden Valley Partners, a wealth management practice in Toronto

The Canadian Securities Administrators recently took another step closer to banning embedded sales commissions to financial advisers. My colleagues and I celebrated this news, since we believe a ban on commissions would be a huge win for both investors and our industry. Surprisingly, many industry stakeholders still argue against a ban. Here's why they're wrong.

Embedded sales commissions (also known as trailer fees) have two contentious problems: They create a conflict between the interests of adviser and clients, and they obfuscate the fees investors pay.

Embedded commissions present a conflict of interest because the adviser is being paid by the very provider of the investments they are recommending to clients. It would be like your doctor getting paid by pharmaceutical companies for prescribing their drugs to you. Even worse is the fact that different investments pay different commission amounts to advisers. So as an investor, you don't know whether your investments are the very best ones out there, or just the ones that rewarded your adviser most handsomely.

The second problem with commissions is that they are embedded within a larger fee (known as the MER, or management expense ratio) that bundles together all sorts of fees to various parties. This makes the amount a client pays the adviser far less transparent. In my experience, most clients don't realize their adviser receives any part of the MER – if they're even aware they are paying an MER.

Those who object to a ban on commissions are almost exclusively people who stand to profit from them. And they offer a variety of disingenuous arguments to defend them.

One common argument is that banning commissions would hurt investors since it would reduce the amount of choice they have in how they pay for financial advice. Portfolio manager John De Goey has been quoted with an excellent response to this: "Today, most restaurants offer a choice between tap water and carbonated water. Would adding a third option – toilet water – make for better outcomes?"
Another common argument claims that Britain banned commissions to disastrous effect. Claims are made that banning commissions created an advice gap, where smaller investors can't find advisers willing to serve them. This is blatant disinformation. No one knows precisely what impact the banning of commissions has had there. There are two reasons for this. First, we don't have enough data yet. The British ban came into effect just more than three years ago. And second, banning commissions was just one part of a sweeping set of changes known as the Retail Distribution Review.

Britain's Financial Conduct Authority has attempted to measure the impact of these changes and published a number of reports. Everyone admits their conclusions are tenuous, though, given how little data we have . Moreover, these changes were made against the backdrop of an evolving technological and sociological landscape, so that it may never be possible to isolate the effect of banning commissions from all the confounding variables.

More important, we have good reasons not to fear a dramatic advice gap in Canada. We have a healthy and robust banking system that gives the vast majority of us access to advice at a reasonable cost. And we have been a beneficiary of the trend toward robo-advisers.

Instead of fighting a commissions ban, let's promote financial literacy. That starts with clear information about what investors are paying for advice, and a system of adviser compensation that allows investors to trust they are receiving objective advice.

If we're successful, the industry won't have to hide the true cost of financial advice, because Canadians will see its full value and willingly pay a reasonable fee for it.

INCLUDES COMMENT LETTERS

http://client.advisor.ca/investing/understanding-financial-statements-ters-10845

Understanding financial statements: TERs

BY **Dean DiSpalatro** February 27, 2015

With all the talk in the media about mutual fund fees, you may have seen references to TERs. What are those?

Trading Expense Ratio (TER) is a metric that figures into the price of mutual fund investing. The TER's calculated by taking the sum of all the fund's transaction costs and dividing it by the average value of fund assets for the annual reporting period.

So, if a fund has a TER of 0.27%, it means 0.27% of the fund's average yearly assets went to trading expenses.

Those expenses include brokerage commissions the fund manager incurs when buying and selling securities, notes Terry Rountes, CFO of Funds at Mackenzie Investments in Toronto.

They also include custodian transaction fees, which are charged each time a portfolio manager buys or sell a security. It's similar to paying bank fees for certain transactions, such as ABM withdrawals.

Investing in global markets is much more expensive, notes Dennis Tew, head of sales compliance and business operations at Franklin Templeton Investments in Toronto, and that will be reflected in higher TERs.

Emerging and frontier market funds tend to have the highest expenses. These markets aren't as efficient and lack the liquidity of developed market exchanges, so it costs more for managers to get trades done.

Tew adds some companies have better access to volume pricing on trades, which trims trading costs — like buying food in bulk.

Comparing TERs of bond and equity funds doesn't work because of the different ways these securities are traded. Commissions are embedded in a bond's spread, so unlike equity trading commissions, they don't factor into the TER calculation.

Funds that hold both stocks and bonds should have similar allocations for it to make sense to compare TERs. For instance, a growth fund with 80% equity and 20% fixed income will have a considerably higher TER than a balanced fund with a 50% equity, 50% fixed income mix, simply by virtue of the asset allocation. (If there's cash in the fund, it's likely going to be used for buying. And, as far as fees are concerned, cash falls in the fixed-income bucket.)

"But let's say you compared two balanced funds that are more closely aligned in terms of asset mix," says Rountes. "Any differences would be dictated by the manager's investment style."

A manager with a buy-and-hold strategy "doesn't go in and out of the market a great deal. So, the expectation is he or she can incur fewer transaction costs and fewer commissions, and therefore the TER will be lower," adds Rountes

The TER, along with Portfolio Turnover Rate (PTR), can help you judge whether a manager's marketing fits the facts.

Say you want buy-and-hold managers who hand-pick stocks through bottom-up analysis. Consistently high PTRs and TERs could be a red flag, notes Tew.

"If [he's] getting into more rapid turnover every year or two years, and [is] being held out as a buy-and-hold, bottom-up stock picker, the question would be, 'Why are you finding better opportunities so quickly after making these picks?' "

He notes it's possible the manager's making consistently exceptional choices that quickly hit her growth targets, triggering sales. When that's the case, gains will be reflected in her fund's performance. But if a high-turnover fund isn't doing so well, there may be a disconnect between the manager's buy-and-hold billing and how she actually runs the fund.

MERs & TERs

https://www.fidelity.ca/cs/Satellite/doc/FF_UAD_A_en.pdf

http://dox3erp.distributech.ca/ModulesERP/Uploads/48/PDF/pps_BT4_en.pdf

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MUTUAL FUNDS

Revealing the closet indexers among Canada's mutual funds

IAN MCGUGAN
The Globe and Mail
Published Wednesday, Nov. 25, 2015 6:11PM EST
Last updated Thursday, Nov. 26, 2015 4:49PM EST

http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/osc-to-examine-actively-managed-funds/article29004948/

Regulators launch probe into the 'closet indexers' of the mutual fund industry

CLARE O'HARA - WEALTH MANAGEMENT REPORTER
The Globe and Mail
Published Wednesday, Mar. 02, 2016 5:49PM EST
Last updated Thursday, Mar. 03, 2016 7:10AM EST

http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/canadians-slow-to-shift-to-low-cost-index-investing/article34011085/

Canadians have been surprisingly slow to adopt low-cost index investing

TIM SHUFELT - INVESTMENT REPORTER
The Globe and Mail
Published Monday, Feb. 13, 2017 6:18PM EST
Last updated Tuesday, Feb. 14, 2017 9:53AM EST

"Even BMO, the country's second-largest ETF provider, wraps its moderately priced ETFs in high-priced mutual funds before selling them at bank branches," Mr. Davis said. ← Christopher Davis, director of research at Morningstar Canada https://www.pwlcapital.com/en/Advisor/Ottawa/Cameron-Passmore/Advisor-Blog/Cameron-Passmore/July-2014/The-shift-to-F-Class-does-not-mean-lower-fees

The shift to F Class does not mean lower fees

July 11, 2014 - 0 comments

Financial advisors throughout Canada are terrified. The Client Relationship Model (CRM2) is coming quickly, and it means that advisors will be obliged to disclose their fees and charges to clients. The non-disclosure of fees has been a quiet issue for years in the Canadian financial services industry. Most investors don't even realize that when they buy a mutual fund, the cost of ongoing financial advice is built into the management expense ratio (MER). It's bad enough that Canada has the highest average MER in the world at well over 2%, many Canadians are also paying for advice that they aren't receiving.

Disclosure is terrifying to advisors because when clients start to see the dollar amount that they are paying for advice each year, they will want justification. With the popularity of low cost ETFs, and the development of algorithm-based advice in the US, there is downward fee pressure coming from all angles.

Financial advisors are not fools. There has been a big industry push over the last few years for commission based advisors to prepare for the impending disclosure requirements. Part of this preparation has been a shift toward F class mutual funds. F class funds separate the advisory fee from the management expense ratio; when an advisor uses an F class fund, the client pays them directly. This eliminates the conflicts of interest present when advisors are paid commission by a product, and it also forces the advisor and client to agree on a fee that is fair relative to the level of service being provided.

I can't predict how commission based advisors will transition into the fee based world, but I would imagine that the standard 1% advisory fee will continue to be prevalent. With this in mind, I decided to look at Morningstar's database of F class mutual funds domiciled in Canada. I found that the average MER across all F class funds (excluding money market funds) is 1.29%. This means that even if an advisor decides to discount the advisory fee to .75%, the client is still paying, on average, over 2% in fees. There are some mutual fund families that do offer low costs; DFA funds come in with the lowest MERs, followed closely by TD's series of F class index funds.

Around 75% of financial advisors in Canada are only licensed to sell mutual funds, making it that much more difficult for investors to find unbiased advice at a reasonable price. IIROC's CRM2 disclosure requirements are moving advisors away from commissions to a fee based model, eliminating an inherent conflict of interest. It is a step in the right direction for financial advice, but unless investors demand a low-cost market-based approach from their advisors, it won't stop Canadians from pouring money into expensive mutual funds.

http://www.cnbc.com/2016/06/29/robo-advisor-ceo-on-friday-trading-haltshould-have-been-better-communicated.html

Robo-advisor CEO: Here's why I told clients they couldn't trade in sell-off

Alex Rosenberg | @AcesRose

Wednesday, 29 Jun 2016 | 5:59 PM ETCNBC.com

Betterment CEO on trading halt Wednesday, 29 Jun 2016 | 5:42 PM ET | 07:08

Automated investment advisor Betterment suspended client trading amid Friday's market turmoil, in what the company's founder and CEO now describes as a good decision that should have been better communicated to clients.

"The only thing I would do differently is I would put a notification in the app and say, 'By the way, we delayed trading right now,'" Betterment's Jon Stein said Wednesday on CNBC's "Fast Money."

Betterment is one of the most prominent robo-advisors, which are known for their low costs and high degree of automation; The company reports managing $4.8 billion for 170,000 customers.

On Friday, as stocks tanked in reaction to the U.K. vote to leave the European Union, Betterment suspended all trading from the market open until about noon EDT, apparently without informing clients. While this is within the scope of its client agreements, other well-known robo-advisors declined to halt trading, and Betterment's move has raised eyebrows on Wall Street.

Stein, however, said that Betterment's sole goal was to act in the best interest of clients.

"In a time of extreme uncertainty, we wanted to be very careful about how we handled customer orders," Stein said. "Even if you have the best technology, you don't want to go out sailing into a hurricane."

Stein made the case that Friday morning was not the best time to execute trades, and that since "Betterment's customers are long-term investors," making money off of the market's next move did not loom large on clients' minds.

Interestingly, Friday's market mayhem did not seem to steer individuals away from the robo-advisor's services.

Not only did customers not leave Betterment, but "more people signed up on Friday than on a typical Friday," Stein said Wednesday.

Search for this string "MFDA-licensed advisors have firm grip on Canada's mass market" at http://www.investmentexecutive.com

MFDA-licensed advisors have firm grip on Canada's mass market

New client research project from the SRO aims to explore what client segment would be most affected by the potential elimination of embedded commissions

By Beatrice Paez | April 25, 2017 17:00

Companies cited in this article

Financial advisors licensed with the Mutual Fund Dealers Association of Canada (MFDA) represent close to nine million households in Canada, or about 56% of all households, according to the results of a new research project from the self-regulatory organization (SRO).

Specifically, of the households that deal with MFDA representatives:

1. about 80% fall within the mass-market space, defined as those with less than $100,000 in assets,
2. while 15% are in the mid-market range ($100,000-$500,000), and
3. 8% are affluent investors (more than $500,000).

These were some of the key findings from the MFDA's client research project, which was announced early in 2016 and designed to produce a wide-ranging profile of mutual fund dealers' client base. The report's "timely" arrival comes at a moment when the mutual fund industry is bracing for a potential ban on embedded fees — the impact of which has yet to come fully into view, says Mark Gordon, president and CEO of the MFDA, who presented the preliminary findings of client research project at the Federation of Mutual Dealers in Canada's annual conference in Toronto.

The MFDA is aiming to explore the data collected in this project, which are based on the responses of all of its registrants, probing for trends that might offer guidance on which client segment, for example, stands to be most affected by the potential elimination of embedded commissions.

Read: The end of embedded commissions? How we got here

"We cannot predict the ultimate impact of the ban because there are too many variables. However, with these data, we can now, with some degree of confidence, identify those stakeholder groups that have the greatest chance of being impacted," Gordon says. "We can also, to some extent, identify the potential scope of that impact on stakeholders."

As part of the project, the MFDA mandated that registrants fill out clients' information, including age, address, account type, product code, the market value of their investments, for example.

The MFDA can also use these data, Gordon says, to map areas in which there may be a concentration of higher-risk products and to produce an aggregate picture of different demographics.

The SRO plans to publish its report on this project sometime in the spring.

Photo copyright: racorn/123/RF

http://www.wealthprofessional.ca/news/a-portfolio-managers-view-on-the-ban-on-embedded-fees-223144.aspx

A portfolio manager's view on the ban on embedded fees

by Joe Rosengarten22 Mar 2017

After the President and CEO of Advocis, Greg Pollock, gave his views on the CSA's plans to ban embedded commissions within mutual fund products last week, WP received a barrage of emails and calls from advisors and portfolio managers eager to speak out on this contentious, polarizing issue. In this special guest article, Portfolio Manager with Industrial Alliance Securities Inc., John De Goey, outlines his response to Advocis' view point.

"In essence, Advocis believes that the proposed discontinuation of trailing commissions would be detrimental to both advisors and their clients. The organization also claims to be in favour of choice and transparency. I'd like to respond to these positions with my own comments – and by asking Advocis to answer a few questions…

Making compensation transparent does not do anything to change pricing. Four quarters does not cost more than a dollar; not liking having to pay separately does nothing to change the quantum of payment. Why does Advociscontinue to suggest that transparent advice is somehow less accessible to investors of all account sizes?

The experience of the Retail Distribution Review (RDR) in the UK shows that once embedded compensation was no longer an option, advisors moved quickly to recommending lower cost products to clients. This is a real world experience that showed all investors paid less after the switch. This was clearly a win for consumers. Why doesn't Advocis mention it?

Investors pay for the sum of both products and advice. Why does Advocis only talk about the cost of advice and not the total?

Advocis says the number of advisors would drop if embedded compensation was no longer an option. I favour high standards/good advice and am opposed to low standards/questionable advice. The consensus is that it was overwhelmingly the less able advisors that left the business in the U.K. because they couldn't meet new (higher) proficiency requirements. Does Advocis want such advisors to continue in business? Is Advocis suggesting that every single advisor has unambiguous utility?

The Brondesbury and Cumming Reports showed that embedded compensation causes advisor bias. This bias, in turn, is extremely harmful to investor outcomes. Meanwhile, Advocis says almost nothing about evidence regarding advisor bias. Is Advocis unconcerned about the harm it may cause? If not, then what, exactly, is the Advocis position about the demonstrable harm caused by the bias that is part and parcel with embedded compensation?

Richard Thaler has done important work to show that people can be made better off by reducing their choices. By being "pro choice" Advocis implies that it merely favours maximizing retail client options. However, if the additional 'choice' on offer is shown to be sub-optimal, wouldn't they agree that removing the worst option can actually improve the universe of possible outcomes?

Many people have long thought financial advice was free. Similarly, many people fear that CRM II statements (which often go unread) still allow some clients to delude themselves into thinking advice is free. As strong proponents of transparency, wouldn't Advocis agree that a separate, itemized bill is more transparent and therefore more desirable than a yearend statement that can easily be misplaced, misinterpreted or missed altogether?

Finally, it should be acknowledged that Advocis does not speak for all advisors. For instance, I have long advocated for transparent, professional financial advice. Will Advocisbe clear in future articles and comments that there are a number of advisors out there who are opposed to their stated views?

I would prefer that Advocis's responses be rooted in demonstrable causal facts. For instance, Advocis has often suggested that the drop in the advisor population in the UK was due to the elimination of embedded compensation, while it is widely believed that the primary culprit is higher proficiency standards. Correlation is not causation… and a little truth and clarity in lobbying would be nice."

John De Goey is a Portfolio Manager with Industrial AllianceSecurities (IAS). The views expressed are not necessarily shared by IAS.

Advisor: Why I support the ban on embedded fees

by Joe Rosengarten19 May 2017

When the CSA launched a consultation paper outlining a possible ban on embedded commissions and trailer fees back in January, a fiery industry debate commenced and it shows no signs of fizzling out. In anticipation of receiving a deluge of responses, the CSA set a longer than usual consultation period of 150 days; a period that comes to an end in early June.

The proposed ban has been met with strong opposition from various industry insiders and bodies, many of whom are currently preparing submissions to send to the CSA. The Investment Funds Institute of Canada, for example, called on the CSA to "reconsider whether there is evidence of a market failure sufficient to justify prohibiting embedded commissions."

"If regulators have concerns about specific sales misconduct, existing rules give them the enforcement tools they need to address the concerns they have identified," Paul C. Bourque Q.C., IFIC president and CEO, said. "As a result, we are asking the CSA to reconsider whether a prohibition on embedded commissions is the only option."

Many in the industry sit on the other side of the debate, including Jennifer Black, a Private Wealth Manager and Portfolio Manager at DFS Private Wealth. Black currently runs a fee-based practice and likes the idea of banning embedded fees.

"I like the first step regulators took with starting to disclose fees a little more clearly to clients, but there is still an element that is not fully disclosed," says Black. "Hopefully the next step is banning embedded fees."

Black believes that, under the current rules, many investors are unaware of the true costs they incur and how they are calculated. "If there are embedded fees which are not paid as commission to the dealership, the actual embedded cost is not being disclosed," Black says. "That makes it difficult for investors to know what their true costs are."

Black sees a discrepancy in the industry between advisors who build holistic strategies and plans for the long-term and those who simply focus on selling products and accumulating assets. "Those advisors who are just sales people and don't add value from a servicing perspective might retain those assets for three or four years, but, going forward, they are going to find it very difficult to hold onto clients in this industry," she says. "In a world with no embedded fees their compensation will go down if they're not adding the value that will warrant their clients to go fee-based. You need to provide service for that."

Gordon Pape: I've crunched the numbers. It's true. ETFs are usually better

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GORDON PAPE
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If you can't beat them, join them.

That's the approach being taken by a growing number of traditional mutual fund companies as they expand into the ETF (exchange-traded funds) business.

Mackenzie Financial, AGF, Dynamic, RBC, and TD have all launched new ETFs in the past couple of years. In April, Manulife and Desjardins entered the field. Fidelity has started an ETF line in the U.S. and it's probably only a matter of time until Fidelity Canada does the same. During March and April, 24 new ETFs were launched in this country.

Mutual funds still dominate in terms of assets under management (AUM) by a wide margin. As of the end of April, the ETF industry reported AUM of $126.3-billion. That was up $3.3-billion from the previous month. The traditional mutual funds business is more than 10 times as big, with assets of $1.3-trillion as of the end of March. You might think the mutual fund companies would just dismiss ETFs as a bothersome fly.

But ETFs are growing at a faster rate and no wealth management company can ignore that for long. At the end of 2006, Canadians had only invested $15.2-billion in ETFs. A decade later, that figure was $113.6-billion. That's an annualized growth rate of more than 22 per cent.

Investors are opting for ETFs for three reasons. First, they are relatively easy to understand. Second, they are cheap – some funds charge management fees of less than one-tenth of a per cent. Third, they are liquid. You can buy or sell at any time either on-line or by calling your broker.

But how do they fare in investment terms? We keep reading stories about how index funds continually outperform actively managed funds. Is that really the case? I did an analysis of three of the most popular ETFs and this is what I found.

Canadian equity funds: The most widely held ETF that tracks the full TSX Composite is the iShares S&P/TSX Capped Composite Index ETF (XIC) with assets of more than $3 billion. It has been around since 2001, so we have a decent track record with which to work. As of April 30, this ETF was showing a 10-year average annual compound rate of return of 4.34 per cent. That is much better than the 3.18-per-cent average for the Canadian Equity category, as reported by GlobeFund, which comprises both mutual funds and ETFs.
There are a few actively managed mutual funds available to the general public that have beaten XIC over that period. They include Mawer Canadian Equity (up 7.97 per cent over the decade), Beutel Goodman Canadian Equity Fund (6.15 per cent), BonaVista Canadian Equity (5.88 per cent), and Fidelity Disciplined Equity (4.71 per cent). However, most actively managed funds fell well short of matching XIC's returns.

(Note that I did not included F-series funds or those with unusually high minimum investment requirements in this analysis.)

U.S. equity funds: The iShares Core S&P 500 Index C$-Hedged ETF (XSP) is the leader here in terms of assets at $4.1-billion. However, the falling loonie has compromised its returns, which averaged only 9.81 per cent over the past three years. There is a smaller unhedged version of this fund that trades under the symbol XUS. It shows a three-year average annual gain of 18.37 per cent.

That's almost the same as the BMO S&P 500 Index ETF (ZSP), which is the largest unhedged U.S. equity ETF. It has a three-year average annual compound rate of return of 18.35 per cent.

To compare these to actively managed funds on an apples-to-apples basis, we need to take currency variations into account. The return on the both the unhedged ETFs is impressive and there are only a few U.S. dollar-denominated mutual funds with the same general mandate that beat them. They include the TD U.S. Blue Chip Equity Fund (up 19.33 per cent over three years), the Beutel Goodman American Equity Fund (up 18.9 per cent), the CIBC American Equity Fund (up 18.72 per cent), and the Mackenzie U.S. Dividend Fund (18.55 per cent).

Global equity funds: The BMO MSCI EAFE Index ETF (ZEA) is the leader here in assets under management. It tracks the performance of large and mid-cap stocks in countries around the globe except the U.S. and Canada. It recently passed its third anniversary and showed an average annual compound rate of return of 8.39 per cent over the three years to April 30. That is comfortably ahead of the group average for the International Equity category of 7.09 per cent but there were several actively managed mutual funds that bettered it by a wide margin.

One of the most impressive was the Trimark International Companies Fund, which posted a three-year average annual compound rate of return of 14.51 per cent. This was despite having a much higher management expense ratio of 2.98 per cent compared to only 0.22 per cent for ZEA. Sometimes you *do* get what you pay for.

The bottom line: Based on this small sample, ETFs are doing the job for investors. Unless you are very skilled (and lucky) at picking actively managed mutual funds, you will probably do as well or better by investing in a comparable ETF. If you want to know why this segment of the wealth management industry is growing so fast, there's your answer.

Gordon Pape is Editor and Publisher of the Internet Wealth Builder and Income Investor newsletters. For more information and details on how to subscribe, go to www.buildingwealth.ca. Follow Gordon Pape on Twitter at twitter.com/GPUpdates and on Facebook at www.facebook.com/GordonPapeMoney

A couple of snippets from Google searches regarding "Mutual Funds Canada Commissions"

How are MERs Calculated and Stated?

The MER is expressed as a percentage of the fund's total assets. For example, if you invested $5,000 in a series A Canadian balanced fund with a 2.28% MER[1], you would pay $114 in fees for management, administration and taxes for a given year.

This chart illustrates how the cost of a mutual fund is calculated, and how it is put to work.

The fund returns you see listed in the newspaper or on your statements are what you get after the fund has paid the MER.

* The 2% management fee represents 81% of the total 2.28% MER. 50% of Mackenzie management fees are paid out to dealers in some form of compensation: trailers, commissions, co-op marketing.
[1] Represents the MER of a typical Canadian balanced fund.
[2] The applicable tax rates are calculated by taking a weighted average of the tax rates applicable to the province of residence of the investors of the Fund. An assumed tax rate of 10.6%, reflecting the current blend of Mackenzie Investments investors in HST and non-HST provinces, was used for the purposes of calculating the MER. The actual tax rate may differ.

Mutual funds

The breadth and depth of the Investors Group mutual fund line ensures that clients have the right mix of fixed income, balanced, and Canadian, U.S. and international equity mutual funds to help them achieve their financial goals.

Commissions, fees and expenses may be associated with mutual fund investments. Read the prospectus before investing. Mutual funds are not guaranteed, values change frequently and past performance may not be repeated.

- IG AGF Canadian Balanced Fund
- IG AGF Global Equity Fund
- IG AGF U.S. Growth Fund
- IG Beutel Goodman Canadian Balanced Fund
- IG Beutel Goodman Canadian Equity Fund
- IG Beutel Goodman Canadian Small Cap Fund
- IG FI Canadian Allocation Fund
- IG FI Canadian Equity Fund
- IG FI U.S. Large Cap Equity Fund
- IG Fiera Canadian Small Cap Fund
- IG Franklin Bissett Canadian Equity Fund
- IG Mackenzie Canadian Equity Growth Fund
- IG Mackenzie Cundill Global Value Fund
- IG Mackenzie Dividend Growth Fund
- IG Mackenzie Floating Rate Income Fund
- IG Mackenzie Income Fund
- IG Mackenzie Ivy European Fund
- IG Mackenzie Strategic Income Fund

http://business.financialpost.com/personal-finance/retirement/why-we-need-regulations-to-protect-seniors-from-unscrupulous-financial-advisers

Why we need regulations to protect seniors from unscrupulous financial advisers

JASON HEATH | July 8, 2016 1:32 PM ET

The Ontario Securities Commission has announced the formation of the Seniors Expert Advisory Committee, with the deadline for applications set for July 29. The committee could be instrumental in preventing the overt financial abuse of Ontario's elderly. But, even more importantly, it can alert children and grandchildren to the more covert abuse that the financial industry is quietly getting away with every day.

"The Seniors Expert Advisory Committee will give the OSC access to a multidisciplinary team of experts on issues related to older investors, providing us with valuable input," says Maureen Jensen, chairwoman and CEO of the Ontario Securities Commission.

The key issue for the committee, as I see it, relates to the lack of a fiduciary standard for Canadian financial advisers. This is a real risk at a time when our aging population is wealthier than ever and becoming increasingly vulnerable due to the natural changes in cognitive function as we age.

Consider this: your aging parents and grandparents' financial advisers have no obligation to provide them with advice that is in their best interest. So, unlike their doctor, pharmacist or accountant, there is nothing to require their banker, mutual fund salesperson or insurance agent to put them first. To me, this is like having a fox guard a hen house.

Here are some things that children and grandchildren should look out for:

1. Bankers who direct savings to proprietary, in-house products, despite the potential of better, non-bank alternatives.

2. Investment advisers who use mutual funds with embedded fees of two to three per cent, which nearly guarantee retirement savings will generate little to no return.

3. Insurance agents offering insurance solutions for all financial needs, when non-insurance solutions may be better or when no insurance may be needed in the first place.

The OSC initiative comes in the wake of last year's establishment of The Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives by the Ontario government. The province has also signed on to the proposed expansion of the Canada Pension Plan. It seems clear that retirement and seniors are important for the province, but unfortunately, there is push-back from the industry.

According to the Investment Funds Institute of Canada, "Financial advisers already are subject to specific rules and regulations that clearly address the main issues that arise in the relationship between a financial adviser and his or her client. The introduction of a statutory fiduciary duty would not help to clarify the scope of an adviser's duties from situation to situation."

Quite to the contrary, I think a fiduciary duty does clarify the adviser's duty in all situations — put your client first, no matter what. This is particularly important because most people have no idea what sort of financial practices to seek out or avoid in the first place.

It's one of the reasons that the U.S. Department of Labor introduced new rules in April forcing American financial advisers managing retirement and pension accounts to act in their clients' best interests — the so-called fiduciary standard that the Canadian industry is trying so hard to avoid. White House estimates peg the cost of adviser conflicts of interest at US$17 billion a year, primarily due to investors being placed in products with excessively high fees.

As near as I can tell, the only negative impact on seniors and retirement security from a fiduciary standard are on the retirement savings of the unscrupulous financial advisers (hopefully, a minority of advisers out there) who are raking in those bloated fees.

The OSC committee will include members from a variety of practice areas, ranging from lawyers and academics to doctors and the financial industry. It will be interesting to see which financial industry participants end up on the panel, given that everyone in the industry has varying degrees of conflicted interests. The pessimist in me can't help but think that some people in the financial industry benefit from passive, uninformed seniors and their busy, trusting children.

As an Ontarian with aging parents, I do hope the Seniors Expert Advisory Committee considers the benefit of a government-imposed fiduciary standard to ensure that all seniors — my parents included — are protected. It seems clear the financial advice industry won't self-regulate and do it themselves.

Financial Post
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Link → https://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/do-it-yourself-investing-fund-fees-draw-fire/article35067755/

No advice but still a price: Fund fees for DIY investors draw fire

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CLARE O'HARA - WEALTH MANAGEMENT REPORTER
The Globe and Mail
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The majority of mutual funds sold through online brokerages are charging clients millions of dollars in fees for advice they are not receiving, an issue regulators are being pressured to reform.

About 83 per cent of mutual funds sold through discount brokerages in Canada include trailing commissions that are typically charged by financial advisers for the advice they provide. Of the total $30-billion in assets held in mutual fund products in discount brokerages, more than $25-billion remain in fund series that bundle an advice fee within the product, according to a paper released in January by the Canadian Securities Administrators.

These funds are commonly known as Series A mutual funds and account for 68 per cent of the total amount of funds sold in Canada, according to the Investment Funds Institute of Canada (IFIC). These funds can charge a management expense ratio between 1.5 per cent to 2.5 per cent. By comparison, Series D funds – those tailored for do-it-yourself investors that strip out advice fees – it can be less than 1 per cent.

Do-it-yourself investors usually do not work with advisers to purchase investment products. As a result, these investors conduct independent research, make their own investment decisions and receive lower cost pricing when building an investment portfolio.

"Since discount brokers cannot and do not provide investment advice, clients are being robbed of returns," says Ken Kivenko, an investor advocate. "The investor abuse is staggering. Collecting money for advice while not providing it doesn't seem to bother [the regulators]."

Mr. Kivenko says there have been repeated efforts by industry groups to get the regulators to sanction discount brokers, but so far they have been ignored.

Earlier this month, IFIC proposed regulators adopt a rule that would ensure mutual funds that carry an embedded adviser fee are only sold in channels where advice is offered.

"Most companies already provide other series of funds with no or nominal trailer fees that investors can purchase if they are do-it-yourself investors or want to pay for advice separately," IFIC says in a statement. "The industry's proposal would advance the goal of ensuring that low-trailer or no-trailer funds are available to these types of investors in a more uniform and transparent way."

The regulators include all provincial securities commissions and the Investment Industry Regulatory Organization of Canada (IIROC) – which oversee investment firms including those in the discount brokerage channel.

"We think with IFIC joining in, IIROC may finally be forced to act," Mr. Kivenko says. "Seniors' nest eggs have been overcharged by these outrageous fees – fees for no service and fees that have been charged for many years."

IIROC recently issued findings on a review it completed on compensation-related conflicts of interest, and while it did not specifically look at the discount brokerage channel independently, the regulator said it will take IFIC's comments into consideration.

There are more than a dozen discount brokerages in Canada, including those run by all the major banks.

When contacted by The Globe and Mail, the majority of these discount platforms confirmed Series A mutual funds were available for purchase by DIY investors. Both HSBC InvestDirect and Desjardins online brokerage platform Disnat do not offer Series A funds for purchase. (Laurentian Bank Discount Brokerage and Credential Direct did not return calls for comment.)

Among those offering the funds, several platforms said they were aware of the discrepancies in fees being paid and either have measures in place, or are working on establishing measures, to make clients aware of additional options for purchase.

RBC Direct Investing will only sell a Series A mutual fund if a DIY version is not available. If a clients search for a Series A fund, they will only see an option to sell. About 50 per cent of all its mutual-fund assets under administration is held under their Series D offerings.

While TD offers DIY investors funds with embedded fees, it also offers its online clients low-cost index funds – known as the e-series – with MERs that can be as low as 0.33 per cent.

Questrade Financial has set up a reimbursement program to pay back all trailer fees directly to clients when they purchase a commission-based product (although there is an administration fee deducted to do so).

Qtrade's platform does not have a reimbursement program, but has pro-actively contacted clients to educate them more on the fund series. In February, Qtrade e-mailed all investors stating: "One way to avoid trailer fees is to hold D series funds, which are a lower-cost option offered by some mutual-fund managers. Many Series D funds are already available on our website."

Virtual Brokers, a division of BBS Securities Inc., offers Series A funds, but they have minimal assets as the platform has seen a significant shift to exchange-traded funds, says Bardya Ziaian, CEO of BBS Securities Inc.

But many industry groups are asking regulators why the funds are allowed to be offered on these platforms in the first place.

FAIR Canada – an investor advocacy group – has long argued that discount brokerages should not be permitted to offer Series A mutual funds since they are not permitted to provide recommendations or advice, says Marian Passmore, director of policy and chief operating officer of FAIR Canada.

FAIR Canada has asked regulators to consider a requirement for discount brokers or fund companies to offer a class of funds that have no trailing commissions. In addition, the recommendation would also see all firms that offer a particular mutual fund be required to offer the "F" class version of the fund, which does not have a trailing commission.

https://www.youtube.com/watch?v=0U1Xe-hF8LE

Note: I tinkered with the title caption below, I snipped it from the beginning and inserted it over the caption at a later point in the video.

https://www.theglobeandmail.com/globe-investor/investment-ideas/strategy-lab/index-investing/dont-bet-against-time-with-actively-managed-mutual-funds/article35081122/

Don't bet against time with actively managed mutual funds

ANDREW HALLAM
Special to The Globe and Mail
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Andrew Hallam is the index investor for Strategy Lab. Globe Unlimited subscribers can view his model portfolio here and read more in the seriesonline here.

Rocky Balboa probably said it best. In his 2015 movie, *Creed*, Sylvester Stallone's character identified every boxer's nemesis. Time.
"Time takes everybody out. Time's undefeated."

It's much the same with actively managed mutual funds. You might think you've found a winner. It might beat the index over a three, five or 10 year period. But the index is much like time. Eventually, it wins.

The SPIVA Canada Scorecard says the S&P/TSX composite index beat 91.11 per cent of actively managed Canadian equity funds over the 10 years ended Dec. 31, 2016. The S&P 500 beat 98.28 per cent of U.S. equity funds sold in Canada. The Global stock market index beat 96.4 per cent of actively managed global stock market funds.
Sometimes we're tempted to search for winning funds. But that's a quest in vain. Take the Thomson Reuters Lipper Fund Awards. Each year, they award top-performing funds. Time, however, has the final laugh.

For example, in 2013 the RBC O'Shaughnessy All-Canadian Equity Fund was Lipper's top Canadian equity fund. It had the industry's best three-year track record. After it won the award, plenty of new investors piled into its corner. But the following year, TD's Canadian stock market e-Series index beat it by almost seven percentage points. RBC O'Shaughnessy All-Canadian Equity Fund earned 3.56 per cent. TD's Canadian Index e-Series index earned 10.23 per cent.
In 2014, the Lipper Fund Awards gave top honours to the new three-year Canadian equity champ. It was the Phillips Hager & North Vintage D fund. New investors jumped on board, putting their money on a winner. But the following year, that fund lost 9.6 per cent. TD's Canadian e-Series Index dropped just 8.53 per cent.
In 2015, Mawer's Canadian Equity Fund Series-A took Lipper's top three-year honours. One year later, it gained 15.77 per cent. TD's Canadian e-Series Index gained 20.63 per cent.
The Canadian Lipper Fund Awards began in 2007. That year, they awarded Dynamic Mutual Funds the top equity fund performer. Dynamic won the award based on their overall performance. But time has hit them hard since then.

Dynamic's Canadian equity funds with 10-year track records averaged 1.23 per cent for the 10-year period ended April 30, 2017. Inflation in Canada averaged 1.61 per cent. That means your grocery bills rose higher than Dynamic's Canadian equity funds.

In the United States, there's at least one firm that boasts they can beat the index. It's called American Funds. The company's website shows that five of its actively managed funds trounced the S&P 500 between 1976 and 2016. It says, "So the next time you hear 'You can't beat the index,' consider American Funds' long-term track record."

Unfortunately, they're boasting from the canvas as they remember better days. After fees, Vanguard's Total Stock Market Index (VTSAX) knocked them out over the past one-, three-, five-, 10- and 15-year periods.
Investing with index funds is like betting on time itself. Time is undefeated.

DYNAMIC CANADIAN EQUITY FUNDS	10-YEAR ANN. RETURN	TD CANADIAN INDEX E-SERIES	10-YEAR ANN. RETURN
Dynamic Power Canadian Growth Class	1.60%	TD Canadian Index-eSeries	4.26%
Dynamic Power Canadian Growth Fund	0.70%		
Dynamic Power Small Cap Fund	1.40%		
Dynamic Canadian Equity Category average	**1.23%**	**TD Canadian Index e-Series average**	**4.26%**

DYNAMIC U.S. EQUITY FUNDS		TD U.S. INDEX E-SERIES	
Dynamic Power American Growth Class	9.60%	TD e-Series U.S. Index	8.73%
Dynamic Power American Growth Fund	9.50%	TD Dow Jones Industrial Average Index-e	9.13%
Dynamic American Fund	7.00%	TD Nasdaq Index-e	11.12%
Dynamic U.S. Equity average	**8.70%**	**TD U.S. Index e-Series average**	**9.66%**

DYNAMIC EUROPEAN EQUITY FUNDS		TD EUROPEAN INDEX E-SERIES	
Dynamic European Value Fund	1.17%	TD European Index e-Series	2.42%
Dynamic European Equity average	**1.17%**	**TD European Index e-Series average**	**2.42%**

*Ten-year returns ending April 30, 2017

JOHN SOPINSKI/THE GLOBE AND MAIL, SOURCES: DYNAMIC.CA; TDCANADATRUST.COM

INCLUDES COMMENT LETTERS

DSC ALTERNATIVE HAS LIMITED MERITS

Melissa Shin / May 12, 2017

“Worried about DSC fees? Find out how to make 5%+ at the grid and not have to lock the client in!”

Intrigued? So was a Toronto advisor, who received this message from his managing general agent.

The answer was a life insurance-style chargeback schedule for segregated funds. If the client exited the fund within a fixed period, the advisor would have to repay the commission earned at time of sale—instead of the client being dinged with deferred sales charges.

On the face of it, that’s an improvement. The advisor gets compensated for the upfront work required to place the funds and, in theory, the threat of a chargeback keeps the advisor providing service for at least the next few years.

Win-win, right? Not so fast.

Advisors we talked to lauded the structure for freeing the client from undue exit restrictions. But some pointed out the advisor penalty could create another conflict.

“While the arrangement gets the investor off the hook for DSC charges, the benefit may be superficial, since this arrangement creates a powerful incentive for the advisor to keep the investor in the fund, even if it has ceased being optimal or suitable,” says investor advocate Neil Gross, president of Component Strategies Consulting.

Great advisors don’t intend to let compensation influence what they sell. Studies have shown, however, that loss aversion can be up to twice as powerful as the desire to gain. Lest you think yourself immune, researchers have found loss aversion to affect undergraduate students, pro golfers, foreign policymakers and capuchin monkeys. At the very least, the chargeback structure would be ill-suited to advisors who can’t stand to lose money.

As CSA says in Consultation Paper 33-404 (which doesn’t apply to seg funds or insurance licensees): “When deciding how to respond to a conflict of interest involving clients, only avoidance or controls (but not disclosure alone in most cases) are responses that [...] can be fully effective.”

One company offering the product concedes it isn’t for everyone. A rep told me an advisor “would need to choose” which clients would be suited. “The main objective was to allow the client [to not have] redemption fees if he left. The advisor is taking the risk.”

“There is evidence that embedded commissions paid by investment fund managers to dealers/representatives on sales made under the DSC option can […] incent unsuitable recommendations.”

–CSA Consultation Paper 81-408

That's fair. But most common retail structures allow clients to redeem funds without undue charges. They just tend to pay out less up front—and there's the rub.

Every structure is vulnerable to conflicts—advisors paid by the hour can drag out a meeting; flat-fee advisors can rush through planning. But it's embedded commissions that have drawn the ire of regulators, and for good reason. A chargeback schedule is an improvement to DSC, but a marginal one, as advisors may be loath to recommend an exit, even if it's the right thing to do. And, since seg funds don't fall under CRM2, clients may never know about that perverse incentive.

Advisors must be paid fairly for their work. But minimizing one conflict while creating another isn't a solution.

Melissa Shin is Editor of Advisor Group. Email her at melissa.shin@tc.tc.

http://www.advisor.ca/news/industry-news/client-costs-will-fall-under-commission-ban-letter-to-editor-234390

CLIENT COSTS WILL FALL UNDER COMMISSIONS BAN: LETTER TO EDITOR

Staff / May 24, 2017

Our current regulatory environment continues to generate reader commentary. Here, we publish a letter to the editor arguing that the cost of advice will not rise if embedded fees are banned.

Where is the evidence that unbundling will put advice out of reach? Where is the evidence that the cost (of advice or otherwise) will rise? Why haven't all advisors been frustrated by what IFIC is only now (in 2017!) noting as a problem ([advice trailers] paid to DIY service providers)?

[I acknowledge that under an embedded commission ban,] the cost of advice is unlikely to change materially. Similarly, product costs (especially re: mutual funds) will likely drop, but only modestly.

The big change regarding client cost is the substitution effect. [As we saw in the U.K.,] advisors will likely move from recommending high-cost products (often used previously due to embedded compensation) to recommending low-cost products (once embedded compensation is no longer available). The absolute savings will be passed on to investors. In short, the U.K. experience is a smoking gun [showing] that advisors are motivated more by compensation than by product merit when making recommendations to clients. When the compensation filter is removed, they actually do the right thing.

Here's an example. Let's say clients are currently paying 2.35% via a mutual fund MER (including a 1% trailing commission that goes the advisor). In an unbundled world, the cost advice might actually go up (say to 1.1%, on average). However, instead of using F-class funds that cost 1.35%, the advisor might recommend an ETF that costs 0.25%. That's a 0.1% increase in the cost of advice – and a 1.1% decrease in the cost of investment products. The absolute total cost to clients (since clients pay for both the investment product "parts" and the financial advice "labour") is about 1% cheaper. A client with a modest $100,000 portfolio would actually pay $1,000 less every year as a result.

It is simply disingenuous to talk exclusively about the cost of advice – as if the cost of investment products was not even a consideration.

Sincerely,

John J. De Goey, CIM, CFP, Fellow of FPSC
Portfolio manager, Industrial Alliance Securities Inc., Toronto

http://www.investmentexecutive.com/-/canadians-prefer-financial-advisors-to-robo-advisors

Canadians prefer financial advisors to robo-advisors

Only 7% of Canadians said they're likely to trust a robo-advisor's recommendations, new global HSBC study finds

By Beatrice Paez | May 24, 2017 16:15

As financial services institutions worldwide throw their weight behind emerging technologies, Canadians appear to be more lukewarm about embracing them than residents of other nations, according to a new report from London, U.K.-based HSBC Holdings PLC.

The survey, which polled more than 12,000 individuals from 11 countries, suggests a divide in attitudes between Asia and the Western nations toward technology, including the adoption of robo-advisors.

Among Canadians, there's still a strong preference for taking guidance from a human financial advisor over advice generated through an algorithm powered by artificial intelligence.

In particular, of the 1,001 Canadians represented in the survey, a mere 7% said they're likely to trust recommendations delivered by a robo-advisor. That's in contrast to 44% in China and 38% in India.

Moreover, the survey suggests that only 18% of Canadians surveyed feel that robo-advisors are able to offer more accurate advice than their human counterparts.

Canadians' ambivalence about the benefits of technological innovation reflects a lack of trust in new technology, the report notes.

In fact, the poll suggests that Canadians are among the most content with their bank's existing technology services — and they may not be so enthusiastic over the use of fingerprint technology to identify themselves or chatbots.

Appetite for chabots, which can dish out information traditionally delivered by a customer service representative, for example, may not be as widespread in Canada. The report suggests that only 16% turn to chatbots for customer service help.

In general, many Canadians express doubts about technology's ability to improve the world, with only 56% saying innovation can yield positive change compared with 89% in China and 85% in India.

"While those in Canada may be more resistant to change than their eastern counterparts, the research also points to the huge potential of educating people on upcoming and existing technologies as Canadians are among the most likely to respond positively to education around biometrics — such as touch and voice ID," says Larry Tomei, executive vice president and head of retail banking and wealth management with Vancouver-based HSBC Bank Canada, in a statement.

Slow uptake of new technology among Canadians could affect support for innovation, hindering financial services' efforts in Canada to develop solutions for the domestic market.

To make clients more receptive to the adoption of new technologies, the report suggests the need for greater education, perhaps even a touch of human intervention, with traditional advisors using the new tools to complement the work they do.

News from globeandmail.com

Looking for fee relief? Do the math before dumping mutual funds for ETFs

Wednesday, April 28, 2010

DAN HALLETT

A recent Globe and Mail article suggested that investors can improve their returns by replacing mutual funds with exchange-traded funds. This argument hinges on minimizing fees with ETFs, thereby adding fee savings (over more expensive mutual funds) to bottom line returns.

But if you think that dumping your mutual funds for ETFs is the path to riches and higher returns, think again.

The average mutual fund investor pays about 2 per cent annually in management fees, operating expenses and taxes. The average investor in TSX-traded ETFs pays closer to 0.4 per cent a year. The average potential cost savings, then, are about 1.6 per cent per annum. But this is only available to do-it-yourself (DIY) investors. Otherwise, investors who need professional advice have to pay for it either through higher product fees or fees paid to an adviser in addition to ETF expenses.

The 2 per cent average mutual fund fee generally includes compensation for advisers, whereas ETF fees do not include the cost of obtaining advice. So-called fee-based or fee-only advisers charge a fee equal to 1 per cent to 1.4 per cent of your portfolio value. Add that to ETF fees and taxes and you've got total annual fees of 1.5 per cent to 1.9 per cent annually. Wave goodbye to that fee advantage.

For those who need advice, there is great value in the design of a custom asset mix. In addition, selecting a handful of ETFs from among the 1000-plus trading in North America is challenging for most. But if you expect to fully benefit from low ETF fees, you'll have to jump into the driver's seat of your portfolio and become a DIY investor.

A problem for some DIY investors is that there is a significant barrier to realizing the full cost benefits of ETFs. In the hands of DIY investors, the ETF fee advantage usually vanishes thanks to poor portfolio construction and frequent trading.

Of all of the "indexed" or ETF portfolios that I have reviewed over the past 16 years, only two were focused on obtaining the broadest diversification possible at the lowest possible cost. This boring strategy is key to successful indexing. But investors can't seem to stop buying all of the market's slices and dices that ETF sponsors have packaged for investors. This not only violates the basic tenets of successful index investing, but it also sets the stage for more return-detracting behaviour.

I estimate that investors in stock mutual funds tracked by the Investment Funds Institute of Canada tend to hold their funds for an average of 6 to 7 years. (Note that this average is dollar-weighted, not based on an average of each investor's holding period.) ETF investors, on the other hand, only hold for a fraction of the time of their mutual fund investor peers. And there is strong evidence suggesting that the more frequently individuals trade, the less money they make.

Brad Barber, Yi-Tsung Lee, Yu-Jane Liu and Terrance Odean studied all the trades made on the Taiwan Stock Exchange from 1995 through 1999 for a 2008 paper entitled "Just How Much Do Individual Investors Lose by Trading?" They found that individuals lost a total of almost 4 per cent annually to trading fees and poor timing (while institutions profited). Similar research on U.S. investors pegs the "trading losses" at about 2 per cent per year. This is consistent with past Barber and Odean stock trading studies.

In a 2000 paper, they found that the higher an investor's trading frequency, the lower the investor's net returns.

My own research over the past decade strongly suggests that more volatile investments lure more investors into making ill-timed trades. But there is hope. Investors can benefit by paying attention to total fees, regardless of the type of investment. Investors that can develop an awareness of the real impact of brokerage costs and ill-timed trades can change their performance-detracting behaviour. Less aware investors, however, may want to think twice about jumping head first into the ETF world.

Dan Hallett is director of asset management for Oakville, Ont.-based HighView Asset Management Inc.

http://www.wealthprofessional.ca/news/mutual-funds/investors-demanding-lowercost-funds-225918.aspx

Investors demanding lower-cost funds

by Leo Almazora25 May 2017

Results from a recent study by a global research firm indicate continued investor demand for low-cost mutual funds and ETFs, which are typically passive funds and institutional share classes.

In a survey of open-end mutual funds and exchange-traded funds, Morningstar found they had an asset-weighted average expense ratio of 0.57% in 2016, down from 0.61% in 2015 and 0.65% the year before that. This was due to increased investor demand for lower-cost funds, mainly passive funds and institutional share classes that charge less in fees.

The asset-weighted average expense ratio was used in the study rather than a simple average. According to the firm, an asset-weighted average could better reflect average costs borne by investors, since a simple average could be skewed by a few high-cost funds with low asset levels. “In 2016, the simple average expense ratio for all funds was 1.14%, but funds with an expense ratio above that level held less than 10% of fund assets at the end of 2016,” the study’s authors said. “So it is very misleading when a fund company touts ‘below-average fees.’”

The firm also found that on average, the largest 2,000 funds in 2013— which accounted for 85% of mutual-fund and ETF assets at the time — did not change their expense ratios over the three-year period. This means the decline in average fund fees that investors paid was due largely to switches to lower funds.

The figures indicate that passive funds hold wide appeal. In 2016, they cost investors an average of 0.17% — 58 basis points less than active funds. From the fund providers’ perspective, passive funds are also cheaper: their asset-weighted costs decline more rapidly than those for active funds. This two-pronged advantage has led to passive funds’ having larger inflows than their active counterparts for the past six calendar years.

Investors’ general appetite for lower fees has affected preferences within the active segment. Past interest in pricier funds has waned in recent years; expensive active funds saw US$91 billion in outflows in 2014, and US$369 billion in outflows in 2016. The rush out of expensive funds accounted for all the outflows from active funds over the past two years.

On the passive side, the preference for low fees is also evident. The funds with fees in the cheapest 20% tended to gather almost all passive-fund inflows. The trend was found to hold across US equities, international equities, and fixed income — the three largest asset class groups. Vanguard and BlackRock/iShares, both firms with a broad offering of low-fee passive funds, were the only two firms to really benefit from the rapid growth in passive funds.

http://www.investmentexecutive.com/-/investors-group-moving-clients-to-experienced-advisors

Investors Group moving clients to experienced advisors
Regional managers are overseeing the reassignment of clients to veteran advisors following the dismissal of approximately 400 primarily younger advisors

By Geoff Kirbyson | May 26, 2017 07:30

Client accounts are moving around at Winnipeg-based Investors Group Inc. perhaps like never before after the dealer firm reduced its roster of financial advisors over the past few months.

The firm recently parted ways with approximately 400 primarily younger advisors as CEO Jeff Carney continues to put his stamp on the company, slightly more than a year into his tenure. At the end of the first quarter, the company had 4,754 advisors, down from 5,321 a year ago. Almost half of those who remain (2,262) are considered veterans with four or more years of experience.

In turn, regional managers at Investors Group are overseeing the reassignment of clients to veteran advisors who remain with the firm, says Ron Arnst, assistant vice president of brand management and media relations.

"Typically, the regional manager matches clients with appropriate [advisors] considering any clients requests, such as age range and gender," he says.

Investors Group clients are free to switch advisors within the company at any time, a process regional directors also facilitate.

However, clients who have opted to follow their departing advisor to another firm were subject to the typical redemption and withdrawal process, Arnst says, noting that the deferred sales charge (DSC) schedule also applies.

"DSC funds carried a slightly lower [management expense ratio], but also had an additional fee schedule that applied if or when the client redeemed the investment prior to the seven-year schedule period," he says.

Investors Group is far from alone in taking such steps, says Dan Richards, CEO of Clientinsights in Toronto. Specifically, larger financial services firms have been taking a harder look at their smaller producers during the past several, often making the payout gird more punitive.

"In some cases, I'm sure [larger firms] hoped the advisors would get the message and find somewhere else to work," Richards says. "If firms aren't seeing the prospects of running a significant book of business, increasingly they're saying [to those advisors], ‘It's not going to work out'."

Along with the increased focus on veteran advisors, Investors Group is also increasing its focus on high net-worth clients. However, the firm isn't looking to shed smaller accounts.

"Investors Group is committed to working in the best interests of all clients," Arnst says, "regardless of asset size."

http://www.investmentexecutive.com/-/igm-downsizing-focusing-on-hnw-clients

IGM downsizing, focusing on HNW clients
The financial giant has let 400 advisors and 80 administrative staff go in recent months

By Geoff Kirbyson | May 05, 2017 17:30

Jeff Carney, CEO of Winnipeg-based IGM Financial Inc. believes sometimes you have to get smaller before you can get bigger.
The firm's biggest operating company, Investors Group Inc., has let go more than 400 advisors and administrative staff positions.
Thanks to higher standards for advisors, 400 primarily younger consultants were let go in recent months.
"I've raised the standard," Carney says. "We didn't think they were going to make it under the new skills we're looking for in the future."
At the end of the first quarter, the number of veteran consultants — defined as those with four or more years of experience — was 2,262, slightly less than half of the cohort of 4,754. There were 5,321 consultants a year ago.
Carney, who took over as CEO of IGM a year ago, says he doesn't rule out further job losses in the future, but says no immediate layoffs are imminent.
The firm also laid off 80 administrative staff. "We combined some different [regional] districts together and created an opportunity to reduce costs and put that money back to work in other things that we're trying to do," Carney says. "It's a reallocation of resources."
Thirty of those affected people were in Winnipeg with the remaining 50 spread out across the country.
"I'm still in my early days. I'm looking at everything. I don't want to sit here and say we'll never have [more layoffs]," he says. "Right now, I'm focused on growing our company and accelerating the growth. In some areas we might be hiring, and in some areas we might be reducing, depending on what we're doing with our business model as we evolve.
"Where we can find efficiencies," he adds, "we [have to act] because it's a competitive landscape and we've got to reinvest in pricing, products and people who can bring new skills to us."
Carney addressed the media following IGM's annual general meeting in Winnipeg Friday morning. A couple of hours earlier, the company announced net earnings available to common shareholders for the three months ended March 31 of $177.1 million (74¢ per share) up from $167.0 million (69¢) in the corresponding period a year earlier.
Part of the increased focus on veteran consultants is a heightened focus on high net-worth clients.
"We're moving more up-market," Carney says. "We were probably working too hard for the smaller clients and now we're working for the right ones. We don't want to walk away from our smaller clients but they don't need that level of sophistication at that stage of their lives vs somebody who has accumulated significant wealth and needs to know that their retirement is going to fund the rest of their lives."

http://www.advisor.ca/news/industry-news/td-lowers-trailers-but-doesnt-seem-to-pass-savings-to-clients-conseiller-exclusive-234482

TD LOWERS TRAILERS, BUT DOESN'T SEEM TO PASS SAVINGS TO CLIENTS: CONSEILLER EXCLUSIVE

Conseiller Staff / May 25, 2017

A Conseiller.ca exclusive report finds that TD has lowered trailers on certain funds, but did not subsequently lower the fees charged to clients.

Several advisors provided Conseiller.ca with documents showing that on April 1, TD Asset Management cut trailing commissions on the following funds:

- TD Ultra Short Term Bond Fund;
- TD Balanced Income Fund;
- TD Balanced Growth Fund;
- TD Diversified Monthly Income Fund.

With the TD Balanced Income Fund, for instance, the trailers fell 25 basis points, but the management fee, so far, remains the same.

When asked for comment regarding the trailer reduction, TD declined.

Advisors told Conseiller.ca they felt the move was, while compliant, unethical. One spoke of boycotting TD funds.

http://www.wealthprofessional.ca/market-talk/csa-osc-grilled-on-embedded-commissions-226088.aspx

CSA, OSC grilled on embedded commissions

by Leo Almazora30 May 2017

In a recent submission to the CSA's consultation paper on discontinuing embedded commissions, a senior investor expressed frustration over regulators' failure to answer questions he asked about the model.

"I contacted the CSA with five questions related to the disposition of embedded commissions under certain changing 'advisor' to investor relations," said an 83-year-old investor Peter Whitehouse in a seven-page letter emailed to the association. "I received a response that I should click on a provided link to the OSC and rummage through 74 Rules, Instruments & Policies papers that should be related to my quest."

Prior to contacting the CSA, Whitehouse reached out to the OSC to ask the same questions. The OSC did not answer them, but did say that embedded commissions are sent from the mutual fund company to the investment dealer, who then distributes the commissions among its advisors based on a pre-arranged agreement.

The questions Whitehouse asked the regulators were:

- What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with their financial advisor? Who gets the future embedded commission payouts?
- What happens to the continuation of the embedded commission payouts when a financial advisor employed by Investment Dealer "A" resigns from an investor's account?
- What happens to the continuation of the embedded commissions payouts when the investor's financial advisor employed by investment dealer "A" sells the investor's account (selling the book) to another financial advisor employed with the same investment dealer "A"?
- What happens to the continuation of the embedded commissions payouts when the investment dealer resigns from the investor's account?
- What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with a financial advisor employed by investment dealer "A" and the investor transfers their account to investment dealer "B"?

In his letter, he asserted advisors – dealing representatives – should not be given sales commissions by the fund companies they recommend, calling it a "pure conflict of interest" that exposes investors, particularly seniors, to various abuses.

He also spoke out against advisors who sell investors mutual funds on a deferred sales charge (DSC) basis without disclosing that they'd immediately receive a 5.5%-6% sales commission. According to Whitehouse, there's no requirement for advisors to inform investors of the high sales commission rate prior to the transaction, or of the detrimental impact related to DSC-based fund purchases.

He further urged the CSA to disallow bank-owned dealers' practice of sending complainants to an "internal ombudsman." Since there is no regulatory disciplinary oversight of such bodies, he contended, it exposes wronged investors to low-ball restitution recommendations and rejection of valid claims based on false and misleading reasons.

"If a dealer rejects a claim, they should be directed to OBSI and never to the unregulated entity of the bank 'internal Ombudsman,' as so many bank brochures do," said Whitehouse http://www.inman.com/2017/06/01/real-estate-referral-fees-the-good-the-bad-and-the-ugly/

Real estate referral fees: The good, the bad and the ugly

The common business arrangement could be improved with transparency

BY TERESA BOARDMAN

TODAY 3:00 A.M.

Key Takeaways

- Helping a homeseller find the perfect agent adds value to the transaction.
- Consumers have a right to know if their agent is paying a referral fee and whether a referral constitutes a recommendation.

I just love it when a check comes in the mail a few weeks or months after I referred a friend, family member or client to a Realtor in another market. I try my very best to find the perfect match. Sometimes I even turn leads away (insert gasp here) with instructions on how to find an agent and what to look for.

There are times when I accept clients from other agents and pay them a referral fee. Usually it works well, and I don't mind paying the fee for a client who is ready to buy or sell now.

That's the good. However, referral fees are also territory for abuse, and the practice can leave consumers in the dark about who's paying who.

More leads than home sales

Agents and other industry players "capture" leads so that they can sell them. The internet has made it easier than ever to do so. (Indeed, there are far more leads than there are home sales.)

We get emails and phone calls about leads who are looking for an agent in our market. Apparently, these leads wait patiently for their captor to sell them to an agent. Maybe that's what happened to all the homesellers this year.

Referring agents can become the middlemen that come between middlemen without adding value. The captor adds no value to the transaction; the client remains in the dark, unaware of the exchange.

One improvement: Transparency

Consumers often confuse referrals with recommendations. They may not vet the agent but assume that the referral is a vote of confidence.

The weakest kind of referral, of course, is the lead capture. The person who captured the lead knows nothing about potential clients and whether they're qualified to buy or ready to sell. If the agent who accepts the lead is able to convert him or her into a client, and that clients buys or sells real estate and the transaction closes, the referrer expects a fee.

Some of the agents who refer business to me found me on the internet. They don't know me or anything about me. They don't know if I will do a good job. Most of the time they do not know the lead either. They acquired contact information, and they want to get paid for it.

Consumers who click on the wrong link or call the wrong agent may end up paying that agent indirectly as their contact information is given to another agent. I wonder about the people who get captured and sold because they cannot find a Realtor — not finding a real estate agent would take some effort.

The system could be improved by requiring the person making the referral to disclose the fee (and who knows who and how they know each other) to all parties.

In Minnesota, we must disclose who is paying us a commission and how much, but we do not have to disclose how much (or who) we are paying for the business.

The law says that I can only pay licensed brokers for a referral. The first thing I do when a referral comes in is check to see if the person making the referral is licensed and if they are active.

Calls about a 'business opportunity'

People I don't know will occasionally call with a "business opportunity." They want share the name of a person looking to buy or sell a house, and for me to pay for it.

Most agents have heard relocation horror stories from clients. Let's say Big Box Brokerage (BBB) has a relocation department. BBB refers persons who are relocating to BBB agents. Often, the agents with the least amount of experience will agree because they do not yet have enough business and they need the experience and the money.

BBB takes 40 percent of the new agent's commission and charges a 35 percent referral fee. The buyers or sellers end up with an inexperienced agent who is working for almost nothing. The consumer ends up with an inexperienced agent tasked with navigating a cross-country relocation.

What consumers have a right to know

We need to do more to educate consumers. They need to understand that if they get referred to an agent, they should interview that agent like they would any other and ask the same questions. They need to understand that in their real estate search, they may get captured and sold, or end up being referred by one agent to another for a fee without ever knowing.

I don't think leaving contact information on a real estate agent website is wise. I have a hard time understanding why people do it and why they enjoy drip email campaigns and having agents keep in touch with them.

I won't leave my contact information on any website, and I block advertising campaigns or opt out of them. I am just not lead material.

Helping a homeseller find the perfect agent adds value to the transaction. It is wonderful when a friend or a past client thanks us for introducing them to that amazing agent.

Referring business to others (even if we don't know them) just because we can add value to our bank accounts could be part of the reason why people don't trust real estate agents.

Teresa Boardman is a Realtor and broker/owner of Boardman Realty in St. Paul. She is also the founder of StPaulRealEstateBlog.com.
Email Teresa Boardman.

http://www.advisor.ca/news/industry-news/rbc-insurance-reduces-mers-on-seg-funds-235011

RBC INSURANCE REDUCES MERS ON SEG FUNDS

Staff / June 5, 2017

RBC Insurance has reduced management fees by 20 basis points on seven of its balanced segregated funds. The changes are effective June 5, 2017, and are available to all new and existing clients with no restrictions.

	RBC GIF Invest series		**RBC GIF series 1**		**RBC GIF series 2**	
	MER before fee reduction (%)	MER after fee reduction (%)	MER before fee reduction (%)	MER after fee reduction (%)	MER before fee reduction (%)	MER after fee reduction (%)
RBC Balanced GIF	2.48	**2.25**	2.79	**2.57**	2.97	**2.74**
RBC Conservative Growth & Income GIF	2.20	**1.99**	2.46	**2.24**	2.61	**2.38**
RBC Balanced Growth & Income GIF	2.41	**2.20**	2.60	**2.39**	2.80	**2.59**
RBC PH&N Monthly Income GIF	2.37	**2.15**	2.76	**2.54**	2.88	**2.66**
RBC Global Balanced GIF	2.48	**2.25**	2.72	**2.51**	2.84	**2.62**
RBC Select Conservative GIP	2.26	**2.04**	2.64	**2.42**	2.83	**2.61**
RBC Select Balanced GIP	2.41	**2.19**	2.70	**2.48**	2.89	**2.67**

Note: The 2016 MERs before fee reduction are the actual MERs for the year ended December 31, 2016. The 2016 MERs after fee reduction recalculate the 2016 MERs as if the new management fee percentages had been in effect throughout 2016. The MERs for 2017 are expected to be between the 2016 MERs before fee reduction and 2016 MERs after fee reduction, since the reduced management fee percentages will take effect partway into 2017.

Investor COM
Simple Compliant Communications

June 9, 2017

Delivered By Email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumers Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

In care of

The Secretary
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20 Queen Street West
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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

RE: CSA Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions ("Paper")

InvestorCOM is pleased to provide our comments to the Canadian Security Administrators' (CSA) Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions ("Paper") dated January 10, 2017.

InvestorCOM is an affiliate member of the Investment Funds Institute of Canada (IFIC) and The Federation of Mutual Fund Dealers (the "Federation"). Having participated in the Advisory Task Force for both organizations, we support IFIC's and the Federation's comment letters submitted to the CSA on June 9, 2017.

As a Regulatory Technology ("Regtech") solutions provider for the investment funds industry, our comments reflect both industry and investor research responses to the CSA investor protection and market efficiency issues outlined in the Paper. In addition to the comments summarized in IFIC's and the Federation's letters, we wish to emphasize the following points.

Embedded commissions provide investors with choice

Based on the CSA Investor Index (October 2012), 80% of Canadian households own less than $100,000 in investible assets and mutual funds, held by 4.3 million households, are the most common and important holding in their RRSP and RRIF accounts. There are many different dealer and advisor compensation models in the mutual fund industry, embedded compensation being one.

The CSA's concern is that payment by the investment fund manager to the investor's dealer, which is used in part to pay the advisor (embedded fee) is a conflict of interest. It is relatively simple for the industry to provide further disclosure and transparency around the embedded fee structure, which will largely eliminate the conflict of interest concern while still providing investors with a fully informed choice as to how they pay for investment products and services.

Low net-worth investors (<$100,000) who invest in mutual funds today have an advice component included in the product fee. If embedded fees are eliminated, many of these investors will not be able to afford to pay for advice through a "fee for service" model or will forego paying for advice and choose a direct investing or robo advice model which may not be suitable for their level of investment knowledge. The embedded commission model fills the "advice gap" for many investors with assets under $100,000 by investing in funds that meet their risk tolerance and long-term savings objectives.

Eliminating embedded commissions will not significantly improve investor fee awareness

CRM2 and POS3 regulations are already in place to make direct and indirect mutual fund fees more transparent. Since CRM2 was only fully implemented in 2017 and POS3 in 2016, more time is needed to measure the effectiveness of these regulations on investor awareness. The industry is committed to ensure that advisors are using these regulations for investor education and fee disclosure. With increased investor education and greater transparency on fees and costs, investors will be armed with better information, leading to net improvement in overall returns to investors.

Investors need help

Despite all the regulatory changes, industry changes, advisor and investor education, the fundamental problem remains that a large majority of investors need the help of an advisor to plan for their future and retirement. The skills required to understand increasingly complex financial products and compare investment alternatives is significant. Investors need the help of advisors to guide them through the wide range of investment choices including securities, mutual funds, exchange-traded funds (ETFs) and deposit products. Bundling financial advice with financial products in the current embedded commission model for mutual funds makes it easier and more accessible for low net worth investors to make choices between investment options.

Unintended Consequences

Independent research conducted by IFIC, the Federation and The School of Public Policy at University of Calgary all conclude that eliminating embedded commissions will hurt low net worth individuals most. This has also been shown to be the case in other jurisdictions as well, including the UK and Australia. Restricting access to advice for low and middle income families in Canada will adversely affect their wealth accumulation and ultimately their retirement savings and the Canadian economy.

Role of the Regulator

The role of the regulators is to ensure that the policies and guidelines protect investor interests and address market failure. The role of the regulator should not be to promote a market outcome. The shift towards a fee-based advice model is underway in Canada, however this should be allowed to occur in a marketplace that allows for all relevant investment options and fee options.

Advisors play a critical role

Advisors play a critical role in helping investors accumulate wealth and prepare for their retirement. Research continues to show that the average investor has limited knowledge of basic financial products and how their advisors are compensated. The recent implementations of CRM2 and POS3 are aimed at increasing investor knowledge and awareness which can be monitored and measured over time. The industry needs time to see the positive impact of these changes. Research indicates that Canadians who use financial advice accumulate significantly more wealth as compared to non-advised households.

Robo advice is one of many investment channels

There is room for both digital technologies and advice products in the marketplace. Digital technologies including robo advice and direct investing provide choice for those investors who have good investment knowledge and are comfortable managing their own investment choices. However, these channels do not serve the needs of low net worth investors who have limited knowledge of investment products and who are currently invested in mutual funds with embedded commissions.

There are alternatives to an outright ban

Instead of an outright prohibition, IFIC has proposed a number of reforms that, if implemented, would address most of the harms identified by the CSA, and would continue to allow investors the choice of paying for a mutual fund investment directly or indirectly, while also avoiding the unintended consequences of an outright ban. These include:

- Providing investors with a choice of both embedded and unbundled fee arrangements with enhanced transparency around fees paid
- Leveraging the current CRM2 and POS3 regulations that mandate fulsome disclosure regarding fees and services to be provided upon account opening, before each purchase and annually
- Standardizing embedded fees across the industry to remove the financial incentive for an advisor to recommend one fund over another based only on trailer fees since all funds would pay the same trailer
- Restricting the sale of Series A funds only in channels where advice is permitted
- Establishing guidelines under which sales of Deferred Sales Charges (DSC) funds are sold, so investors are not locked into funds that are not suitable for their age or time horizon
- Allowing modest investors access to embedded fee series funds so they can continue to receive financial advice

- Separately disclosing embedded fees to increase transparency and standardize naming conventions for fund series to facilitate comparisons of MERs and trailer fees across similar products

Conclusion

The dynamic consequences of an outright ban on embedded commissions will not elicit the results that the regulators or investor advocates are looking for, but rather will result in a negative impact on the retirement savings and wealth of the low to middle income investor; exactly the target group for which the ban was intended to help.

Our recommendation is to keep embedded commissions as a marketplace choice for investors and make fees more transparent. We agree that the industry needs competent financial advisors that can deliver affordable and transparent financial advice to all Canadian households. We also agree that the industry needs to increase investor proficiency standards, promote best practice and enhance suitability requirements.

As a Regtech provider to the industry, InvestorCOM is committed to working with the industry and regulators to develop products and services that help advisors disclose fees, help educate clients and help fund managers monitor compliance.

Thank you for giving the industry an opportunity to comment on the consultation paper.

Sincerely,

Anthony Boright, President
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VIA E-MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Re: CSA Consultation Paper 81-408 - *Consultation on the Option of Discontinuing Embedded Commissions*

We are writing to provide comments with respect to the CSA Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions* ("Paper").

Quadrus Investment Services Ltd. ("Quadrus") is one of the largest mutual fund dealers in Canada with more than 3770 registered investment representatives. It is the exclusive mutual fund dealer for London Life Insurance Company and preferred mutual fund dealer for investment representatives of The Great-West Life Assurance Company.

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Introduction:

Studies have shown that Canadians at all economic levels have significantly better long term economic outcomes when working with an advisor than when not[1]. However, as noted in the Paper, not all Canadians, particularly in the mass-market segment, use an advisor. In our view, the test of any regulatory initiative relating to advice is whether it is likely to *increase* (or at least not decrease) the number of Canadians obtaining good, qualified, understandable and affordable advice, and therefore obtaining improved financial outcomes. Our principal objective, when responding to this and other related CSA papers, is to arrive at a solution that maximizes the range of access to advice and payment options available to Canadians at all economic levels. We believe that in this regard our overall policy objective is shared with CSA members: providing a solid framework allowing Canadians to confidently invest and save for their own current and future needs. Certainly any initiative that is likely to eliminate or limit access to good, qualified, understandable and affordable advice is not likely to improve financial outcomes of Canadians and will not benefit the Canadian economy in general.

We strongly support CSA initiatives to improve the professionalism of advisors, clarify the costs of investments and of advice, clarify titles used in the industry and improve the financial literacy of Canadians. We are convinced that all of these initiatives will increase the quality of, and access to, investment advice thus leading to improved financial outcomes for Canadians.

Canada has benefited from a robust regulatory environment that differs materially from those of some other jurisdictions where scandals and investment failures initially led to the kinds of regulatory reform the CSA is currently contemplating. As the CSA notes in the Paper, Canada cannot fully compare itself to the experiences of other jurisdictions as Canada's starting conditions differ. Canada, and Canadians in general, were not subjected to the worst of the global recession or localized fraud and scandal. We have seen no convincing evidence of widespread negative consumer implications resulting from embedded compensation arrangements. To the contrary, given the massive growth in retail investment in mutual funds over the last 30 years and the popularity of embedded compensation models in that growth sector, a strong argument could be made that embedded compensation has played a major role in helping Canadians get and stay invested, allowing them to achieve their relatively strong retirement readiness level today.[2]

The Paper asks specifically that the industry not reiterate previous arguments and produce new, Canadian, evidence. We have done this when possible, but we also wish to stress the legitimacy of the positions the industry has raised to date. We acknowledge that the CSA has the best interests of Canadian investors and the health of a robust market as its core motivations. We do as well. We think that fair thinking market participants and regulators can work together for the benefit of all. The Paper makes it clear that the CSA has given this issue serious consideration. We respect that, but on many elements we do not arrive at the same conclusions, and in our response, we submit alternate proposals to address the items we agree cause concern. We are deeply concerned that the direction the CSA is proposing is dangerous for Canada, and not just for our business. The research and analysis presented by the Paper is not determinative, focuses on the wrong things and fails to establish any conclusive evidence that banning embedded compensation models will result in improvements to consumer outcomes. As another jurisdiction has pointedly noted, a ban is a "blunter option"[3]

[1] CIRANO, Econometrics Models on the Value of Advice of a Financial Advisor, 2012, and The Gamma Factor and the Value of Financial Advice (2016) and IFIC, The Value of Advice, 2012
[2] See McKinsey & Company, "Building on Canada's Strong Retirement Readiness" (February 2015).
[3] Regulatory Impact Statement, Review of the Financial Advisers Act 2008,Ministry of Innovation & Employment, New Zealand, p. 46

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of public policy. If a payment method has undesirable implications, we should focus on working together to find solutions that do not run the serious and internationally recognized risks[4] of unintended and serious consequences for small and moderate Canadian investors that would likely be the result of a ban.

We are strongly in favour of offering a diverse selection of payment options to clients, consistent with their needs. Although we do not support eliminating all embedded fee models, as the market evolves and client needs change, we are not opposed to eliminating fee models that may no longer be aligned with those needs, such as deferred sales charges. We believe that targeting reforms in this manner results in a better outcome for Canadians and market participants than banning all types of embedded commissions.

In addition to our submission, we have been involved in and strongly support the submission of the Investment Funds Institute of Canada. That submission includes significant and relevant new data specific to Canada, as requested by the CSA. We will let the IFIC Submission speak for itself.

Implications for Access to Advice:

The Paper continues from the original Consultation Paper 81-407: Mutual Fund Fees, of 2012, noting that the CSA has reviewed a number of studies and commissioned additional research to assist it in its deliberations with respect to the implementation of a ban on embedded commissions. The CSA has concluded that embedded commissions raise three investor protection and market efficiency issues in Canada:

(1) Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;
(2) Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and
(3) Embedded commission paid generally do not align with the services provided to investors.

These issues generally exist in one form or another for most compensation models and are not exclusive to embedded commissions. We agree with the CSA that improvements can be made on these three concerns, but we suggest that the solution is to develop targeted responses specific to each concern rather than a sweeping ban on a commission structure that has served Canadians well.

We strongly believe that the investment funds business should offer multiple ways for clients to pay for advice, and to the extent conflicts arise, disclosure is obscure or there is concern about the value clients are getting for those payments, they can be dealt with directly and for all payment methods. We discuss each of these concerns in more detail in the next section, and propose alternative approaches for consideration that would not create the serious risk of unintended consequences.

The Paper reviews the use of embedded compensation in the sale of investment funds, concluding that the only way to remedy the concerns raised is to completely eliminate the option. In our view, the imposition of a complete ban on any otherwise legal activity is an extreme measure and should only be done where the harm is clear, material and not remediable in a manner that would cause less disruption. We do not believe that the case has been made for any of these, and are very concerned that the real consequences of banning this

[4] Final Report, Review of the operation of the Financial Advisers Act, 2008, Ministry of Business, Innovation & Employment, New Zealand, pgs 78-9, including references to FCA Financial Markets Review final Report, 2016.

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method of paying for investment advice, intended or otherwise, will be to reduce access to advice by those Canadians most in need of it. In short, the proposal will not increase access to advice, and therefore will not improve investor outcomes.

The Paper suggests that advice will still be available and will be provided, but will be:

(i) paid for directly by the client in amounts negotiated with the advisor,
(ii) paid for at hourly rates for services rendered,
(iii) provided by employed advisors in bank owned firms, or
(iv) provided through algorithm based robo-advisor services.

What will be largely eliminated, however, is direct human advice provided to small and medium level investors by independent financial advisory firms. Our expectation is that firms will continue to require a minimum asset level of at least $100,000 before negotiating account fees because it will be driven by the cost of the time involved in properly engaging in the meetings and work required for account opening and client analysis. The vast majority of Canadians have less than $80,000 in savings – as a result, negotiated fees will simply not be available to them.

The Paper suggests that firms may develop fee based services, with charges based on specific activities provided by the advisor. The experience in the United Kingdom suggests that the price mass-market clients will be willing to pay for these services is materially lower than the price advisors will need to charge in order to maintain a viable business. As a result, a ban on embedded commissions will create an advice gap because many investors are not willing or able to pay the fees required to operate a viable advisor business. The likely result is that these investors will leave their current advisor and either turn to bank owned firms (significantly limiting choice and competition), move to self-managed tech solutions/robo advice (which do not offer the "gamma" element proven to be successful) or worse still, avoid investing entirely.

The Paper places significant weight on the CSA's expectation that bank owned firms will take on the vast majority of small and medium investors who currently obtain independent advice through embedded commissions. We are concerned about the loss of competition such an approach will create, and are particularly concerned about entrusting the financial future of an entire cohort of Canadians who are at risk of not meeting their retirement needs to one primary distribution channel. Fostering a competitive advice environment can improve the quality of the service provided and create incentives for lowering the cost, but it also tends to provide alternatives should one channel be found to have engaged in inappropriate selling behavior, for example. For all these reasons, actions that have the effect of limiting competition and fostering concentration are generally to be avoided.

The Paper also appears to rely strongly on the growth of technology based solutions which promise to provide platforms that will offer automated portfolio strategies for very low cost. We also support such initiatives, but such services do not offer the core value of advice – the "gamma" of coaching and convincing necessary to ensure clients engage and remain in the investment process through difficult times.

Alternatives:

Although we disagree with many elements of the Paper, we would prefer to work toward solutions with the CSA that may resolve our mutual concerns regarding some forms of embedded commissions without the need

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for their elimination. Such an approach has the benefit of dealing with the problem without eliminating a valuable payment option for Canadians. As noted above, the following three concerns expressed by the Paper apply to any compensation structure to varying degrees. We support more payment options – not less – and believe that properly framed rules can deal with the concerns without eliminating one of those options.

(i) Conflicts of Interest;

All forms of compensation create potential conflicts - embedded commissions are not uniquely problematic in this regard. In the classic economic situation, the client wants the service for free and the provider wants payment for minimum work. In reality, every payment method has this inherent conflict, which can be resolved through transparency and availability of alternative options. CRM2 initiatives already appear to be having an effect on all models and there is no evidence that eliminating a popular option will improve client outcomes on this point.

Similarly, as advisors' compensation is often a percentage of client assets, advisors and clients are fully aligned in their desire to increase those assets. We do not see a significant misalignment between advisor and client interests arising simply from the fact that advisors are paid by the manufacturer. Any percentage based compensation structure will serve to align interests as best as possible. Set fees for services may actually misalign interests, as the advisor would have an incentive to process as many such clients and transactions as possible, potentially driving the quality of each individual client experience down.

With respect to the concern that fund managers have the ability to enhance compensation in order to generate sales, whether the fund's performance warrants the attention or not, much of the research relied upon by the CSA pre-dates current market changes, which have generally flattened commission schedules among fund firms. This largely eliminates the argument that firms "purchase" sales: as funds move to common compensation grids, the incentive to sell one over the other for payment alone disappears. The CSA deserves significant credit for sparking this market movement, which in our view arose in no small part as a reaction to CSA Consultation Papers 33-404 and 81-407. These papers shed light on the issue, which led to advisors and dealers moving away from funds that paid non-market compensation.

We suggest that requiring advisors to take the cost of the investment into consideration as part of a suitability analysis has led to this result. As an alternative to an outright ban of embedded commissions, the CSA could continue to monitor compensation structures offered by fund families and act surgically if it has concerns that a fund is 'purchasing' sales. This would remove the misalignment of interest between the fund manager and client, driving fund managers to distinguish themselves on price, performance or both.

(ii) Awareness, Understanding and Control;

Embedded commissions no longer limit investor awareness given the adoption of CRM2 transparent disclosure rules. In fact, because of CRM2 embedded commissions are fully disclosed to the client. This provides a clearer picture for clients than they would obtain from working with salaried bank employees for example (who may receive bonuses or other incentives on the sale of certain products, but which would not be disclosed on a CRM2 statement). In addition, as embedded commissions are disclosed in Fund Facts they allow the market to operate using complete information. Negotiated fees are not disclosed to the market and therefore are not subject to market discipline. We are concerned that clients may find themselves put in a position where they

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are directed to a negotiated fee based account when that may not actually be in their best interest.[5]

We are concerned that the Paper includes a dangerous underlying assumption: that individual Canadians have the skills, knowledge and desire to "negotiate" fees with a trained advisor. Behavioural Economics research suggests quite the opposite, and in our experience a large majority of Canadians prefer not to negotiate, but to simply accept a reasonable price for services. Given that, the key is to ensure that potential clients are given the information they need.

We suggest that disclosure of the cost, in a clear and simple way, prior to the transaction resolves these concerns and provides clients with control over their investment decision. We also suggest that offering different payment options prior to sale achieves the same purpose as well. Perhaps a simple standard illustration could be developed that would indicate the impact of different fee payment options on the clients' account using standard assumptions. Alternatively, or concurrently with this proposal, clients could be required to acknowledge in writing the fee arrangement they have with their advisor (embedded or otherwise).

The Paper suggested that the large number of different fund series available to investors creates complexity and makes it difficult to understand the costs of investing. Many of these series are not available to the small and moderate investor in any event, and we think this can be easily resolved with simplified disclosure.

Tiered structures also should be considered. For example, given that the vast majority of Canadians have less than $80,000 to invest, most cannot meet the asset thresholds for fee based accounts (currently at least $100,000 for most firms). However, over time clients may achieve these thresholds. Firms could be required to alert clients when these options become available to them, and indicate the effect that such fees may have on their account.

All of the concerns raised under this section can be dealt with through simplified communications and disclosure.

(iii) Value for Compensation;

We agree that clients are entitled to understand the services they will receive for the compensation paid to their advisor. We think this can be done through a clear, simple services statement to be provided to the client at the point of account opening. Such a statement would set out the reporting, analysis, accessibility, number of meetings and the like that will be provided by the advisor, and include the anticipated annual compensation paid to the advisor and dealer for those services under different payment options. This has the benefit of clarifying, for all parties, exactly what is expected in return for the fees paid. We think such an approach will empower clients and allow advisors and dealers to distinguish themselves based on service, and does not require the elimination of embedded commissions.

We also think there is merit in considering whether embedded commissions should be subject to a cap or a trigger point where negotiated fees should be proposed to the client. Such an approach would help in avoiding situations where client accounts grow significantly, generating much more compensation to the advisor without any additional added value to the client.

[5] IIROC Notice 19-0093, April 27, 2017, s. 2.3.1

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Appendix:

The Paper sought input on 36 specific questions. We attach an appendix setting out those questions and our responses.

In closing we thank the CSA for the opportunity to provide feedback on this Paper. The changes mentioned in the Paper are significant and far reaching, with the potential to seriously harm small Canadian investors inadvertently. Large investors will always have access to financial advice and the market. Smaller investors, who make up the bulk of Canadian society, do not have that luxury and any change that has the potential to weaken their abilities to invest for their futures should be subject to the most intense scrutiny and analysis. In particular, any prohibition of a method to pay for financial advice that has allowed average Canadians to invest and stay invested through market cycles, with a view to a long term goal that is of benefit to those individual Canadians and society as a whole, should be the very last option considered after all other methods have been tried and found wanting.

Yours truly,

Quadrus Investment Services Ltd.

By: Michael Campbell
President and Chief Executive Officer

Appendix A to Quadrus Investment Services Ltd Submission

Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

1. Do you agree with the issues described in this Part? Why or why not?

For clarity, we will respond to each issue as raised.

Issue 1: Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.

i. Embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance.

The Paper concludes that embedded commissions "may" provide an avenue for fund managers to "buy" investment growth, allowing them to avoid actually having to focus on performance. The data relied upon by the Paper predates recent market activity by the few fund managers that offered compensation at above median rates. Currently most, if not all fund managers now offer the same compensation levels, effectively resulting in flat compensation across fund families.

This has come about since the release of the Cummings Report. We believe that the Report served a useful purpose by questioning the appropriateness of using compensation to drive product sales. The industry reacted quickly and responsibly by moving to a flat commission structure. As such, the problem has already been resolved by the consultation process, and this criticism of embedded compensation is no longer applicable.

In our experience fund managers focus almost entirely on performance in marketing their products. With the flattening of embedded trailing compensation already achieved, performance, reputation, service and cost are the only remaining differentiators, all of which are valuable fields for competition to generate improved results for consumers.

If the CSA has concerns that firms may slip back into paying embedded compensation that is higher than industry standard, then they can either mandate a maximum trailer level or monitor fee structures through the prospectus review process, depending on how market intrusive they wish to be. This would be less drastic than removing embedded compensation completely, yet would address the concern.

ii. Embedded commissions can encourage dealers and representatives to make biased investment recommendations which may negatively affect investor outcomes.

The Paper suggests four major categories of concern:

1. High compensation paid by some fund managers;

   The Paper makes it clear that any "bias" arises not from the existence of embedded commissions but from higher compensation for the sale of one fund family, or one fund category, over another. As noted above, that concern no longer applies and in any event could be addressed directly without resorting to a ban on embedded commissions.

2. Equity vs. Fixed Income;

Existing suitability requirements are designed to drive advisors to a portfolio recommendation in line with the clients' stated needs, timeline and risk appetite. In a low interest rate environment, most clients are required to take on some level of risk in order to achieve their goals. Generally speaking, fixed income funds pay lower compensation than do equity funds. In our experience advisors do not offer clients higher risk funds in order to obtain higher compensation, but because clients require higher returns in order to meet their investment goals in a low interest rate environment, and such funds are otherwise consistent with clients' needs, timeline and risk appetite.

3. Passive vs active managed funds;

   This issue is dealt with in issue iii, below.

4. Improper sale of Deferred Sales Charge (DSC) series.

   With respect to DSC's, we believe that they should be considered as a unique subset of embedded compensation. The Paper notes that the market appears to be dealing with the potential negative implications of DSC's, and we support market movement in that direction. If the CSA is of the view that conflicts inherent in the DSC model cannot be remedied in other ways, perhaps it should limit its proposed ban to DSCs, rather than applying it more broadly to all forms of embedded compensation.

The Paper notes that research indicates that many advisors' personal portfolios tend to look very similar to their client portfolios. It is not clear what this information is intended to imply. Certainly this result could be obtained by clients seeking advisors with similar investment approaches and vice versa. Having the same investment approach as your client does not suggest impropriety. From our point of view it actually shows that advisors and clients' interests are very closely aligned: both have the same interest in the success of comparable portfolios.

The studies cited in this section tend to conclude that advisors add no active management ("alpha") to justify the impact of fees on portfolio performance. Our position has consistently been that "alpha" is not the true measure of the value of advice: better financial planning ("gamma") is. In our view these studies are measuring the wrong thing, and consequently have limited value in the debate. The real question is whether clients would have achieved better outcomes without the involvement of an advisor at all than they would with an advisor, net of fees. The few studies on this point conclude in all cases that clients with an advisor are significantly further ahead than those without.[1]

The proposal to ban embedded fees means that many clients will be put in a position of having to negotiate fees with their chosen advisor. We have seen no evidence suggesting that this will improve client outcomes, and we are concerned that most small and moderate investors, even if they can find an advisor willing to advise them, will not have the skills or knowledge to effectively negotiate. Clients may end up paying more in a fee-for-service model than in an embedded fee model. Indeed, a recent guidance note from IIROC (17-0093, April 27, 2017) expressed concern regarding fee based and managed accounts relative to commission based accounts; "Our concern is that clients may be moved into fee-based accounts, whether or not such accounts are consistent with the client's best interest."

iii. Embedded commissions can encourage high fund costs and inhibit competition by creating a barrier to entry.

Evidence cited in the Paper suggests that on average active managers do not beat the index on a regular basis when fees are taken into consideration, suggesting that it may be more appropriate for consumers to invest in low fee passive index funds. We are concerned that market dynamics may change in unexpected ways should retail clients stop investing and instead buy the index. Buying the index is not "investing", as the consumer does not analyze the business or bond being considered. Writing in The Financial Times, Yves Choueifaty CEO of TOBAM noted an additional challenge:

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[1] CIRANO, Econometrics Models on the Value of Advice of a Financial Advisor, 2012, and The Gamma Factor and the Value of Financial Advice (2016) and IFIC, The Value of Advice, 2012

"By definition the average active manager cannot outperform the benchmark because the benchmark is determined by the sum of activity carried out by both active and passive managers. And because passive managers have no impact on the benchmark – they merely follow it – it is, in fact, the sum of all the bets taken by active managers that determines the benchmark. It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers"[2].

In short, the "average" active manager IS the index, and therefore cannot beat it. This does not mean that active management is inappropriate for retail investors - clearly some active managers add value by managing taxable gains and losses, selecting non-correlated investments and manage volatility – all beneficial actions for investors. It is not appropriate to conclude that these services are not worth the fees being charged. We think this issue deserves more research in itself.

The Paper also suggests that the Canadian investment industry structure creates a barrier to entry for low cost investment products that do not pay commission to advisors. This argument appears flawed, as the growing success of ETF's in Canada has shown. Note that low cost fee products have been available to self-managed accounts for years. It reasonably appears that advisors whose business models are based on payments by manufacturers are not inclined to offer products for which they receive no payment. The benefit of an embedded fee ban with respect to this issue would appear to be that if clients pay for advisors services, advisors will be free to recommend products irrespective of commissions and generally they would move to lower fee products to justify their service. That appears to have been the result in the UK for example. However what also happened in the UK was that advisors could only afford to offer fee based accounts for clients with in excess of 100,000 pounds, cutting off access to advice for the vast majority of moderate investors. We expect a similar impact in Canada – in fact the recent MFDA Client Research Report (Bulletin 0721-C, May 23, 2017) came to the same conclusion: "As mass market households are less likely to be able to afford direct pay arrangements and are less likely to be eligible for fee-based programs, they would be the most impacted by a ban of embedded compensation." (pg 15)

Simply banning one way to pay for advice that is most used by Canadians with less than $100,000 to invest may not remove a barrier to entry for lower cost products, but it does limit access to advice for the majority of Canadian citizens. We do not see this as a positive outcome.

Issue 2: Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.

i. The lack of saliency of embedded commissions reduces investors' awareness of dealer compensation costs.

CRM2 and Point of Sale, stage 3 deliver transparency around dealer compensation. These critical initiatives have just been implemented and we do not yet know the extent to which they will change dealer, advisor and client behavior. It is reasonable to carefully assess the impact of these material regulatory changes before imposing additional changes that limit client choice and have strong potential for negative consequences for retail investors. We strongly support the CSA's detailed study of the impact of CRM2 and POS3, expected to occur between 2017 and 2019. This is the right way to manage regulatory change: make the change; test to see if it has accomplished the purpose; make additional changes if necessary.

We believe that when the fee options are fully explained to the investor, with full immediate and long term cost explained, many investors will still prefer embedded compensation to direct pay. As noted above, the Paper presents no compelling evidence that banning embedded compensation produces better outcomes for consumers. In a free market it's advisable that consumers retain as many options to pay for advice as possible, provided that those options are clearly explained.

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[2] Choueifaty, Yves, CEO of TOBAM; Active managers can't beat a benchmark, they are the benchmark / The Financial Times, January 4, 2016

The Paper raises concerns that when manufacturers pay compensation for product sales to dealers, the client loses control over what they are willing to pay for the service. This really comes down to ensuring the client has clear information on the cost to them of the service, whether they pay it directly or not, and the availability of other payment options. Given the information provided by CRM2 and POS3, we believe that clients will be able to decide if their advisor and dealer are providing value or not.

ii. Embedded commissions add complexity to fund fees which inhibit investor understanding of such costs.

Fund companies offer a broad range of fee options in an attempt to avoid creating a "one size fits all" approach to a heterogenous mix of consumers. This is a reasonable approach, and is not designed to confuse retail clients. For most small and moderate investors, the actual range of options are quite limited, and their advisor is there to present those options to them. If there are concerns about the clarity of that presentation, that can be addressed without resorting to a ban of one form of compensation.

We believe that this concern is misplaced: the real issue is not superficial complexity, but the fact that cost of ownership is not disclosed. CRM2 is very useful in that it establishes the cost of advisory services provided by the dealer, but it is also misleading as it may suggest to unsophisticated clients that this is all that they pay for. We strongly support a move to full cost disclosure, rather than partial cost disclosure. This would allow clients to have a complete picture of their cost to invest, and allow them to compare that cost to other potential investment options.

iii. The product embedded nature of dealer compensation restricts investors' awareness of dealer compensation costs.

As noted previously, CRM2 gives clients the ability to be aware of dealer compensation costs. We encourage the CSA to evaluate the improvement to investors' awareness arising from CRM2. In addition, if the concern is that CRM2 provides cost disclosure after the fact, consideration could be given to modifying the Fund Facts document to include dollars and cents comparable costs for each available fee option, so that clients could compare.

Issue 3: Embedded commissions paid generally do not align with the services provided to investors.

i. Investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid.

This is not correct as a general statement. However, even though all advisors are paid the same on an embedded model, not all advisors provide the same services at any given time. We believe that the real issue is not the fee structure itself, but the clarity of the service agreement established between the client and advisor, and how that service can be monitored by the client, adviser and dealer over time. Banning embedded commissions will not improve outcomes for clients with respect to increasing ongoing advice/servicing. The issue is not how the fee is paid or by whom. Rather, it is about how the ongoing servicing of a client is defined and monitored. Ongoing service is not inherently stronger in a direct pay model (such as on fee based accounts). When the issue is properly defined in this way we suggest other approaches to resolve the problem are more appropriate, such as service commitments delivered to clients at account opening setting out exactly what the dealer and advisor agree to provide in return for the commissions paid. This would apply for any form of compensation – embedded or not. On this latter point we direct attention to IIROC Notice 17-0093 of April 27, 2017 which draws attention to concerns surrounding the value of negotiated compensation structures for a buy-and-hold investor, for example.

ii. The cost of advice provided through commissions may exceed its benefit to investors.

This concern appears to be rhetorical – the cost "may" exceed the value provided. "May" is not a reason to ban an entire compensation structure that allows small and medium investors to participate in the market and gain access to advisory services.

This is always the case in any service industry, and is usually (and inappropriately) measured with the benefit of 20/20 hindsight: it is always the case that at some point in the future the "value" of the service may not be readily apparent. We are concerned that the Paper does not truly take into account the real value of advice – the "gamma" element of coaching and mentoring – and instead focuses on "alpha" – fund picking. The Paper appears to suggest that advisors should foster a "market timing" approach to investment advice, given the research focus on fund flows. We strongly disagree, and in particular disagree that the CSA should even suggest that such an approach is appropriate.

Alignment around servicing accounts needs to be a major focus and this can be strengthened under the current embedded compensation model. Establishing improvements in these areas along with the improved transparency that is occurring as a result of the Point of Sale and CRM2 initiatives can address this concern. Again, establishing service expectations at the outset should resolve this issue without the need for a ban.

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

The question is unfortunately phrased, because it assumes that there are "significant issues or harms" arising just from embedded commissions. As noted above, all of the stated concerns are not sourced in the nature of the fee, but in aspects of the process that have equal applicability to all fee structures to one degree or another.

There are no "significant issues or harms" only associated with embedded fees. The stated harms can all be resolved – for all fee structures – through processes and actions that are targeted at those concerns.

The consequence of a ban on embedded commissions will simply be a replacement of certain conflicts with other similar conflicts in the remaining compensation models.

"Embedded fees" as a category is comprised of two components: point of sale commissions (DSC) and trailing commissions. DSC structures (as noted in the recent MFDA Bulletin 0721-C) have been a source of regulatory concern and consumer complaints, as clients realize that they must pay a fee in order to sell out of the series. DSC series, though still comprising a significant segment of the MFDA dealer asset base, are declining and some fund firms have stopped offering them. We expect this trend will continue.

Trailer compensation not associated with DSC's do not have the same regulatory or consumer concerns, as they do not involve fees payable by clients on redemption. In our view, these are two very different fee structures and they should not be lumped together for purposes of this Paper. We would support action being taken to limit or eliminate DSC's, for example, but would not support the elimination of trailer compensation for the reasons stated in our comments.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

We believe that there are.

First, breadth of choice in payment methods is important when dealing with a broad and heterogenous consumer group. Often referred to as the "one size fits all" issue, consumers should have the ability to choose amongst as wide a range of options as possible unless a given option is inherently to their detriment.

It's important to acknowledge that clients come to advisors specifically because they don't understand all aspects of the business and don't want to. They expect the advisor to review their situation and make intelligent and informed recommendations, and then continue to assist them over time. They are generally willing to pay for this service over time: if they are willing to pay a percentage fee directly, then it is reasonable to assume that they would be equally willing to pay that same fee indirectly. In our experience when advisors have the fee conversation with clients, most small and moderate investors prefer to invest on a front end zero, embedded trailer basis as opposed to their only alternative: direct deduction from their account. As noted above, we support the elimination of the DSC option, so we do not include it in our comparison.

The embedded compensation model provides for greater inherent protection against the informational asymmetries that direct compensation models suffer from. The average retail Canadian investor does not have the requisite knowledge, desire and/or ability to negotiate compensation levels with an advisor. As noted above, investors seek an advisor because they do not have this expertise. The embedded compensation model offers a fixed, and generally common, compensation level. It is fixed in the Fund Facts and, because of public disclosure, is available for comparison to competitors and regulators alike. If a commission payment is materially out of line, market and regulatory forces move it back into line. That has been the experience over the last four years as fund families with higher embedded commissions have fallen out of favour, largely in our view as a result of these CSA consultations and improved focus on client outcomes in a low return environment. All of these protections would either not be available, or would be in place to a much lesser degree, if each Canadian was forced to negotiate their compensation directly with an advisor. Negotiated compensation is not visible to competitors and is not subject to market discipline.

The CSA paper suggests that insurer and bank owned dealers will support the moderate investor because they are already doing so with a non-embedded commission structure. This is not true for our firm, which is an insurer owned dealer. Our current model uses embedded compensation to provide access to advice for thousands of Canadians. The vast majority of our clients are small and moderate investors. Most now invest on a zero front end load, trailer fee basis. Elimination of this payment option will have serious negative implications for our clients.

Our current dealer fee based program starts at account values of $250,000. Most of our clients do not meet this threshold. Assuming that embedded fees are discontinued, these clients would either have to be let go or agree to have at least the same fee amount deducted directly from their accounts. The Paper provides for this option to allow clients to direct the fund manager to deduct and pay amounts to the dealer. The end result is that the client pays the same net amount (assuming that the IMF for the fee based series drops by the same amount as the negotiated compensation payment), but has less to invest and redemptions from a non-registered account are fully taxable in their hands. The end result – the client pays more if for no other reason than taxes, and is exposed to the potential for higher fees because of unequal bargaining power with their advisor that is not subject to market discipline. The offsetting benefit: clarity of cost to the client, and a theoretical ability to control their costs through negotiation. We are concerned that the cost of advice for many Canadians will go up because of their inability or unwillingness to negotiate a fee equivalent to or less than what they are currently paying through the embedded compensation structure. We strongly believe that the only remaining benefit – clarity – can be achieved in an embedded model without risking the serious negative consequences of interfering in the market with a ban on an otherwise acceptable fee payment arrangement.

We strongly believe that choice in the payment of fees should be as broad as possible to accommodate as many potential consumers as possible. Advice has value, and if the level and cost of service is clearly indicated at the point of sale, consumers should have the option to select an embedded approach. The Polaris study of 2016 found that over 50% of Canadians prefer the embedded fee model. Embedded compensation allows investors who do not desire to have a negotiated fee conversation with advisors (either because of preference or lack of education or confidence) to still participate in the market and accumulate wealth.

We see the recent CSA Papers as a call to action for the industry to improve disclosure – of cost and services provided – to do better. We agree. Recent compensation changes by fund managers have eliminated most, if not all, incentives to sell one fund family over another. We think changes of this nature can and will continue to resolve the concerns expressed in the Paper, but for *all* fee models and not just for embedded compensation. This is not the time to put the future of consumers at risk by eliminating embedded compensation on theoretical grounds.

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**

- **structured note**

Should the product be subject to the discontinuation of embedded commissions? If not:

a. **What would be the policy rationale for excluding it?**

Generally, we support a 'level playing field' with respect to regulation (including with respect to compensation arrangements) on various forms of investment products, and we note that a true level playing field would require that any compensation ban or rule apply equally to the products listed above, as well as to banking and deposit products (such as GIC's) and segregated funds.

Although we do not advocate for a ban of embedded compensation, if such a ban should be implemented by the CSA we agree that it should apply to all similar products whether sold under a prospectus or through the exempt market (or with respect to products sold by banking/deposit institutions). There is no valid policy rationale for an unlevel playing field within the securities regulatory space. As noted throughout our response, a ban of embedded compensation will result in a greater cost to the consumer than the corresponding benefits received. Although we do not support discontinuing all forms of embedded compensation, we do support discontinuing particular forms of embedded compensation that do not serve clients well, such as deferred sales charges. We encourage the CSA to go no further than to a ban DSCs.

b. **What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?**

A consistent approach with respect to compensation rules across all aspects of the investment products market place (including banking/deposit institutions and segregated fund products) is the best approach to avoiding potential opportunities for arbitrage. As noted by the CCIR in the recent past, they have seen no evidence of such arbitrage with respect to segregated funds. However, as noted recently in another submission with respect to the Paper, there does appear to be some evidence that banks may direct clients to savings products over mutual funds when their capital requirements increase.[3]

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

We do not support a complete ban on all forms of embedded compensation. However, if a ban is implemented by the CSA then we suggest that all types of mutual funds, non-redeemable investment funds, structured notes, banking/deposit products and similar products should be subject to comparable rules (see our answer to question 4(a) above).

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

We do not support a complete ban on all forms of embedded compensation and, as noted in our answer to question 4(a), for purposes of a level playing field, if a ban on embedded commissions is implemented, it should apply equally to bank products (such as GICs and deposits). We agree with the position put forward by the CCIR and IFIC which suggests that insurance regulators should work in conjunction with the CSA to develop consistent compensation policies that give customers compensation disclosure that will allow them to have the information necessary to compare product offerings and related compensation among all types of available investments. This is an important benefit to Canadians that should be seriously considered.

[3] "The Pros and Cons of Discontinuing Embedded Commissions by Regulatory Fiat, June 5, 2017, Pierre Lortie, Dentons Canada LLP, pg. 15

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

No, we do not agree.

We think that many Canadian investors will be harmed by the discontinuation of these payments. Specifically, we are concerned that many Canadians are not well suited to negotiate fees with their advisor, due to their level of financial education, the moderate size of their portfolio, and/or their confidence in negotation.

As noted in the recent MFDA Bulletin 0721-C (May 23, 2017) a ban on embedded commission structures will most materially impact "mass market households" – Canadians with less than $100,000 to invest. That Bulletin notes that this cohort of Canadians are also least able to afford direct pay arrangements or qualify for fee-based programs, most of which require asset levels in excess of $100,000.

Economic studies suggest that advice is a "credence good" – the value of which must be accepted in advance of it being proven over time. Studies suggest that advice adds significant value over a longer time horizon, but unless a client is aware of this value they are unlikely to be willing to pay a reasonable fee for it in advance of receiving that proof. Embedded fees make it easier for a mass market client to pay for advice in the absence of direct evidence of its value. Over time, as their account increases, they see the value and in due course may qualify for fee based programs. At that point they have experienced the value of advice directly and are more willing to pay directly for it. But without the experience gained under the embedded fee model, they may never reach that point.

For many Canadians, total cost of ownership of their investments may increase as a result of the CSA ban on embedded compensation. When the options are fully explained to them, we believe that many Canadians would prefer to pay compensation under their current embedded compensation structure. Removing this preferred method of payment (particularly when the related concerns can be fully mitigated in other ways) will have a negative and unnecessary impact on consumers and consumer choice.

Further, suggesting that compensation can be paid by redeeming investments from the investor's account, and for convenience those redeemed funds can be paid by the fund manager directly to the dealer, is effectively allowing the same payment to the adviser and the same cost to the client as with embedded compensation, but with the added potential negative tax consequences for the non-registered investor. The only gain associated with this scenario is that the investor should be fully aware of the amount debited from their investment account. Although theoretically the investor has the power to negotiate that cost with the advisor, in reality we believe that advisors will set their fee and most clients will accept it. It therefore stands to reason that disclosure of compensation cost is the chief concern. We agree that investors should be made aware of all costs associated with their investments, and submit that this can be accomplished through other means without discontinuing embedded compensation and limiting investor choice.

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

a. **the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;**
b. **referral fees; and**
c. **underwriting commissions**

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

Current rules prohibit the payment of material incentives to dealers and advisers. As the core issue underlying discussions of banning embedded compensation models appears to be either transparency or inappropriate incentives for behavior, we think the perceived potential for negative behavior is already dealt with appropriately. Enforcing existing provisions should be sufficient.

Funds often provide valuable educational opportunities to dealers and advisers, and these are not inherently bad. Nor is most marketing material.

Banning referral fees could result in advisers not passing appropriate clients on to another registrant category that may be more appropriate for them.

As an MFDA dealer, we have no comment on underwriting commissions.

With respect to concerns of "regulatory arbitrage", we have seen no evidence of it occurring between insurance and mutual fund dual registrants, and our observations are supported by the CCIR. This appears to be a concern rather than a reality. We cannot comment on whether banks have, from time to time, directed clients to deposit vehicles when a mutual fund may be a more appropriate option (or vice versa), but given recent publicity it is a question that should be explored. (Also see footnote 3, above).

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

If there is evidence that payments and benefits received by dealers and representatives for marketing and education are having an undue influence, then we would encourage the CSA to better define the range of acceptable practices. It is our position that educational opportunities benefit the consumer by resulting in a more professional and articulate advisor. The professionalism of advisors is enhanced when they are better educated on the products available to their clients. As there can be a grey area between marketing and education, any conflicts arising from marketing practices can likely be dealt with through the enforcement of NI 81-105 as it is currently drafted, or subtle modifications to it designed to address specific, identifiable concerns.

10. With respect to internal transfer payments:

a. **How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?**

Our firm offers one family of proprietary funds and a wide range of third party investment products. In our view NI 81-105 provides sufficient guidance to ensure that advisers have no incentive to offer proprietary funds over third party funds.

Although we are not directly familiar with the practice, it may be possible that integrated financial service providers could show lower fees paid to the dealer in their CRM2 disclosures even though the total cost of an investment to the client is similar to other funds. We support full disclosure of the cost of the investment, which is not currently required. CRM2 is only required to show amounts received by the dealer, and not how much the client paid during the statement period for the investment. We think that can mislead clients into misunderstanding the actual cost of the investment as a whole and to the extent that integrated financial service providers are able to take advantage of this, it would not be appropriate. Full cost disclosure would be sufficient to avoid this issue. We note that IFIC and the CCIR both support the concept of full cost disclosure, or "CRM3", and it would be appropriate to move forward on this initiative collectively. We are concerned that bank products are not subject to similar cost disclosure, and that creates an inappropriate situation.

b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

Integrated financial service providers can provide services to affiliated dealers that are reasonable and at reasonable rates, and such arrangements are not inappropriate in our view. However, we do not believe that integrated providers should be permitted to make an indirect payment (that does not have to be disclosed to clients) if such payment would be required to be disclosed if it had been made to a non-integrated provider. Such arrangements lack transparency and result in an unjustified competitive advantage to integrated providers. The spirit of CRM2 (providing transparency of dealer costs to clients) is not respected if such payments between integrated providers are permitted; the result is harmful to clients, as they may be led to believe they are paying less for a product than they actually are. Internal transfer payments related to capital maintenance or services provision are reasonable and should not be of concern. This is because it is not the existence of an internal transfer payment that creates the problem; the problem is created by the lack of transparency to clients regarding actual product cost. As noted earlier, full cost disclosure would assist in this regard.

c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

See comments in our answer to question 10 (b) above.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

Yes, this should be allowed as it benefits the investor and facilitates payments to the dealer in an efficient way. However, we note that in practice, from the client's perspective, this structure is strikingly similar to embedded compensation payments but it can result in negative tax consequences to the unregistered client. Allowing this payment structure suggests that the CSA is not primarily concerned with money flowing from the investment fund manager to the dealer, but rather with the lack of transparency to and control by the client that may exist with embedded commissions. As noted above, transparency is already being dealt with through CRM2 initiatives, and in our view the "control" issue (requiring clients to negotiate fees) is neither a preferred approach by small and moderate investors nor is there evidence that average consumers are willing or capable of successfully negotiating fees with advisers. We expect that most clients will either take the proposed fee or leave it, and most will simply take it as proposed.

Addressing the issues – SECTION 4

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

Although discontinuing embedded commissions may address the three key investor protection and market efficiency issues discussed in Part 2 with respect to embedded commissions, it will simply move eligible clients to other fee structures with similar issues. It will also create the negative consequences discussed in our preceding answers: potential negative tax implications for non-registered clients who pay fees themselves and an advice gap for lower and moderate level investors. We are very concerned about the CSA's assumption that such clients will be adequately served by bank owned dealers. We do not support actions that directly limit the scope of competition.

As noted above, rather than discontinue embedded commissions, we suggest that alternate measures could successfully address each of the three key investor protection and market efficiency issues discussed in Part 2, while avoiding the negative consequences to Canadian investors that a ban on embedded compensation would create. Such alternate measures will achieve our mutual goals of investor protection and market efficiency.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

Yes – although the market has already begun to address some of these issues (for example, by fund managers lowering MERs), we suggest that there are other alternative ways to address the issues raised without banning embedded commissions.

For example, consumers who currently pay fees through embedded compensation could be given an option to modify their account to a fee-based model when the account reaches appropriate thresholds. Dealers could be required to alert eligible clients when this occurs, and in clear and simple language illustrate the impact different fee structures would have on their investment account. This provides clients with more choice (rather than limiting their options) and allows those who prefer the embedded compensation model to retain it. This also allows Canadians who prefer fee-based compensation structures to elect to receive the benefits of that model. We think that with proper supervision, enforcement and good disclosure, clients will be better served by having the opportunity to choose from a variety of payment models. We suggest that the industry and regulators could work together to create a clear and consistent communication guide addressing the options available to consumers.

We also suggest that effective disclosure will address significant concerns raised by the CSA. For example, a simple standard illustration could be developed that would indicate the impact of different fee payment options on the clients' account using standard assumptions. Alternatively, or concurrently with this proposal, clients could be required to acknowledge in writing the fee arrangement they have with their advisor (embedded or otherwise).

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

All compensation arrangements in any profession have an inherent conflict of interest - including direct pay arrangements. Eliminating embedded commissions will not solve the inherent conflict of interest issues related to dealer and representative compensation. Rather than eliminate embedded compensation and still be faced with the question of how to handle the remaining conflicts related to direct-pay arrangements, we propose that the conflict issues can be dealt with just as effectively without eliminating a popular payment option for Canadians.

As noted above, negotiated fee arrangements are private between adviser and client and not subject to market discipline. Clients seek out advisers because they have greater knowledge and expertise: there is an inherent - and intentional - information asymmetry to the relationship. That could provide an opportunity for advisers to set their prices at a level that they believe the client will accept, which could exceed amounts paid in an embedded model. We are not convinced based on the evidence presented thus far that the average Canadian is in a position to negotiate lower fees, or that they are inclined to do so. We think significantly more investigation is required before concluding that banning embedded fees improves investor outcomes, or results in a better environment for investors.

For this reason, we are strongly in favour of dealing with conflict issues that arise for all forms of compensation, rather than eliminating one investor option.

Change in investor experience and outcomes

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- **Will investors receive advice and financial services that are more aligned with the fees they pay?**

We do not believe so. Advisors will not negotiate fees below a minimum asset threshold, simply because doing so is uneconomic for them; they are entitled to be paid for their services, and the work required to open an account will result in a cost – either fixed fee or percentage – that will not work for small accounts. As explained in our response to question 22, below, the minimum account size for fee based accounts is generally $100,000, which exceeds the average asset base for the vast majority of Canadians.

Advisors may be willing to accept direct payment of their fee from the clients/ account, but we are concerned that this could result in some clients paying more than they would in an embedded fee model.

We believe the best approach would be to develop a service promise between the advisor and the client, indicating what the client is getting and how much the client is paying for it in different payment options. We believe there is great confusion over the value of advice, and there is merit in clarifying the services rendered for the fee.

- **What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?**

The trend towards automated advice has started in the absence of a ban on embedded commissions, and will continue to grow regardless of any change to compensation structures. Clients that benefit from this service and find it suits their needs and knowledge base will continue to do so.

However, the presence of automated advice does not mean that an advice gap that may be created by banning embedded commissions will be filled by automated advice. It is a further option that will be available, but not one that every investor will prefer. There is no evidence or data that supports the position that smaller clients who receive personal advice today will be just as well served by automated advice.   In fact, a number of reports on the value of advice have shown that the principle factor in investor success when using an advisor is the “gamma” element of coaching and comforting – of convincing Canadians of the need to invest and to stay invested during difficult times. Automated advice services are “on demand”, and do not seek out clients, nor do they provide the direct, personal interaction that many clients expect. A recently published Global survey by UK based HSBC Holdings PLC found that only 7% of Canadians would trust advice received from a robo-advisor, and only 18% believed that robo-advisors were able to offer more accurate advice than humans. (“Canadians prefer financial advisors to robo-advisors”, Investment Executive, May 24, 2017).

- **Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?**

It is possible that high asset clients will migrate to discretionary platforms – such platforms usually have minimum asset thresholds. Our primary concern relates to small and moderate investors who will not qualify for those programs. These clients will be effectively disenfranchised from personal advice. As noted above, we should be focusing our attentions on increasing access to advice for the small and moderate investor, not decreasing it.

- **What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors**?

See our answer to bullet above.

- **What effect will the proposal have on the cost and scope of advice provided to specific investor segments**

Moderate investors have a higher likelihood of being harmed by the proposal because they may have to pay more (if their advisor can negotiate a higher fee or has a threshold fee) or may not receive advice at all (if they cannot afford or choose not to pay what the advisor proposes). The evidence supports that independent dealers (including insurer-owned dealers) use the existing embedded compensation model to service moderate investors. If this compensation model is no longer available, those investors may not be serviced by representatives of independent dealers, resulting in an advice gap for small and moderate investors.[4]

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- **Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?**

Pay arrangements that would result include: employed advisors, fee for service, hourly, and consultation service fee.

Employed advisors are generally limited to the bank channel. Compensation to these advisors will remain opaque to clients, who will have neither transparency nor leverage. Generally these advisors serve the small and moderate investor market, as higher asset clients are usually referred to affiliated broker dealers.

Today many fee based programs **[**are only available to clients once they reach a threshold investment amount, usually at least $100,000. Clients with account assets below this threshold (who are the vast majority of Canadians) will not be able to participate in these programs. In addition, clients who have saved enough to access these programs will eventually begin their decumulation program after retirement. As their assets drop below the threshold they will no longer be able to participate in the program. Banning embedded commissions could result in removing access to advice from both those who are starting small and seeking advice as they aim to build a lifetime of savings for retirement, and the elderly and more vulnerable client segment as they engage in the de-accumulation process; the result is a negative outcome for two segments of investors (who arguably need advice most), and for Canadian society at large.

17. Do you think this proposal will lead to an advice gap? In particular:

- **Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.**
- **Do you agree with our definition of an advice gap?**
- **Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?**
- **What types of advice or services currently provided today would be most affected by the proposal?**
- **Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?**
- **How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?**
- **Do you think that online advice could mitigate an advice gap? If so, how?**

[4] MFDA Bulletin #0271-C, May 23, 2017

- **Do you think that the significant market share of deposit-taker owned and insurer owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?**

As noted in our previous responses, we think that the elimination of any method of payment for advice is likely to have an impact on those investors that currently use that method of payment. Research has shown that small and moderate investors are most likely to use the embedded fee model until their asset levels are sufficient to make a negotiated fee model viable.[5] We are very concerned that these smaller investors – those with less than $100,000 to invest – will lose access to independent advisory channels and be forced to choose between no advice, self-service or bank owned employed staff advice generally offering proprietary product lines.

As shown in the recent MFDA Bulletin (0271-C), approximately 39% of MFDA member firm assets lie with independent financial advisory firms, 59% lie with bank owned firms and only 2% lie with direct sales channels. Although direct sales channels, including online advice services, are growing, they are unlikely to serve the needs of those currently using an independent channel. Further, direct sellers do not offer the "gamma" element critical to successful long term savings and investing that is available from independent dealers.

We think that there already is an "advice gap" in Canada – a significant number of Canadians are not currently seeking advice and not saving for their personal needs. There are likely many reasons for this, but as noted in our cover letter, we think the success measure of regulatory action in this area is whether the proposed action is likely to increase access to advice – not decrease it. Clearly, elimination of embedded fees will decrease payment options for consumers, and at least some of those consumers will forgo advice entirely, to their long term detriment. We do not see any balancing positive gain from this action that could not also be obtained through other, less damaging methods.

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

- **Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?**

We think it important to differentiate between "deferred sales charges" (DSC's) and "trailers", as both are paid for by the manufacturer, but they have different potential impacts on the consumer. DSC's pay a sales commission to advisors up front on behalf of clients, but clients have to pay a redemption fee if they want to sell out of the fund family within a set period of time. This limitation on the clients' ability to trade is problematic for many clients. Recently we have seen moves to eliminate DSC's by one major dealer and several fund managers. We support this trend and believe that it will continue. Certainly DSC sales have decreased rapidly over recent years, as clients' accounts reach negotiated fee levels or as advisors transition to a trailer based model.

We think that the fund industry and dealers will eliminate DSC's without further regulatory involvement in any event, but that regulatory support of their elimination would likely speed up the process.

We do not think that trailers will disappear, nor should they. Properly disclosed and explained, they are a reasonable method for low asset clients to pay for advice.

Generally, the trend towards fee based compensation structure is expected to continue. This is driven by competition, the focus of firms on the high net worth space, and the work that regulators have been undertaking. Many advisors and high net worth clients appreciate the transparency and negotiability of a fee based model. These commercial forces, if given enough time, will lead to a rationalization of fee structures.

[5] MFDA Bulletin 0721-C

However, regardless of the current trend, there will always be a cohort of investors who will benefit from an embedded compensation model. This cohort will consist of small and moderate investors. These investors should have the option of selecting an independent financial advisor, and not be forced to proprietary bank channels or low interaction online models.

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

- **Do you see payment options and business models evolving at present?**
- **How are they likely to change over time if the CSA were to choose not to move forward with the proposal**?

The recent MFDA Bulletin (#0721-C) sets out some interesting data that may inform assessment of Figure 8. Our firm falls into the "insurer owned" category, and a significant portion of our clients fall into the Front End Load Zero (FEL 0) category. Our experience has been similar to that noted by the MFDA: that DSC, though a high percentage of assets, is a rapidly declining percentage of sales and FEL0 is increasing significantly.

This suggests that advisors are moving their practices from a DSC basis to a trailer basis. We believe that, with appropriate explanation and disclosure to clients and an offering of options, this transition is reasonable. We note that the Gandalf Group recently published the results of surveys done on behalf of AGF[6] concluding that when different methods of compensation were explained to survey respondents, "most said they considered trailing commissions acceptable and no different than other forms of advisor compensation. Those who considered themselves to be relatively knowledgeable about investing were in fact more likely than others to say trailing commissions were acceptable."

We think that when payment options are explained to consumers, with examples, some will prefer fee based, some will prefer trailers and some will prefer no advice direct options. We believe that properly explaining the costs, limitations and implications of these options empowers investors to choose the approach best suited to them.

Potential impact on competition and market structure

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Fee-based series have grown in recent years, in our view at least in part as a result of the growth in client account sizes. As noted earlier, fee based programs generally require minimum asset levels to be economic for dealers and advisors. Consequently, as client account sizes grow (as baby boomers age and their lifetime savings increase through access to advice) more accounts qualify for fee based approaches. Generally speaking, higher net worth clients are more likely to access fee based structures, principally because they qualify for them. Small investors do not.

Only 33 of the 93 MFDA Member firms are configured to offer investments on a nominee basis. The 60 remaining firms offer client held investments only. Client held structures are not set up to allow the dealer to directly charge the client fees. As a result, two-thirds of MFDA members are not designed to offer this service. Dealers are moving to a nominee structure, but doing so has significant systems and compliance costs that can be inhibiting. As a result, removing trailer based compensation completely, and not just DSC options, will disadvantage their business model.

Dealers' system structures are important in the implementation of a fee based program. As noted earlier, many MFDA dealers are not structured to collect fees directly from clients. In addition, some dealers have been caught 'double dipping' (negotiating a fee-based charge with clients, and then investing that client's assets in a fund series that also pays embedded

[6] "The Canadian Investors Survey", May 30, 2017

compensation ; resulting in the client being charged twice to invest in one fund). This ‘double dipping’ can occur if the dealer does not develop a system capable of separating fee-based compensation from embedded compensation structures.

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- **Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?**

Discontinuing all forms of embedded commissions will tend to eliminate independent firms and drive small and moderate investors to the options noted above: no advice/self-service online or banks offering generally proprietary products. 2/3rds of MFDA members offering client held only accounts will either consolidate or exit the business. This reduction in competition, investor choice, and investor access to a preferred advisor who is already familiar with their circumstances, does not advance the interest of Canadians.

- **What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?**

The small and medium investor will have limited access to advice. Face-to-face advice will only be available through one channel if investors are forced to move to bank-owned firms in the wake of a ban on embedded commissions. Aside from lack of competition and choice, this could result in investors being underserved, We are concerned, for example, that in recent years banks have moved to close branches, particularly in outlying areas that are currently served by independent financial advisors. We are also concerned about any regulatory action that tends to concentrate a service in the hands of any one industry player, as that tends to place consumers in a position of having limited options.

- **What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?**
    - **Independent dealers?**
    - **Independent fund manufacturers?**
    - **Integrated financial service providers?**
    - **Mutual fund dealers?**
    - **IIROC dealers?**
    - **Online/discount brokers?**

Independent firms will have a more difficult time competing with bank-owned firms if the proposal is implemented. This includes independent dealers, fund manufacturers and mutual fund and IIROC dealers.

- **What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?**

We strongly support dual registration for persons offering financial advice, as it allows them to offer the appropriate product for the client’s need. Our understanding is that the concerns about potential “arbitrage” have not occurred in practice. The CCIR indicated that in its view, for example, no such “arbitrage” was occurring between mutual fund and segregated fund licensed advisors. If an advisor sells an inappropriate product to a client principally for personal benefit, such a sale should be challenged under existing rules and codes of conduct.

With respect to “arbitrage” related to banking products, we believe further research should be done into the patterns of GIC recommendations relative to mutual funds in bank owned dealers.

- **What would be the impact on dually-licensed mutual fund dealers and insurance agents?**

As noted above, most dually licensed mutual fund and insurance representatives utilize the embedded compensation model. Eliminating this option would result in a dramatic impact to this community. We are concerned that many advisors – single or dual licensed - would leave the business and it would be more difficult for new advisors entering the business. The decline in the number of these advisors will have an adverse effect on access to advice for the small investor. Dually licensed advisors may be more likely to be acting in the client's best interest because of a broader suite of offerings and the requirement to fulfill the professional standards of both regulatory authorities, and impeding client access to such advisors by banning embedded commissions is not a favourable investor outcome.

- **Will the proposal lead new, lower-cost entrants to the market? Why and how?**

Lower costs products (such as ETFs) and lower cost delivery methods (such as automated advice) are already available in the Canadian marketplace, and they appear to be thriving in the current competitive environment. There is no restriction on investors preventing them from using these options. Indeed, fee based advisors are already using ETF's in their portfolio planning for clients and we expect access to ETF's to only grow. Note that although MFDA dealers have the regulatory ability to offer ETF's currently there are still costly administrative, compliance and technical issues that prevent many from adopting them. As effective solutions to these issues develop, ETF access through MFDA dealers will increase.

Many investors prefer dealing with an advisor and will prefer to continue receiving their financial advice and services through the advisor model. We support ETFs, automated advice, and other new products and delivery methods entering the market and believe that greater choice for consumers is beneficial, although we firmly believe that regardless of the product or its delivery method, there should be standardization of applicable rules. As a useful analogy, this may be somewhat akin to the taxi industry and the entry of Uber into that market – although Uber is available, it does not mean that everyone will prefer to use it – some users will still prefer taxis and the benefits inherent with that service. The increased choice for consumers is important to maintain, however with respect to fairness, competition and consumer protection, it is also important that the same rules be applicable to both services.

- **Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?**

No – we have taken both papers into consideration in our response. We are concerned that this proposal goes too far by eliminating an otherwise legitimate payment option used by the majority of small and moderate investors. We are also concerned that the proposal treats DSC's and trailers as comparable, when they give rise to different concerns and should be treated separately.

The "best interest" proposals require significant consideration given that they also go too far. Simply instituting an undefined "best interest" standard may seem like an easy answer, but it will create significant compliance challenges, unreasonable client expectations and very likely lower access to advice for average Canadians. We are pleased at the interim report from the CSA which indicates that most provinces understand these consequences and are giving serious consideration to alternative methods of achieving measurable objectives.

- **Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?**

Clearly eliminating a fee option for consumers will by definition lower the number of series available. However, for retail clients the actual number of series available to them is a much smaller segment of the total number of fund series. If the concern is confusion for retail investors, there may be better ways of showing the different series – for example having separate fund facts for retail and HNW or institutional series of the same fund, or otherwise highlighting retail options. We do not think that this "complexity" is a material issue, and to the extent that it causes a concern, it can be dealt with outside of a complete ban of a payment option preferred by many small and moderate Canadian investors.

- **Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?**

To the extent that integrated financial service providers have any advantage, it likely would be eliminated by requiring disclosure of the cost of investing rather than just the cost of advice. However, recent allegations of potentially inappropriate sales practices at Canadian banking institutions may indicate that client interests are not the focus of the sale of various types of products, which is an issue that should be addressed, particularly if investors do not have a clear understanding of the cost of those products.

- **What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?**

As noted in our previous responses, we do not believe that any one channel for advice will serve the interests of all Canadians. We strongly support a diverse, robust and equally regulated advice marketplace.

Competition amongst types of advice offerings provides a positive outcome in the market place. This includes on-line advice as well as other forms. The regulation of all types of advice including on-line should result in a level playing field among all forms of advice. Automated advice is not a panacea for all of the issues raised in the Paper. Automated advice is good for some (and some investors will seek it out regardless of compensation structures and other regulations) but not for others. As long as there is a level regulatory playing field among the various available delivery options, adding automated advice to the already-existing choices is good for competition and investor choice.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- **Is there any specific operational or technological impact that we should take into consideration?**

Effectively managing fee-based compensation requires that such arrangements are appropriate for the client. This requires additional compliance structures and processes, which will increase the cost of providing advice. These additional costs are part of the reason why dealers have minimum account size thresholds for fee-based compensation. The added costs associated with maintaining appropriate safeguards for fee-based clients include:

1. Initial set up of client account must be completed by head office staff. All initial trades are placed by the order entry team. Once the client account is set up the advisor can then place subsequent investments.
2. Head office staff must monitor account balances that may fall below the minimum threshold due to redemptions
3. Head office staff must monitor advisors placing purchases into a fee based fund to ensure that minimums are met and fee agreements are provided
4. Head office staff must perform the manual calculations of fees when a client redeems or transfers mid quarter
5. Head office staff must monitor accounts to ensure that the account has sufficient assets to cover fees.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- **Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?**

No. Direct pay arrangements have their own inherent conflicts of interest. Allowing advisor/client negotiation under direct pay arrangements can actually create higher degrees of conflict. Controls and oversight are needed over either structure, and as a result there are no savings to be gained from moving to this model.

In our view oversight may be more difficult under the fee-based model because of the variety of negotiation tactics and arrangements that advisors may employ in such an open-ended negotiation environment. As noted in previous comments, this may result in investors paying more. Oversight to ensure suitable arrangements are agreed to will be more difficult, as there is generally no public market against which privately negotiated fees can be measured.

Furthermore, if the reforms proposed in the Paper and the CSA 33-404 best interest paper are both implemented, it will be difficult for advisors to comply with both in a generic sense. Advisors cannot simultaneously act in the 'best interest' of their client and also be expected to negotiate the fee that they will be paid. Advisors could more readily comply with a best interest standard if the fee was not required to be negotiable.

- **To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?**

As noted above, there are no savings to be gained from conducting oversight with respect to the fee based model, and in fact a fee-based model may result in higher oversight-related costs.

<u>24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?</u>

It is possible that some dealers would not be able to compensate for this loss of a steady source of revenue. This may result in smaller independent dealers exiting the market, and thereby decreasing competition and choice - a negative outcome for clients of those dealers.

We note that the CSA has proposed allowing clients to instruct manufacturers to deduct fees from their account and automatically pay the dealer. If this happens, we expect that many advisors and dealers will simply set a fixed price for advice that is comparable to current embedded fee structures, although there is potential for some to go higher and some to go lower. The end result is that in most cases there will be no material change for consumers other than that non-registered account holders will be subject to taxation on redemptions from their account to pay for the fees. We are not certain what policy objective this achieves, and based on recent consumer surveys[7] it is not entirely clear that Canadians, when fully informed of these results, would support them.

<u>25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?</u>

Dealers must charge enough to afford to stay in business, and advisors must be compensated for the work they do or they will exit the business. If embedded fees are a core element of a dealer and advisors business model, one can expect that they will find ways to replace the income or exit the business. We anticipate that exiting the business will amount to ceasing to provide services to clients who cannot afford or choose not to pay on a fee for service basis or who otherwise do not meet negotiated fee thresholds.

<u>26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:</u>

- **career path;**
- **attractiveness of the job;**
- **typical profile of individuals attracted to the career;**

[7] "The Canadian Investor Survey", Gandalf Group, May 30, 2017

- **recruitment; and**
- **relative attractiveness of careers in competing financial service business lines?**

The proposal will make it more difficult for advisors to join the industry. New advisors tend to provide products and services to low and moderate investors as they are starting their careers, and their clients grow with them – and as described in detail above, these investors are not likely to be willing to pay on a fee for services basis, nor will they meet the thresholds for a negotiated fee service. Additionally, many seasoned advisors who have built their business on the embedded compensation model may exit the business prematurely if their client base can no longer afford their services.

PART 5

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

- **access to advice for investors,**
- **choice of payment arrangements for all investor segments, and**
- **a level playing field amongst competing investment products?**

The mitigation measures proposed include: increased access to automated advice; allowing investment redemptions to be paid directly from the fund manager to the dealer; continue working on investor financial literacy; allowing various fee-based arrangements; and an intention to act proactively to prevent the opportunity for regulatory arbitrage.

Automated advice is not and will not be the choice for all clients, and in any event requires the client to seek advice in the first place. It does not include the "gamma" element which has been shown to be the core basis for successful advisory services. Is it practicable? Yes, because it is available now. Is it a panacea? No.

Allowing redemptions to pay for services will not change the costs of advice for most investors and will simply become a way for "trailers" to be paid via taxable redemptions. We understand that it could be achieved with relative ease, but it is not clear to us that it improves client outcomes. In addition, it increases the direct cost for unregistered investors by adding a taxable disposition element.

Financial literacy is an important task and we fully support it. Our best clients are those who are reasonably educated about investment and household finances. Financial literacy will not make every Canadian an advisor however, anymore than increased health education makes everyone a doctor. We want our clients to be engaged and financially literate enough to have an informed discussion about their personal financial futures. Such clients will better understand the cost and value of advice.

Fee based arrangements are fine, and we already have them, but experience in the UK suggests that consumers are not willing to pay the actual cost of the work required to provide them with informed advice. Adding a "fee for service" menu of prices may also be useful, and we do not oppose it. However, we believe that if given an informed choice between trailer fees, fee for service and negotiated fees, including realistic costs and long term portfolio performance impacts, many low and moderate investors would choose the trailer fee option. As noted above, a recent survey has come to this conclusion[8].

With respect to the comments on "regulatory arbitrage", acting proactively to deal with something that is currently not happening does not seem like it will have much impact. We do not oppose it though. However it does not require a ban on trailer fees to implement.

[8] "The Canadian Investor Survey", Gandalf Group, May 30, 2017

For the reasons indicated above, each of these mitigation measures have inherent issues, and/or do not adequately address the concern.

28. What other measures should the CSA consider to mitigate the above unintended consequences?

As described above, rather than creating unintended consequences and then attempting to mitigate them, we propose targeting reforms to address the issues raised, rather than banning embedded commissions. We have suggested a number of alternative approaches in our letter and this appendix that we believe will resolve any core concerns relating to trailer fees without eliminating a popular and useful payment option.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

- **Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.**

  Yes, this would result in negative tax consequences to investors, specifically those invested through non-registered account. This type of pay arrangement is a redemption, which will trigger taxable gains or losses, for the purpose of paying a fee (rather than a fund-level deduction which does not have direct tax implications for the investor). That redemption is taxable in the investor's hands.

- **To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?**

  We defer to fund management firms to comment on this element.

- **What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?**

  Short of CRA allowing redemptions to be made on a tax-free or tax-deferred basis, mitigating tax consequences to investors in the instances above will be difficult if not impossible.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower wealth investors in a fund further to a transition to direct pay arrangements,

- **To what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;**

  It is not clear to us what this comment is attempting to capture. If such a "cross subsidy" exists, we look to fund managers to comment. Generally, we do not agree that high net worth investors are subsidizing lower wealth investors. High net worth investors have access to fee-based arrangements because, at a certain threshold, continuing to charge the same percentage-based fee to these clients is not suitable. Lower wealth investors are serviced under embedded commission models for many reasons, one of which is the unavailability of fee-based models to these clients due to the increased systems and monitoring costs associated therewith (as detailed above). Therefore, high net worth investors are not subsidizing lower wealth investors; rather, these investors have access to different pay arrangements based on the economic realities of their circumstances.
  We are concerned that discontinuing embedded fees will lead to lower and moderate wealth investors not being serviced by independent dealers, and others who rely on an embedded compensation model, such as Quadrus. It is not our concern that 'subsidies' by high net worth investors will end if embedded commissions are discontinued; but rather that many dealers will no longer be capable of servicing low and moderate investors.

- **Does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and**

  No – see our response to the previous bullet. Many high net worth investors pay threshold tiered fee-based commissions or negotiate lower compensation to account for this.

- **What measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?**

  See above – we do not believe there is a cross-subsidy. We do not see this as a relevant factor in the discussion.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

As indicated throughout our responses, we do not support discontinuing embedded commissions and then attempting to mitigate the inevitable negative consequences. Instead, we propose targeted reforms that will surgically deal with the current issues, while increasing investor choice rather than decreasing it.

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- **Are there unique costs or challenges to specific businesses?**

  As noted above, there would be significant system changes and costs associated with discontinuing trailer fees.

- **What transition period would be appropriate?**

  Although we firmly disagree with any ban, and strongly support targeted approaches to resolving the key issues, the degree of market disruption, exiting from business and client transfers involved suggests a longer, rather than shorter period. We suggest five years.

- **Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?**

  As noted above, we are supportive of discontinuing DSCs only, rather than all forms of embedded commissions. Having said that, fund managers paid compensation to advisors and incurred financing charges and expenses as a result, on a basis agreed to by the client. We believe that existing DSC programs should be grandfathered and allowed to run out.

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

We are not inclined to comment on transition options, as we firmly believe that targeted approaches are the more logical and appropriate response. Targeted approaches can be implemented reasonably quickly and effectively, and in many instances are already occurring without direct regulatory direction in response to existing market forces.

<u>34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?</u>

As noted above, the market has already effectively moved to impose a cap of 1% on FEL/NL based trailer commissions. The CSA can certainly monitor this to ensure that trailer fees do not become a differentiating factor in the future, but this does not require the elimination of the category entirely.

We support the elimination of DSC fees generally, and are of the view that doing so will eliminate much of the concern applicable to "embedded fees" generally without eliminating the beneficial concept of annual trailer compensation. Rather than focusing on a fee cap, we think the CSA should consider looking at embedded fees as two separate things (DSC and FEL/NL trailers) and consider discontinuing DSC only.

<u>35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:</u>

- **Address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and**

No, discontinuing embedded commissions will not address the issues identified. In particular, conflict of interest issues will persist, and become more difficult to manage if advisors (with a power and information imbalance in their favour) are required to negotiate fees with all clients. Further, this initiative will result in decreased funds invested and/or increased tax consequences to investors. And finally, and perhaps of most concern, discontinuing embedded compensation will exacerbate an existing advice gap that will not be sufficiently filled by automated advice or bank-owned/insurer-owned dealers. Rather than pursue initiatives that will limit access to personal advice, the CSA should be looking to increase the number of Canadians with access to such advice. That will enhance investor outcomes.

- **Address or not address any additional harms or issues that you have identified.**

The most concerning additional harm relates to low and moderate level investors being underserved, not served at all, or served almost exclusively by banks (which decreases competition and drives investors to institutions which, according to recent reports, may have a lack of regard for customer-centricity). As indicated above, not all investors will want to seek out automated advice, and may not be well served by the banks, particularly if they develop a monopoly over moderate level mutual fund investments. Currently bank owned MFDA firms service approximately 59% of MFDA member assets, independent advisors service 39% and direct sellers 2%[9]. Although banks do service a significant portion of Canadians, independents do as well. Abandoning almost 40% of the market to banks does not appear to be an appropriate course of action. This concerning harm is noted in the Paper, but we do not agree that the mitigating factors suggested by the CSA will be sufficient to come to the aid of moderate investors.

<u>36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.</u>

Yes, as identified above, we strongly suggest that various targeted reforms could sufficiently address the issues examined in the Paper. These include:

- a cap on embedded commissions (effectively already in place) and/or a threshold amount at which investors must be offered the opportunity to take advantage of fee-based compensation;
- a requirement that investors sign an acknowledgement of the available fee options and their desired choice;
- complete disclosure of the total cost of investment to investors rather than just amounts received by the dealer; and

[9] MFDA Bulletin #0721-C, May 23, 2017

- a recognition that lower-cost investment options have the ability to come to market through a variety of sources (such as via ETFs, or a dedicated distribution channel) and are currently already growing in popularity and accessibility.

The risks associated with discontinuing embedded fees outweigh the benefits. However those risks can be eliminated and the benefits still realized by instituting the targeted reforms we have suggested rather than moving forward with a complete ban on embedded commissions.

We note that New Zealand has taken such an approach – discontinuing trailing commissions was considered as an option and subsequently rejected after a government examination concluded that elimination of these commissions (i) could restrict access to advisory services, and (ii) would not reduce certain conflicts of interest. New Zealand ultimately made the decision to regulate advisor behaviour rather than eliminate these commissions. At the same time, New Zealand made it clear that it would be observing that behavior and if it did not change, it reserved the right to use the ““blunter” options to ban or restrict conflicted remuneration…” [10].

[10] Regulatory Impact Statement, Review of the Financial Advisers Act 2008, Ministry of Business, Innovation and Employment, NZ, page 46

British Columbia Securities Commission June 9th, 2017
Alberta Securities Commission
Financial and Consumer Affairs, Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorite des marches financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavit

Personal Submission by M. George Lewis re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

Introduction

I want to first of all congratulate and thank the CSA for the time and care it has taken and is taking to study the option of discontinuing embedded commissions in the market for mutual fund and related products. Mutual funds in Canada represent the highest percentage of household financial assets (18%) of any country in the OECD data base. This contributed in my view to the strong annual growth rate in Canadians' financial assets of 5.8% cited in the Consultation Paper ("CP") from 2005-2015, a rate higher than in the U.S. (4.6%) despite higher equity market returns in the U.S. over the same period. The importance of mutual funds, and the access to the professional investment management delivered through them, to the financial well-being of Canadians and the efficiency of our capital markets, is considerable. In fact, it is much greater than in any other country that has experimented recently with the types of changes being contemplated in the CP. As someone who had the privilege of a leadership role in the mutual fund/asset management industry from 2000 until my retirement as Group Head of Wealth Management and Insurance for RBC in late 2015, I hope my personal submission will be of assistance at this late, deciding stage of your deliberations. While drawn from my experience at RBC, the following represents my personal views and not those of RBC.
The CP is an extensive yet very readable document which provides good insights into the current thinking of the project team/CSA. I recognize that the CSA has sought and received extensive input from current participants who are better positioned to respond to the questions posed in the CP. I also acknowledge the CSA's desire to receive stakeholders' analysis and perspectives that were not raised in prior consultations and that are "evidence-based, data centric and Canadian-focused". This is my first submission and I hope that my analysis and perspectives will be useful in the CSA's final "judgment" stage; they are definitely "evidence" and "data" from my experience leading RBC's asset management business from 2000-2008 and Global Wealth segment (which included RBC's asset management business) from 2007 until late 2015. I recognize that my comments will form part of the public record of the CSA's deliberations; the initiatives and perspectives shared no longer have current competitive value but hopefully will aid in your understanding of the historical development of the mutual fund market and, in particular, Canada's position as a global leader in the access of individual clients to professional investment management.

In addition to the roles described above, from 2012 I represented RBC's Insurance segment until my retirement from the Group Executive of RBC in November 2015, during which I gained perspective on the different environments for investment products in the separate regimes of insurance and securities regulation. Between 2004 to 2006 I had responsibility for all of RBC's banking product businesses, many of which (like our mutual fund business) faced significant competition from large, specialized global competitors including new entrants in the credit card business. Finally, earlier in my career I was an equity analyst covering the utilities, pipelines and telecom service industries, during a period when regulators were implementing competition in long-distance telephony and overseeing the beginnings of wireless services. The CP has many indications that the CSA is attempting to direct rather than regulate the industry, including predictions of (hoped-for) future industry developments (greater variety/complexity of advisory service models, growth of passive investment products, attraction of "disruptive" new entrants to the industry) if the recommendations in the CP are implemented. There may be useful lessons learned from other regulatory environments in this regard.

Review of RBC GAM

I believe it would be useful to provide a brief review of the key business initiatives and their outcomes by RBC Global Asset Management since 2000; many asset managers affiliated with deposit-takers/insurers have implemented similar moves and, where this is the case, I will highlight observations from the CP where these business initiatives have been significant contributors. The efforts described below, and the positive outcomes generated for investors, advisors and RBC GAM's business are the result of dedicated work by the employees of RBC GAM and their partners in serving clients.

1. **RBC GAM entry into non-branch channels/third-party funds made available to RBC branch financial planners (2000-2003 and onwards)**

Prior to the year 2000, RBC GAM focussed exclusively on the bank branch network of RBC (including financial planning teams) as partners to reach individual investors. This strategy was successful during a period of fast growth for the mutual fund industry overall in the 1990s as interest rates declined significantly. This approach resulted in RBC GAM achieving a market share of roughly 8 percent and becoming the third-largest mutual fund company in Canada at the time.
However, to sustain and improve its industry position, RBC GAM needed to compete in all channels of the mutual fund industry and, in particular, support the sales and servicing of our funds in the IIROC channel, the largest industry channel as detailed in the CP. At the same time, in order to improve the competitive positioning of RBC's financial planning teams (relationship managers in branch focussed on clients with greater than $100,000 in financial assets), individual third-party funds were made available to those teams and their clients. Portfolio solutions comprised of third-party funds were also made available to all clients of the branch network. From this time forward, RBC GAM was operating in a competitive environment across multiple channels.

2. **Market-based trailer-fee vs. Cost-recovery transfer pricing from RBC GAM to RBC branch channel (2000 onwards) – Investment in Branch Advice/Delivery by RBC**

Coincident with the separation of the mutual fund manager (RBC GAM and predecessor companies) and dealer (Royal Mutual Funds Inc. – "RMFI") activities at RBC, RBC GAM moved to market-based transfer pricing using the "trailer-fee" model, compensating all dealers (affiliated or otherwise) at the same level. This provided additional, and recurring, funding for RMFI's operations and the significant expansion of its sales-force and advice-giving capabilities. Similar moves by other deposit-takers/insurers were likely a large contributor to the high number of advisors per client in Canada cited in the CP, relative to other countries where access to advice and professional investment management is more limited.

3. **RBC GAM multi-channel, investor choice strategy – focus on no-load/trailer-fee model and series F in IIROC/third-party advisor channel (2000 onwards), launch of series D funds**

In addition to a strong focus on its primary partner (RMFI), RBC GAM significantly expanded its efforts with the IIROC/third-party advisory channel as well as non-advice/direct channels. The product series focus in the IIROC/advisory channel was primarily two-fold – series A (no-load funds with trailer fees) and series F (no-load funds with trailer fees excluded from the MER for use by advisors who charged their clients using fee-based accounts). Both models align the interests of asset managers, dealers and clients and the focus of RBC GAM on investment performance/process, product design and pricing and overall service proves this. On the other hand, it is questionable whether the DSC structure meets this test of alignment, as clients are "locked-in" via redemption penalties.

To attain the #1 market share position in the industry, RBC GAM needed to have competitive and tailored offerings for clients to access, no matter who they chose for advice, how they chose to pay for advice (bundled or unbundled) or if they were self-directed investors and didn't want to pay for advice. Accordingly, RBC GAM was the first asset manager to launch series D funds which carried a lower trailer fee (25bps) and were made available for clients of non-advice/self-directed dealers. Frankly, over ten years after their introduction I would have expected series D shares to make up a larger proportion of mutual fund holdings in self-directed platforms. The CP notes that the large proportion of series A (full advice trailer fee) funds held by clients on self-directed platforms indicates these clients may be providing a subsidy to these businesses (or a subsidy to other non-mutual fund clients of these businesses). See Recommendations below.

4. **Consistent low-fee positioning (2000 to present)**

RBC GAM has been a consistent leader in providing lower-MER funds in each series of funds, with over 90% of its fund MERs being below the industry average and, in many cases, significantly so. PH&N, acquired in 2008, had a similar low-fee positioning which has been maintained with both RBC Funds and PH&N funds offered across RBC GAM distribution partners. RBC GAM has continued to lower MERs periodically even where it is already a low-fee leader in the category.

5. **Investment in active management, performance measurement, ESG**

While RBC GAM offers an extensive range of index funds, ETFs, and funds based on purely quantitative strategies, the majority of its capabilities are delivered through actively managed funds. This has been the result of considerable internal expansion of teams in Canada, the U.S., the U.K and Asia, as well as significant acquisitions (roughly $1.5B each) of PH&N and Bluebay Asset Management. RBC GAM faces competition from other Canadian-based firms with strong domestic and global capabilities, as well as large U.S.-based global firms (Fidelity, Invesco and Franklin Templeton) with a significant share of the Canadian mutual fund market.

RBC GAM's enhanced capabilities have been incorporated into its portfolio solutions which are used by financial planners/advisors to align with clients' risk tolerance and return objectives and which, together with good performance and ongoing advice and service on the part of these planners/advisors, has resulted in a significant reduction in redemption rates (especially during periods of market stress) and better investor outcomes.

The performance of RBC GAM's mutual funds is measured internally against both a competitive actively-managed universe (all series) and relative to passive benchmarks (series F). Its portfolio managers are compensated based on this performance over various time-frames with an emphasis on the longer-term record. At least with respect to RBC GAM, and I suspect with other managers who rely on the no-load/trailer fee model (with daily redemption possible with no penalty for investors), the assertion in the CP that embedded compensation can lead asset managers to downplay the importance of investment performance is simply wrong. Again, I see the risk being more likely with DSC-based providers.

This focus on active investment management has gone hand-in-hand with significant efforts in exercising RBC GAM's role as owners, on behalf of its investing clients, of publicly traded corporations. RBC GAM was a founding member of the Canadian Coalition for Good Governance in 2004 and its Chief Investment Officer was the Chair of the organization for several years. As the CSA knows, the CCGG is a coalition of investment managers that focuses on working with public companies to improve performance through enhanced corporate governance, with positive outcomes recently documented in a University of Toronto (Rotman) study. RBC GAM was also the first mutual fund company to publicly disclose its proxy voting record and also established a senior executive role several years ago with responsibility for implementation of ESG policies throughout the firm. These and other activities of active investment managers contribute significantly to market efficiency, one of the objectives outlined in the CP, which makes passive investing options viable. See Recommendations below.

6. **Results:**
    a. **Investment awards/investor outcomes**

While it is difficult to generalize with respect to investor outcomes, a good proxy is investment performance of the overall fund group, especially as judged by quantitatively-oriented services such as Lipper Analytics, a division of Thomson Reuters. Since bringing their analysis to Canada in 2008, Lipper has identified the top-performing funds and overall fund families across the Canadian mutual fund industry. Over the last nine years of awards (2008-2016) RBC GAM (PH&N and/or RBC families) has been named best overall fund group in seven years and best overall bond fund group in all nine years.

b. Lower redemption rates

Since the early 200os, redemption rates of RBC GAM's long-term funds have fallen significantly (50-70%) and remained low, even during the 2008-2009 financial crisis. Investments in active management capabilities, growth in RBC bank's salesforce and advice-giving capability, and products better designed to meet client needs resulted in clients "staying in the market" to a much greater degree in 2008-2009 than was the case in the tech bubble of 2000. This resulted in significantly better client outcomes as markets recovered.

c. Market share gains

Taken together, these business initiatives by RBC GAM have resulted in an increase in market share from 8 percent in 2000 (third position) to 15 percent presently (first position). Roughly 3 percent was due to the acquisition of PH&N, with the balance being organic market share growth as a result of the initiatives detailed above. Other competitors with high performing/lower cost funds have also gained share, while those who have lost share have generally been among the higher cost fund families. This result is what would be expected in a competitively-functioning market delivering positive results to clients.

Recommendations

I have focussed my recommendations in line with the CSA's areas of encouragement for industry participants' business models (page 3 of the CP) along with the objective of at least maintaining the current level of access to advice in the Canadian market:

1. Having investor interests at their core
2. Aligning the benefits to investment fund managers, dealers and representatives with the benefits of clients
3. Making for more informed, engaged and empowered investors that expect and demand services aligned with the fees paid
4. Promoting fair, competitive and efficient capital markets and fostering confidence in our market

1. **Maintain no-load/embedded trailer fee model in existing channels/eliminate sale of DSC funds –** The no-load model meets all of the tests above, especially with the enhanced disclosure initiatives (CRM2, Fund Facts) which RBC GAM and other industry participants have actively supported. There seems to be an underlying concern in the CP that this model is both high cost and a barrier to new entrants which doesn't make logical sense. In any event, to the extent that the cost of advice embedded within the no-load model reflects the higher costs of a full-advice, "bricks and mortar" delivery model, there are already initiatives from new entrants and established players to address this potential opportunity. No additional "disruption" from the CSA is needed that would limit the range of customer choices without clear evidence that they are harmful. The research provided in the CP with respect to no-load funds doesn't meet that hurdle and is, in fact, at odds with the actual experience in the market which has seen investor-friendly, lower MER/no load firms, such as RBC GAM, gaining market share.

In the case of the DSC sales model, the CP and my own experience does make it clear that this model may not meet the CSA's tests. The compliance issues cited in the CP (e.g. customers unaware of redemption penalties) are telling. Fundamentally, if the industry is arguing (correctly in my view) that there have been significant improvements in the breadth and quality of investment advice available to Canadians over the last two decades then why do we need a product feature whose only historical benefit has been to "keep clients in the market"? Surely, the threat of a financial penalty is no longer required to have clients avoid doing the wrong thing at the wrong time (i.e. redeem at a market bottom). I would recommend a reasonable transition period as outlined the CP (36 months) during which sales would continue to be permitted but there should be no redemption penalties permitted after the Transition Date. This should limit the possibility of an "unintended outcome" such as a surge of sales activity in DSC funds prior to the Transition Date. Elimination of the DSC model, together with my second recommendation, should provide sufficient "disruption" to the market to accomplish the CSA's objectives, without limiting the availability of business models (no load funds) that continue to meet client needs and maximize access to advice in all regions of the country.

2. **Only allow F or D Series in DIY/Automated advice channel**

While I agree with the CP's conclusion that it would be inappropriate to require mutual fund managers to offer all series of funds (i.e. series D funds for DIY investors/dealers), it would be appropriate to prohibit DIY dealers from carrying series A funds which include the full cost of physically-delivered personal advice through a trailer fee three to four times higher than the trailer fee embedded in series D funds (typically 25bp). The extent of the holding of series A funds within discount brokerages, over ten years after the introduction of series D funds, is surprising. Some of the series A funds may be held by clients of integrated firms who are receiving advice on these funds from other channels within the enterprise and are simply using the self-directed platform as their preferred "holding" platform for investments. In any event, it would not be unreasonable for the CSA to require self-directed brokerages to allow only series D or F funds on their platforms.

Since automated advice channels are in their early stages of development and growth, both as stand-alone businesses and as part of the multiple options for investors offered by integrated firms, it would be reasonable for the CSA to restrict embedded compensation from the products offered in these channels where there is no physical delivery/meeting or one-on-one individual client/advisor relationship). Investor choices and preferences are still evolving in this space and, hence, clients would not be negatively disrupted. This would also create a "level-playing field" for both active and passive investment management solutions in the automated advice channel as performance comparisons for active investment management would not be burdened by the cost of embedded compensation for advice. Many of the current automated/light advice models have passive investment options as their primary or sole fulfillment option. It is vital for long-term market efficiency and effective corporate governance that the products of active investment managers - who contribute to market efficiency through the analysis and valuation of companies, and engagement with their boards and management teams as owners – be included and become over time the largest share of solutions in this channel as well.

3. **Don't establish "goals" of increased diversity of service business models, increased levels of passive investments, or significant new entrants as tests of policy success**.

The CP expresses a clear view in favour of diversity of service models (one-time fees, hourly time-based charges, fees based on account level, itemized services, etc.) in an effort to better align investor needs and desires with the level and type of service and advice provided. This is an understandable goal but some of the excellent observations in the CP, especially concerning the "intangible" (but very real in my view) benefits of advice may make this difficult. Simplicity in terms of a business model (i.e. fees based on account size) is not necessarily a sign of misalignment between investors and their representatives and dealer firms. Similarly, I am not sure why decreasing product complexity (cited as an objective in the CP by eliminating fund series with embedded compensation) while increasing service model complexity will result in better outcomes for investors. Furthermore, increasing service model complexity would make regulatory compliance by MFDA/IIROC industry participants and the effective regulation of those participants more challenging.

The CP also displays a clear preference for passive investment solutions, including projections of hoped-for increases in market share for these solutions if embedded commissions are eliminated. This seems to be based on an assumption that this will result in better investor returns when, in fact, the record is far from clear. The ability of active managers to outperform passive, indexed solutions varies by asset class, geographic market and, importantly, over time during periods of varying levels of market volatility. It is also important to ensure proper comparisons and the interpretation of results; actively managed series A funds, with the full-cost of advice embedded in their MER, will very rarely outperform passive index benchmarks with no costs of investing (either investment management or advice) included. (On the other hand, RBC GAM's series F funds, reflecting the cost of active investment management without advice fees, compare favourably with actual passive solutions.) The CP notes that only 8 percent of actively managed portfolio solutions outperformed their benchmarks without noting that, by definition, the comparable percentage for passive solutions would be zero percent as even passive solutions have costs to implement not included in the benchmark return. My point is that the CSA should not establish increasing the market share of passive investment solutions as a policy goal. If any model deserves a "regulatory preference" it would be active management due to its contribution to market efficiency noted above.

Finally, the CP contains many expressions of hope that eliminating embedded compensation will attract sizable new entrants, large and small, to the mutual fund industry. Spurring innovation and competition is an appropriate objective to improve investor outcomes but, as the experience of RBC GAM detailed above illustrates, it doesn't depend on new entrants. The "siren song" of the new entrant is one familiar to regulators in many industries with a much higher degree of concentration than the Canadian mutual fund industry; just one more subsidy, just one more encumbrance on established competitors to "level the playing field", and the new entrant will deliver on the promise of competition and innovation.

Let's be clear; the opportunity for a large global direct-to-consumer mutual fund provider to compete in the Canadian market has always existed. Other global monoline product providers (e.g. credit card companies) have established a presence in other areas of financial services in Canada through direct-to-client models. U.S.-based asset managers (Fidelity, Franklin Templeton, Invesco have established significant shares in the Canadian mutual fund industry, largely through advisors. Rather than being discouraged to enter by the embedded compensation model in mutual funds, it is more likely that large passive providers such as Vanguard and Blackrock have chosen to focus on ETF's (versus mutual funds) due to the ability to leverage the in-place securities exchanges/IIROC dealer platforms, rather than having to build a "stand-alone" mutual fund platform.

4. **Avoid regulatory arbitrage.**
I want to close by commending the CSA and the working teams for their focus on avoiding the potential for regulatory arbitrage between similar products. I agree with the recommendations to apply the same decision, whatever that may be, to structured products and the other products noted in the CP similar to mutual funds and would encourage the CSA to co-ordinate the timing of implementation of its decision with that of insurance regulators to ensure there is no ability for advisors to be compensated differently for similar products.

Conclusion

Thank you again for the opportunity to provide my thoughts and advice as you consider this important decision. Canadians enjoy levels of access to professionally-managed investment solutions that are unprecedented on a global scale, which has resulted in significantly better outcomes and returns than those available through fixed-rate term deposits/insurance contracts. Effective and committed industry participants and regulators have contributed to this result over many decades and I would encourage you, in your deliberations, to not take the breadth and quality of this access for granted. First, do no harm.

Yours Very Truly,

M. George Lewis FCA/FCPA, CFA, ICD.D

Mérici
Services Financiers inc.

Sherbrooke, 9 juin 2017,

Me Anne-Marie Beaudoin
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Par courriel
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Objet : Consultation 81-408 des ACVM sur l'option d'abandonner les commissions intégrées

Madame Beaudoin,

La présente fait suite à la publication, le 10 janvier dernier, du Document de consultation 81-408 des autorités canadiennes en valeurs mobilières (ACVM) sur l'option d'abolir les commissions intégrées. Nous sommes heureux de vous présenter notre réponse à ce document ainsi que des pistes de réflexion et de solution en relation avec les enjeux importants qui y ont été soulevés.

Observations préliminaires

Nous tenons premièrement à remercier les ACVM pour l'occasion qui nous est offerte de contribuer aux réflexions importantes sur l'encadrement du secteur des valeurs mobilières. Nous avons à cœur la protection des investisseurs et l'efficience des mécanismes de marché. Nous croyons que ce sont les fondements de notre système financier et qu'il est de notre devoir à tous d'en préserver l'essence.

Nous tenons également non pas à remercier mais à féliciter l'Autorité des marchés financiers pour son leadership et son engagement dans le cadre de la présente consultation.

De mémoire, jamais le dialogue n'a été aussi ouvert, riche, respectueux et constructif que dans les derniers mois et ce, de la part de toutes les parties impliquées. Cette consultation, par la manière dont elle a été abordée, puis menée, par l'équipe de l'Autorité constitue sans équivoque un cas d'école qui mérite d'être étudié et répété.

Soulignons que la qualité des échanges que nous avons eu nous aura permis de mieux comprendre la position de départ des ACVM et de mieux définir notre réponse ce qui devrait se traduire par un dialogue de grande qualité entre les régulateurs et les intervenants du secteur.

Nous croyons que cette qualité d'échanges et le climat de respect qui a prévalu se manifestera tant dans nos commentaires écrit que dans l'analyse qu'en fera l'Autorité au terme du présent exercice. Nous avons donc grand espoir que le projet de réglementation qui émanera de ce processus sera à la hauteur des enjeux soulevés par les ACVM mais également empreint de réalisme et de sens pratique pour le bénéfice des investisseurs de tous ordres.

C'est dans cet esprit d'ouverture et d'échanges constructifs que nous abordons notre document de réponse.

Toutefois, tel que nous aurons l'occasion de le détailler, les enjeux soulevés par les ACVM sont très complexes et les solutions proposées, potentiellement dangereuses. La prudence et l'analyse doivent guider les ACVM dans leur démarches afin d'éviter de créer des problèmes pires que ceux qui ont été ciblés. L'heure n'est pas à l'approche idéologique ou dogmatique mais à la recherche de solutions concrètes et efficaces.

À propos de Mérici

Il est pertinent de mieux qualifier ce que nous sommes pour permettre aux ACVM d'apprécier l'angle sous lequel nous faisons nos observations et commentaires. En effet, au fil de nos échanges, nous avons compris que, un peu malgré elles, les ACVM disposent de très peu de données concrètes et pratiques sur des courtiers tels que Mérici et que cette « zone d'ombre » ne leur permet pas une analyse complète des forces du marché et de l'accessibilité des conseils aux investisseurs canadiens. Nous proposons donc un bref aperçu de notre parcours, de nos principes et de notre réalité.

Mérici Services Financiers est un courtier en épargne collective indépendant qui a été fondé et qui a ses opérations au Québec depuis 15 ans maintenant. Mérici n'est pas membre du MFDA et sa structure de propriété est totalement reliée à des particuliers, exempte d'institution financière, de compagnie d'assurance ou de manufacturier de produits financiers.

Nous permettons, dans le cadre de la réglementation et de la législation pertinentes, un maximum de liberté à nos représentants quant à l'offre de service aux clients. Nos représentants sont triés sur le volet et répondent à des critères stricts en matière d'intégrité et d'honnêteté en ayant toujours en tête l'un de nos principes fondateur : le client d'abord.

Bien que la règlementation en valeurs mobilières prévoit que le courtier est propriétaire de la clientèle (achalandage), nous reconnaissons que le développement et le maintien de cette clientèle est d'abord le fruit du travail de nos représentants qui œuvrent à titre de travailleurs autonomes. En ce sens, nous reconnaissons contractuellement à chacun de nos représentants la propriété de leur clientèle et respectons le libre choix des clients d'être servis par le professionnel de leur choix.

Parce que nos représentants sont triés sur le volet et grâce à notre structure d'encadrement efficiente, nous donnons à nos représentants une très grande liberté sur un certain nombre de sujets :

- Recrutement de la clientèle : Chez Mérici, le représentant est libre, sous réserve de la règlementation applicable, d'accepter comme client qui il veut. Aucun solde minimum de compte, aucun profil type de client n'est imposé;
- Choix des produits d'investissement : Nous avons des ententes de distribution ou de référencement avec plus de 50 sociétés. Nous ne donnons avantage à aucune d'entre elles et laissons nos représentants choisir ce qu'il y a de mieux pour les clients;
- La rémunération est linéaire et n'est aucunement liée à l'atteinte d'objectifs ou de niveau de production de commissions;
- Nos représentants ne sont assujettis à aucun quota de production, aucun incitatif de vente, aucun produit vedette, produit maison ou concours quelconque et ce, depuis que nous existons;
- En reconnaissance de l'apport essentiel du travail de nos représentants, nous effectuons chaque année un partage des profits de Mérici avec eux;
- Sans l'interdire, nous n'encourageons pas le recours aux structures avec frais de vente différés ou réduits. Nous reconnaissons que ces structures peuvent avoir leur utilité mais nous encourageons l'utilisation de structures où la rémunération est basée sur la gestion d'actifs;
- Nous permettons le recours aux solutions à honoraire;

- Nous permettons et encourageons le remboursement des frais encourus par les clients ainsi que la réduction de la rémunération versée pour les comptes à valeur ajoutée afin de mieux refléter la valeur réelle des services rendus;
- Les comptes de nos clients ne sont assujettis à aucun frais d'ouverture, de fermeture, de transfert ou de transaction de la part de Mérici. La seule rémunération que nous touchons provient des commissions versées par les gestionnaires de fonds ou des honoraires assumés par le client.

Nos représentants détiennent également, dans plus de 90% des cas, un permis en assurance de personnes. Nous comptons également dans nos rangs plusieurs représentants qui détiennent un droit d'exercice à titre de planificateur financier, de courtier hypothécaire ou qui ont un profil de spécialité approfondi (fiscalité, droit, etc.).

Nous encourageons nos représentants à consacrer à leurs clients tout le temps nécessaire afin de les aider à améliorer leur situation financière. Il n'est pas rare qu'un représentant passe de très nombreuses heures avec un jeune investisseur qui a tout à apprendre et qui débutera modestement à épargner à raison de quelques dizaines de dollars par paie ou que nous aidions un client à assainir sa situation financière avant même d'envisager investir pour l'avenir.

Mérici est un courtier engagé dans sa communauté. Que ce soit par l'action de ses dirigeants ou représentants, nous avons un impact significatif dans un grand nombre d'organismes et de causes partout au Québec. Nous avons également un engagement clair et continu auprès de la communauté des services financiers du Québec grâce à des implications concrètes au Conseil des fonds d'investissements du Québec, à la Chambre de la sécurité financière ou dans le cadre de notre participation aux consultations de l'Autorité ou du ministère des finances du Québec et ce, depuis plusieurs années.

Nous appartenons à la catégorie des PME et en sommes fiers. Nous n'avons pas pour ambition de croître pour devenir un joueur majeur de l'industrie canadienne. Nous voulons simplement offrir des services de qualité au plus grand nombre possible, en respectant cet ordre de priorité.

Nous avons souci de préserver notre indépendance car nous croyons que c'est ce que nous avons de plus précieux à offrir à nos clients et nous avons à cœur que nos actions et notre discours ne puissent être opposés l'un à l'autre.

C'est dans cette perspective que nous livrons aujourd'hui notre analyse et nos suggestions dans le cadre de la consultation 81-408.

Rappel historique

Il n'y a pas besoin de remonter aux calendes grecques pour déterminer le commencement de ce qu'il conviendrait d'appeler la « démocratisation de l'accès aux conseils ». Néanmoins, malgré la proximité historique de l'accès de l'investisseur débutant ou modeste aux marchés, nous craignons que nous ne soyons en train d'oublier d'où nous sommes partis ainsi que le chemin parcouru dans la prise de décision actuelle. Il est donc nécessaire de faire un bref rappel de jalons importants de notre histoire financière.

- 1932 : Création du premier fonds commun canadien
- Années 60 : Début de l'intérêt des consommateurs canadiens pour les produits d'investissement comme les fonds communs
- Années 70 : L'inflation et les difficultés économiques poussent les investisseurs à préférer des produits bancaires aux fonds communs. L'état de développement peu avancé des réseaux de distributions de fonds communs au Canada explique également cette tendance.

- Années 80 : Émergence de certains grands réseaux de distributions en dehors des banques et autres institutions de dépôts. À cette époque, l'industrie était très orientée sur la vente, le représentant ne touchant que des commissions de vente, directement prélevées sur l'investissement initial de son client.
- Années 90 : Forte progresse de l'industrie des fonds communs au Canada. La distribution se démocratise et on voit l'émergence de réseaux de distributions indépendants de tailles diverses. Afin de diminuer la pression sur les réseaux de distribution et de favoriser la prestation de conseils, on voit l'apparition de différentes structures de rémunération comme les frais de vente différés et les commissions de suivi. À la fin de la décennie, les institutions financières commencent à réagir et à s'ouvrir d'avantage à l'offre de fonds d'investissement en envoyant massivement ses employés obtenir leur permis.
- Années 2000 et suivantes : Maturation de l'industrie, grandes vagues de réformes réglementaires et consolidation des réseaux de distribution.

Ce (trop) bref survol a pour but d'avancer les éléments suivants :

- Le recours relativement récent dans l'histoire canadienne de produits d'investissement plus démocratiques et accessibles à des investisseurs de toutes tailles;
- La faiblesse relative des réseaux de distributions jusqu'aux années 80 et 90;
- L'existence d'une certaine « culture de vente » aux fondements de l'industrie, laquelle était nécessaire dans une perspective de survie;
- L'apparition de structures de rémunération intégrées dans les années 90 qui ont mis de l'avant les notions de conseil et de pérennité du service;
- L'arrivée massive des employés d'institutions financière à titre de représentant de courtier à la fin des années 90 et au début des années 2000, notamment par l'intermédiaire d'un cours de Cégep créé pour l'occasion et abandonné depuis, vu sa qualité discutable.
- L'existence d'une phase, toujours en cours, d'augmentation du volume réglementaire laquelle a été concomitante (et, dans une certaine mesure, participante) à la consolidation de l'industrie et à sa concentration.

Ces considérations historiques n'invalident en rien les enjeux soulevés par les ACVM et qui motivent le document de consultation 81-408. Toutefois, il serait risqué d'ignorer l'histoire car les enjeux soulevés actuellement trouvent leur source quelque part et il existe un risque, bien réel, de voir ressurgir des problématiques du passé en retirant des éléments du régime actuellement en place. Nous y reviendrons ultérieurement.

Portrait de l'industrie en 2017

Nous avons été frappé, à la lecture du document de consultation, par l'absence de données ciblées et détaillées sur les forces de marchés actuellement à l'œuvre au Canada. Nous comprenons que les ACVM ont mis de l'avant ce qu'elles ont à leur disposition et ce sur quoi elles basent leur position.

Avec respect, nous estimons que le portrait de l'industrie dressé dans le document de consultation est trop générique et a besoin de raffinement pour permettre aux ACVM de prendre des décisions éclairées.

Nous sommes conscients que l'ACFM et l'OCRCVM ont fourni aux ACVM des données plus détaillées sur l'état de leurs membres et des forces de marchés en présence. Nul ne doute que ces données pourront être utiles mais nous soulignons que l'OCRCVM n'encadre pas les courtiers en épargne collective et que l'ACFM n'a pas de force réglementaire au Québec.

En conséquence, il existe un risque de manque de représentativité importante dans les données fournies puisque certains courtiers en épargne collective québécois ne sont pas membres de l'ACFM, dont Mérici. Il est donc important de contextualiser cela au moment où les ACVM considèreront ces données.

Également, il existe toujours un risque que des réalités précises et concrètes soient masquées ou noyées dans un flot de statistiques. La prudence s'impose alors car s'il est statistiquement vrai d'affirmer que les données présentées sont valables, il serait faux de prétendre qu'elles sont LA vérité.

Malheureusement, nous ne disposions ni du temps, ni des ressources nécessaires pour effectuer une recherche approfondie du portrait de l'industrie financière au Québec et au Canada. Nous nous limiterons donc à un certain nombre d'observations générales touchant la situation particulière de Mérici que vous pourrez considérer afin de mieux contextualiser les données dont vous disposez ou qui vous seront fournies.

Les informations fournies dans le document de consultation[1] démontrent clairement une forte concentration des actifs auprès des courtiers intégrés. De faits, les indépendants, au sens de la définition du document de consultation, ne représentent que 5% des actifs totaux gérés. Cette mise en évidence est très importante puisqu'elle démontre une très forte concentration du marché auprès de joueurs qui sont, d'une perspective globale, à la fois manufacturier et distributeur de produits financiers.

Ce sont ces joueurs qui sont à risque d'être placés en situation de conflit d'intérêts, ne serait-ce qu'en apparence. Les indépendants, sur ce point, ne présentent pas le même profil de risque.

D'ailleurs, le document de consultation avance que « la majorité des courtiers en épargne collective intégrés offrent surtout des produits exclusifs, cette restriction implique que la majorité des ménages du marché de masse se font offrir ces produits en priorité »[2]

Le document souligne également que les courtiers membres de l'OCRCVM qui sont considérés comme intégrés offrent presque tous une liste ouverte de produits.[3]

Nous soumettons que le fait que certains de ces courtiers membres d'un groupe intégré puissent distribuer d'autres produits ne règle pas la question. Nous avons, au cours des années, recueilli de nombreux témoignages de conseillers rattachés à ces réseaux à l'effet qu'il existe une pression pour « vendre les produits de la famille ». Ces pressions peuvent prendre plusieurs formes : quotas, incitatifs à la vente sous forme de boni ou de gratification, mise en valeur des produits de la famille de manière avantageuse face aux tiers ou encore des pressions verbales ou informelles.

D'ailleurs, il serait intéressant d'analyser le contenu de portefeuilles de ces groupes afin de déterminer s'il existe une plus forte concentration de « produits maison » et si cette concentration se justifie selon des critères de compétitivité au bénéfice de l'investisseur.

Dans beaucoup de cas, nous avons accueilli des clients provenant de tels courtiers. Il nous a semblé que la proportion de « produits maison » était plus forte et ne pouvait se justifier uniquement par la performance ou les frais de ces produits. Nous n'avons mené aucune étude approfondie sur le sujet et nos données sont clairement anecdotiques mais il demeure que nous trouvons que ces éléments mériteraient réflexion et investigation.

Nous reviendrons plus amplement sur ces points au fil de nos réponses aux questions du document de consultation. Néanmoins, nous soulignons que la concentration de l'industrie entre les mains de groupes intégrés nous semble une problématique directement liée aux enjeux soulevés par les ACVM et qu'il serait possiblement plus avisé de cibler spécifiquement les pratiques plutôt que les modes de rémunération afin de rencontrer les objectifs visés.

Mérici, avec quelques autres courtiers du Québec, fait partie d'un segment de l'industrie qui n'est malheureusement pas représenté dans le document de consultation. Notre poids relatif est certainement très modeste mais la réussite de notre modèle d'affaire et la satisfaction de nos clients à l'égard des services rendus démontrent que nous occupons un espace délaissé par nos concurrents et que nous sommes en mesure, dans les conditions actuelles, de maintenir un niveau de compétition adéquat.

Cette compétition est essentielle car elle offre un choix aux investisseurs : celui d'un service de proximité, accessible et généreux, sans égard à la taille du portefeuille.

Car, si nous comprenons la mention du document de consultation à l'effet que les courtiers indépendants membres de l'ACFM offrent généralement leurs services aux clients aisés[4], nous pouvons vous assurer que nous sommes loin de cette réalité.

Chez Mérici, le client moyen a 52.62 ans et un actif sous gestion de 85 945.73$ alors que le client médian a 53.1 ans et un actif sous gestion de 33 609.24$.

Les représentants de Mérici se consacrent donc à ce que plusieurs appellent le « marché de masse », bien qu'un certain nombre de nos clients soient beaucoup plus aisés.

En fait, nous croyons profondément que tous commencent quelque part, souvent à zéro ou presque, et que le client mérite nos conseils dès le départ, pas à compter du moment où ses actifs atteignent une certaine taille parce qu'il a travaillé dur ou qu'un autre professionnel a fait le travail pour nous.

Plus précisément, le client bénéficie grandement de nos conseils au départ car il a alors la possibilité d'adopter un meilleur comportement face à sa situation financière et à investir adéquatement ce qu'il a réussi à épargner.

Nous redoutons que cette portion de notre soumission ne soit classée dans la catégorie « folklorique » ou anecdotique puisque, malheureusement, nous avons peu de données à offrir aux ACVM pour étayer notre point.

Mais cette démonstration a simplement pour but d'inviter les ACVM à la plus grande prudence car les données statistiques ou provenant d'études larges masquent parfois des réalités précises qui méritent qu'on s'y attarde. L'industrie canadienne de la distribution de valeurs mobilières s'est déjà beaucoup consolidée depuis plusieurs années. Les régulateurs devraient porter une attention particulière au niveau de compétition existant afin de s'assurer qu'il ne tombe pas sous un seuil où les joueurs demeurant auront le loisir de l'immobilisme et de la complaisance.

En ce sens, l'existence de joueurs indépendants offrant des services larges et de proximité tel que Mérici offre l'opportunité que le marché rehausse son niveau, au bénéfice des clients.

Considérations relativement à l'environnement réglementaire actuel

Nous recevons la position des ACVM à l'effet que la présente consultation a son existence propre et demeure pertinente malgré les initiatives réglementaires récentes ou en cours telles que l'aperçu du fonds au moment de la souscription, MRCC2, la consultation 33-404 ou l'Avis 33-318 des ACVM.

Avec égards, si nous comprenons que ces initiatives et la présente consultation ont leurs existences propres et ne visent pas délibérément les mêmes points précis, elles ont toutes des impacts concrets sur une même industrie et les effets sont une réalité.

Nous avons apprécié que des questions précises du document de consultation traitent de la consultation 33-404 et des interactions avec le projet actuel. Ces interactions nous semblent bien réelles et nous aurons l'occasion de le détailler ultérieurement.

Néanmoins, malgré l'assertion des ACVM à l'effet que ce sont des sujets distincts, il nous semble hautement probable et crédible que l'aperçu du fonds au moment de la souscription jumelé au déploiement toujours en cours de MRCC2 puissent apporter des éléments de réponse très pertinents et concrets à un certain nombre de préoccupations des ACVM.

Cette idée est largement reçue auprès de nos représentants qui vivent concrètement les impacts de ces réformes avec leurs clients. Ces réformes ont en effet augmenté significativement le niveau d'intérêt de plusieurs investisseurs et amélioré de manière intéressante la communication entre nos représentants et leurs clients.

L'éducation est une fleur qui met du temps à pousser et à s'ouvrir. Tirer dessus n'améliore en rien la situation. Il nous semble que plusieurs enjeux soulevés légitimement par les ACVM relèvent beaucoup des questions d'éducation et de littératie financière plutôt que du strict volet règlementaire.

L'abolition des commissions intégrées, comme nous le verrons plus loin, pourrait créer des impacts négatifs importants à différents niveaux alors qu'il n'aura pas d'influence positive sur l'éducation des investisseurs. Il nous semble pertinent que les ACVM se penchent concrètement sur cette dimension du problème.

Également, nous invitons fortement les ACVM à ne pas tomber dans le piège du silo. S'il est vrai que chaque initiative réglementaire des dernières années avait son objectif propre, il ciblait une même industrie et pouvait avoir des effets collatéraux parfois importants en termes de coûts ou de défis organisationnels. Le peu de rétroaction et d'analyse suite au déploiement des initiatives des 10 dernières années nous font craindre que la situation présentée par les ACVM n'est pas, à certains niveaux, celle que nous vivons actuellement sur le terrain.

La phase de consolidation actuellement en cours dans l'industrie n'est pas un phénomène isolé de ce que nous appelons « l'hyperactivité réglementaire ». De nombreux acteurs de l'industrie ont vécu ou vivent une grande fatigue face aux nombreux changements et plusieurs ont choisi de cesser leurs activités ou d'être littéralement avalés par un concurrent à la recherche de volume pour absorber les coûts d'une réglementation plus exigeante.

Sans compter que, considérant le champ d'action des ACVM qui est limité aux valeurs mobilières, d'autres secteurs d'activité n'évoluent pas au même rythme alors que, dans les faits, ils lui livrent compétition. Nommons entre autres, sur ce point, les banques et le secteur de l'assurance.

Soyons clairs : nous n'affirmons pas que les préoccupations des ACVM n'ont pas de fondements. Nous affirmons qu'il serait irresponsable pour les ACVM de balayer du revers de la main l'argument voulant que cette consultation s'ajoute dans un vase déjà plein à rebord sans le considérer sérieusement. D'autant plus que nous aurons des suggestions ou alternatives concrètes à proposer aux ACVM afin d'appliquer des réformes ciblées pouvant résoudre les enjeux formulés sans pour autant mettre en péril l'accès au conseil et la structure de l'industrie au Canada.

Nous invitons donc formellement les ACVM à considérer concrètement l'état de l'industrie et des réformes antérieures dans son processus de décision relativement à l'abolition des commissions intégrées. Ne pas le faire serait comme prescrire un nouveau médicament à un patient, sans bilan complet et sans considération pour les autres médicaments qu'il consomme. Les effets secondaires pourraient être bien désagréables.

Considérations pour l'environnement d'affaires actuel

La suite logique aux enjeux liés à l'environnement légal et réglementaire est sans contredit l'environnement d'affaire qui prévaut actuellement.

Nous évoluons dans un marché globalement compétitif où des milliers de professionnels et des centaines d'entreprises ayant différentes autorisations de pratique, offrent aux millions de canadiens leurs services en matière de services financiers.

Des grandes banques aux coopératives financières de toutes tailles, en passant par les assureurs ou les courtiers indépendants, l'investisseur a beaucoup de choix pour faire fructifier ses avoirs et obtenir, à des degrés divers, des conseils.

Également, l'ère moderne apporte avec elle des opportunités de développement d'outils ou de services dématérialisés qui entrent en compétition avec l'approche plus classique des joueurs du marché.

Notre but n'est pas d'argumenter à savoir si c'est bien ou mal, juste ou pas. Nous croyons qu'une offre abondante est au service de l'investisseur qui pourra trouver ce qui répond le mieux à ses besoins, à condition d'être en mesure d'effectuer ce choix en disposant des connaissances minimales requises pour ce faire.

Notre but est de souligner aux ACVM que notre monde est hautement compétitif et que l'équilibre ce cette compétition est fragile.

Alors que les réformes, les exigences et l'encadrement dans le domaine des valeurs mobilières a connu un rehaussement important dans les dernières années, il est impossible de dresser un constat similaire ou comparable pour les secteurs bancaire ou de l'assurance.

Nous comprenons que ces derniers secteurs ne relèvent pas des ACVM et qu'on ne doit pas empêcher la marche du progrès sous prétexte que d'autres ne suivent pas le rythme. Mais le danger de créer ou d'augmenter le risque d'arbitrage réglementaire est réel et chaque nouvelle mesure prise par les ACVM qui ne trouve pas son équivalent dans les autres secteurs accentue ce danger.

Le représentant en épargne collective d'une institution financière peut aussi, très souvent, vendre des produits bancaires. Selon le produit qu'il recommandera à son client, il n'a pas à répondre aux mêmes normes et exigences.

Le représentant en épargne collective qui détient également un permis en assurance de personnes peut offrir des produits relativement similaires mais qui auront un traitement bien différent en matière de processus et de rémunération.

Le risque d'arbitrage que nous avons maintes et maintes fois soulevé revient en force et nous semble plus actuel que jamais.

Chez Mérici, plus de 90% de nos représentants sont également conseillers en sécurité financière. Un très grand nombre nous affirme sans détour qu'un changement au mode de rémunération pourrait avoir un impact sur leurs activités et la façon dont ils orienteront leurs clients, surtout les moins fortunés où une rémunération à honoraire pourrait ne pas représenter le temps et le travail effectué par le conseiller.

Ajoutons à cela l'impossibilité pour les représentants d'effectuer un transfert en bloc de la clientèle, ce qui nuit à la compétitivité entre courtiers ainsi qu'aux dossiers de relève, le vieillissement de la profession qui est un défi constant, la difficulté de recruter de jeunes conseillers et de les maintenir en affaires, ainsi que le fait que nos représentants sont des travailleurs autonomes qui vivent avec un risque d'affaire et vous avez le début d'un portrait du cadre d'affaire dans lequel nous évoluons.

Nous aborderons de nouveau ces éléments au fil de nos réponses aux questions du document de consultation. Nous tenions simplement à apporter une démonstration sommaire que l'état actuel de la situation n'est pas simple ou linéaire et que la réalité de notre cadre d'affaire est déjà fort complexe et représente des défis importants.

Nous croyons que les ACVM ont avantage à prendre cette réalité en considération dans leur réflexion avant de bousculer le mode de rémunération actuel.

Conseil versus vente : la difficulté de dissocier produit et rémunération

Bien que ce ne soit pas volontairement l'objet de la présente consultation, nous croyons nécessaire d'ouvrir la discussion sur un sujet complexe qui a cours dans l'industrie depuis de nombreuses années : la lutte entre la vente et le conseil.

Actuellement, à l'exception des rares inscrits qui sont rémunérés par honoraires horaire ou forfaitaire directement par le client, tous les intermédiaires de marchés sont rémunérés grâce aux ventes effectuées (commission de vente) ou à la perception d'une rémunération sur l'actif sous gestion (commission de suivi ou honoraire basé sur un pourcentage de l'actif).

Cette réalité fait que la vente et le maintien d'un actif sous gestion sont, dans une certaine mesure, essentiels au maintien de la structure de distribution et de conseil malgré le fait qu'ils peuvent sembler en conflit avec ce dernier.

Les professionnels des services financiers ont, depuis des dizaines d'années, été rémunéré selon des systèmes répondant à ces éléments. Cette réalité fait en sorte que l'investisseur n'a jamais eu l'habitude de rétribuer directement son conseiller pour les services professionnels qui lui sont rendus alors qu'il a l'habitude de le faire lorsqu'il consulte son avocat ou son notaire par exemple.

La différence est que le recours à un avocat ou un notaire est épisodique et temporaire. Ce sont également des professions libérales qui ont toujours eu recours à des honoraires et qui ne recommandent pas de produits mais livrent des conseils sur un enjeu précis.

Les professions liées aux valeurs mobilières et au conseil sont différentes en ce qu'elles s'établissent sur la durée et requièrent un suivi dans le temps. Elles sont donc perçues différemment par les clients. Ces derniers savent également qu'au-delà de recevoir des conseils et des services, il leur faudra possiblement avoir recours à des produits financiers pour mettre en œuvre les conseils reçus.

Les clients apprécient recevoir ces conseils et services sans avoir à en débourser, immédiatement et à même leurs deniers propres, le coût. Cela leur permet de profiter de la relation professionnelle sans entendre le tic-tac de l'horloge, sachant que la facture grimpe à chaque question soulevée.

Ce serait donc une erreur de dissocier la rémunération du produit car cela ne répondrait pas aux besoins et volontés du client.

Il existerait même un risque que le client se prive de conseil par souci d'économie alors qu'il en aurait réellement besoin.

À titre d'exemple, les tribunaux regorgent de gens se représentants seuls et qui auraient réellement bénéficié de conseils professionnels.

En tout respect, nous croyons que la dissociation de la rémunération du produit ne répondrait pas non plus adéquatement aux préoccupations soulevées par les ACVM, tel que nous le démontrerons dans le cadre de nos réponses aux questions du document de consultation en plus d'engendrer des effets négatifs important sur une foule de sujets.

En effet, croire qu'il est possible, sans conséquence importante, de départager totalement la vente du conseil relève de l'utopie à notre avis. Les juridictions où cette séparation a été tentée ont connu une perte d'accès au conseil pour les investisseurs les moins nantis, comme au Royaume-Uni où l'état doit même subventionner le conseil.

La volonté du client à l'intégration des frais

Afin de démontrer cette réalité, il convient à notre avis de séparer les modes de rémunération en trois grandes catégories :

- La rémunération intégrée avec les commissions de suivi
- La rémunération à honoraire établie selon un pourcentage de l'actif sous gestion et perçu depuis celui-ci directement par le courtier ou son mandataire
- La rémunération à honoraire horaire, payée directement par le client

Nous traiterons, à même les questions du document de consultation, de l'enjeu des commissions de vente ou du recours aux fonds avec frais de vente différés qui sont, à notre avis, des enjeux distincts et particuliers que nous ne souhaitons pas confondre avec les modes de rémunération liés aux conseils et qui s'établissent sur une durée de temps plus longue.

Notons également que nous prenons pour acquis, dans chacune de nos trois grandes catégories, qu'aucune commission de vente n'a été perçue au moment de la souscription.

Disposant de peu ou pas de données probantes sur la question, nous avons cru qu'il serait naturel de demander à celles et ceux qui sont concernés au premier chef par cette question : nos clients.

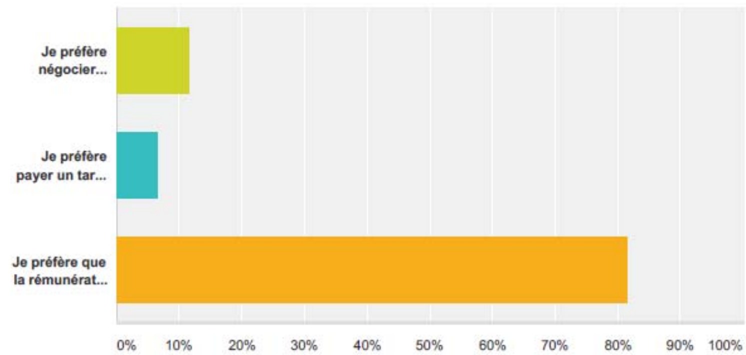
Nous avons donc mené, du 12 au 21 mai 2017 un sondage[5] auprès de tous nos clients pour lesquels nous disposions d'une adresse courriel. Nous avons ainsi contacté, à l'aide d'un outil de sondage reconnu, l'ensemble de ces clients et avons obtenu plusieurs centaines de réponses nous permettant d'affirmer qu'un échantillon substantiel et significatif des clients de Mérici s'est exprimé.
La question principale du sondage portait sur le mode de rémunération que préfèrent nos clients. La question était la suivante :

> « Les Autorités canadiennes en valeurs mobilières mènent actuellement une consultation sur la manière dont les clients payent pour les services qu'ils reçoivent de la part de leur conseiller et de leur firme de courtage. À l'heure actuelle, la rémunération que vous payez à Mérici Services Financiers ainsi qu'à votre conseiller fait partie intégrante du frais de gestion que vous payez au(x) gestionnaire(s) des fonds que vous détenez. Par exemple, si vous détenez un fonds de la société Fonds XYZ et que celui-ci est assorti d'un frais de gestion de 2,0% annuellement, une portion de ce frais total, par exemple 1,0%, est automatiquement versée à Mérici et à votre représentant en contrepartie des services et conseils qui vous sont offerts et ce, tant que vous détenez votre placement. Les régulateurs envisagent de modifier cette méthode et de la remplacer par d'autres modes de rémunération directe où vous auriez à payer directement le courtier et le conseiller. Nous préparons actuellement notre réponse à cette consultation et votre opinion est très importante pour nous afin de déterminer la manière que vous préférez payer pour les services que vous recevez de la part de votre

conseiller et de Mérici. Parmi les modèles de rémunération suivants qui sont envisagés par les autorités réglementaires, lequel préféreriez-vous? »

Les résultats sont sans équivoque : 81.6% des clients sondés souhaitent le maintien de la structure de rémunération intégrée actuelle.

Les 19.4% restant se partagent entre l'option d'une rémunération à honoraire basée sur un pourcentage des actifs sous gestion (11.73%) et l'option d'une rémunération à honoraire horaire (6.68%).



Choix de réponses	Réponses	
Je préfère négocier directement avec mon conseiller un honoraire selon un pourcentage de mes actifs et vendre de façon périodique certaines des unités de fonds que je détiens afin de payer ces honoraires.(Par exemple : Vous détenez un portefeuille de 10,000$ et vous négociez un honoraire de 1,0% avec votre conseiller. Chaque année, un rachat de 100$, plus taxes, serait donc placé automatiquement dans votre compte de manière à payer ces honoraires. Le gestionnaire du fonds prélèvera quant à lui ses honoraires, par exemple 1,0%, ou 100$, à même le fonds. Vos coûts de détention totaux s'élèveraient donc à un total de 200$ annuellement.)	11,73%	72
Je préfère payer un tarif à l'heure pour les services rendus par mon conseiller et vendre certaines des unités que je détiens afin d'acquitter ces honoraires.(Par exemple : Vous détenez un portefeuille de 10,000$. Votre conseiller vous informe qu'il a un taux horaire de 100$/heure. S'il effectue 1 heures de travail dans votre dossier, un rachat de 100$ sera placé dans votre compte afin d'acquitter ses honoraires. Le gestionnaire du fonds prélèvera quant à lui ses honoraires, par exemple 1,0%, ou 100$, à même le fonds. Vos coûts de détention totaux s'élèveraient donc à un total de 200$ annuellement.)	6,68%	41
Je préfère que la rémunération de mon conseiller soit intégrée à même le frais de gestion du ou des fonds que je détiens (modèle actuel).(Par exemple : Vous détenez un portefeuille de 10,000$ investi dans un seul fonds assorti d'un frais de gestion total de 2,0% dont 1,0% est consacré à la rémunération de Mérici et de votre conseiller et 1% au gestionnaire du fonds. Le fiduciaire du fonds prélèvera automatiquement à même le fonds la somme totale de 200$ et distribuera la part revenant au conseiller, au courtier et au gestionnaire pour vous.)	81,60%	501
Total		**614**

Le résultat de ce sondage est éloquent et les clients se sont prononcés pour eux-mêmes sans interférence de leur représentant. D'ailleurs, le taux de satisfaction à l'égard des services et conseils reçus de la part de ceux-ci et de Mérici s'établit, pour l'ensemble des répondants, à plus de 88%.

Bien que ce sondage ait été mené par invitation courriel aux seuls clients de Mérici, la réponse forte de notre clientèle et leur position non-équivoque doivent être prises en considération par les ACVM.

Il démontre une affection particulière des clients pour un mode de rémunération intégré où le client n'a pas à négocier un honoraire ou à rémunérer le courtier en fonction du nombre d'heures consacrées au dossier.

Nos clients veulent la transparence, la communication et l'obtention d'un bon service. Ils ne cherchent pas à tout négocier ou à payer directement pour des services rendus s'il est possible que les frais soient intégrés autrement.

Notons également la similitude entre l'option des honoraires négociés basés sur un pourcentage de l'actif et des commissions de suivi intégrées. Exception faite de la négociation et de la vente périodique d'unités pour acquitter les frais, les deux options ne forcent pas l'intervention du client dans la rémunération, tout comme les commissions de suivi. Elles ne comprennent pas non plus la mise en place d'un système de minutage où le client pourrait censurer ses propos pour gagner du temps et réduire sa facture et où le professionnel doit gérer un autre conflit d'intérêts, celui entre sa rémunération et le coût imputé au client.

Ensemble, ces deux options (honoraires à pourcentage et commissions de suivi) rallient plus de 93% de nos clients, démontrant un vif intérêt pour une solution simple pour le client.

Également, en analysant de plus près les répondants qui ont exprimé une préférence pour les honoraires horaires, nous découvrons que 37.5% de ceux-ci ont un actif sous gestion de moins de 50 000$ et 17.5% entre 50 000$ et 100 000$. Nous en concluons qu'il est probable que ces clients sous-estiment la valeur des services qui leur sont rendus car un honoraire horaire provoquerait vraisemblablement dans leur cas une augmentation des coûts du conseil.

En somme, nous invitons les ACVM à évaluer les enjeux liés à l'intégration de la rémunération non pas uniquement sous un aspect de transparence (sur lequel nous reviendrons) mais également sous l'angle de la volonté des investisseurs et de l'accessibilité au conseil.

Réponses aux questions du document de consultation

Nous proposons ici nos réponses aux questions soulevées dans le document de consultation. Afin de faciliter le travail des ACVM, nous suivrons l'ordre des questions tel qu'établis dans le document.

Nous nous sommes également permis, lorsque la situation l'exigeait, d'élargir le spectre de la question ou de soulever des enjeux qui nous semblent liés mais qui n'étaient pas abordés dans le document.

Finalement, en certaines occasions, nous avons dû souligner le caractère incomplet ou imparfait de certains éléments avancés par les ACVM qui risquent de miner le processus décisionnel de celles-ci puisqu'il est essentiel que le fondement de la réflexion soit bon pour que la réglementation future repose sur des bases solides.

Question 1 : Convenez-vous des enjeux exposés dans cette partie? Pourquoi?

En partie.

Voici nos observations relativement à chacun des enjeux et le traitement qui leur est réservé dans le document de consultation :

Enjeu #1 : Les commissions intégrées donnent lieu à des conflits d'intérêts qui entraînent un décalage entre les intérêts des gestionnaires de fonds d'investissement, des courtiers et des représentants et ceux des investisseurs.

En tout respect, nous croyons que cet énoncé n'est pas exact, puisqu'il est nettement incomplet.

Toute forme de rémunération peut, potentiellement, être génératrice de conflits d'intérêts ou de décalages entre les intérêts des inscrits et ceux des clients. De même, de nombreuses pratiques d'affaires peuvent également générer de tels conflits. Nous croyons donc que la question des conflits d'intérêts est un enjeu professionnel qui ne se limite pas aux commissions intégrées.

Réduire l'enjeu des conflits d'intérêts au seul aspect des commissions intégrées est une erreur que nous nous expliquons mal même si nous reconnaissons que cet aspect doit faire partie de l'évaluation de ceux-ci.

De manière plus précise, le rapprochement fait dans le document de consultation pour démontrer l'existence d'une problématique à cet égard mérite qu'on y apporte certains éléments afin de compléter le portrait et de permettre aux ACVM d'avoir une meilleure évaluation de la situation.

Premièrement, l'affirmation voulant que « les commissions intégrées peuvent réduire l'attention que le gestionnaire de fonds d'investissement doit porter au rendement du fonds, ce qui peut entraîner une sous-performance » est très générale et englobe des situations qui méritent d'être départagées.

Le travail du gestionnaire de fonds est, dans le cadre d'un mandat, d'effectuer une gestion efficace et de maximiser le rendement des investisseurs.

Affirmer que le gestionnaire pourrait se montrer insensible aux rendements de son fonds sous prétexte que le réseau de distribution est rémunéré selon un système de commissions intégrées est réducteur et inexact. Si le gestionnaire n'arrive pas à procurer un rendement adéquat aux investisseurs, les conseillers consciencieux et professionnels recommanderont aux clients de déplacer leurs actifs vers un autre véhicule d'investissements.

Dans un second temps, l'affirmation que « les commissions intégrées peuvent encourager les courtiers et les représentants à faire des recommandations d'investissement partiales qui pourraient nuire à l'atteinte des résultats obtenus par l'investisseur » nous semble très grave et suppose que le représentant et le courtier contreviennent sciemment aux règles de convenance ainsi qu'à un certain nombre d'obligations déontologiques, ce qui serait inacceptable.

Nous soulignons que les structures de commissions intégrées comprenant des commissions de suivi, le représentant et le courtier ont intérêt à favoriser la croissance des actifs de leurs clients puisque celle-ci augmente conséquemment leurs revenus récurrents. Il y a donc avantage à rechercher des produits offrant des rendements intéressants après frais pour le client et non pas les produits offrant une grosse rémunération immédiate. Les intérêts du client et des intermédiaires de marché sont liés et non pas en conflit.

À la lecture du document de consultation, nous comprenons pourquoi les ACVM en viennent à ces conclusions. Nous soumettrons toutefois trois éléments supplémentaires afin de démontrer qu'il est erroné de viser le système de rémunération plutôt que d'autres éléments potentiellement plus importants et générateurs des problématiques rencontrées :

1- Les études citées sont larges et n'offrent pas le bénéfice d'une contextualisation adéquate

   Notre perspective de courtier indépendant nous permet d'avoir une perspective différente et très près de la réalité du client et du conseiller. Nous déplorons que cette perspective ne trouve pas écho dans les études commandées ou compilées par les ACVM.

   En effet, les principales études avancées par les ACVM à l'appui de la position d'abolir les commissions intégrées présentent l'industrie des services financiers comme un bloc homogène de courtiers et de conseillers alors qu'en réalité, il existe une grande diversité de pratique et de réseaux de distribution.

   L'industrie est composée à la fois de petits et de grands courtiers, parfois à l'intérieur d'un groupe intégré ou purement indépendants. Certains courtiers ont des pratiques très agressives en matière de ventes alors que d'autres n'en ont simplement pas. Certains courtiers servent une clientèle très ciblée qui répond à des critères précis (taille du portefeuille, emploi, etc.) alors que d'autres sont ouverts à tous.

Les études noient toutes ces réalités et ne présentent qu'un portrait global. Ce portrait n'est pas statistiquement faux, mais il ne permet pas de cibler adéquatement les problématiques particulières et de proposer des remèdes efficaces et ciblés.

Un peu comme si votre médecin se contentait de dire que vous avez mal à votre corps sans chercher à savoir quelle partie, comment et pourquoi. Le diagnostic doit être plus précis dans cet exemple comme dans notre réalité.

2- Le problème est davantage présent dans les groupes intégrés

Nous soumettons ici l'hypothèse que la problématique est plus présente dans les groupes intégrés que chez les courtiers indépendants.

En effet, les groupes intégrés ont souvent une offre de produits ou services très définie qui se limite aux produits « maison » ou « de la famille ».

La question des frais (et incidemment des commissions) n'est donc pas un enjeu que le conseiller peut adresser puisqu'il est limité dans l'offre de produit qu'il présente à son client. Sans compter qu'il est possible qu'il existe, au sein de son organisation, d'autres enjeux liés à la vente (quotas, produits vedettes, objectifs, etc.) qui influent sur sa prestation de service.

Chez les courtiers indépendants, cette réalité est fondamentalement différente.

Par exemple, chez Mérici, il n'existe aucun quota de vente ou de production, aucune taille de compte minimale, aucun produit maison, aucun incitatif à la vente. Nos représentants bénéficient d'une grande liberté dans le choix des fonds qu'ils recommandent à leurs clients et ils effectuent ce choix en se basant sur des critères de convenance, de performance, de frais et d'optimisation fiscale.

Nos clients ont souvent quitté les institutions financières ou un autre courtier et viennent chercher auprès de nos représentants des conseils qui favoriseront l'atteinte de leurs objectifs. Le rendement est une donnée essentielle du succès financier de nos clients et si nous choisissons des fonds sous-performant ou trop onéreux, nous ne pourrons rester en affaires longtemps, surtout avec l'application de MRCC2.

De plus, nos représentants qui utilisent les fonds dans une série en frais d'acquisition ne perçoivent, sauf très rare exception, aucune commission au moment de la vente. Les actifs ainsi détenus ne génèrent, en termes de commissions, que la commission de suivi. Cette pratique s'apparente donc grandement à une rémunération par honoraires à la différence que c'est le gestionnaire de fonds qui fixe la commission et en assure la perception.

Nous remarquons également que la détention de fonds générant une commission de suivi plus importante que la moyenne de l'industrie est plutôt marginale et peut s'expliquer, dans la majorité des cas, par une stratégie particulière ou la performance du fonds et non pas par l'appât du gain du représentant ou du courtier.

Nous croyons donc, qu'avant de se fonder sur cet enjeu pour abolir les commissions intégrées, les ACVM devraient effectuer une étude exhaustive des forces de marchés, des pratiques de distribution et de conseil pour avoir un portrait plus complet de la situation.

Une telle étude devrait, à notre avis, permettre une différenciation selon le type de courtier (intégré ou indépendant), la catégorie d'inscription (épargne collective, plein exercice ou marché dispensé), la présence de pratiques de distribution particulières (concours, quotas, actifs minimum, etc.) et évaluer l'ouverture réelle à une offre élargie de produits, pas seulement théorique.

Le sondage mené par les ACVM sur les pratiques de distribution et l'avis 33-318 qui en a résulté constituent un pas dans cette direction. Toutefois, la généralité de l'avis peut laisser croire que certaines pratiques inappropriées ou douteuses sont généralisées alors qu'elles sont le lot de certains inscrits seulement.

Avec des outils plus détaillés en mains, les ACVM seront en mesure de déterminer si l'abolition des commissions intégrées demeure la solution optimale ou si des solutions plus ciblées ne permettraient pas de mieux corriger les enjeux soulevés.

3- Il serait plus efficace de miser sur la professionnalisation du conseil

Depuis plusieurs années, nous remarquons une augmentation importante de la réglementation en valeurs mobilières ainsi qu'une hausse constante des obligations des inscrits, particulièrement des courtiers.

Il semble en effet que la voie choisie par les ACVM pour augmenter l'encadrement du secteur mise fortement sur la responsabilité des courtiers.

Nous soumettons que, bien que cette approche a ses avantages, il est possible que nous ayons atteint un point où le ratio coût-bénéfice de cette approche n'est plus aussi intéressant qu'à une certaine époque.

En effet, les tâches et obligations des courtiers ont considérablement augmentées, lesquelles se traduisent concrètement par une augmentation de la bureaucratie et un alourdissement des structures.

Il nous semble que plusieurs des enjeux soulevés par les régulateurs relèvent d'avantage de l'encadrement et de l'éthique professionnelle que de structure de distribution.

Nous reviendrons sur ce point en réponse à différentes questions mais souhaitions immédiatement soulever cette réflexion : les ACVM ne devraient-elle pas réduire leur approche réglementaire pour favoriser une approche déontologique où des professionnels, justement reconnus à ce titre, doivent agir et travailler selon des normes éthiques rehaussées et en répondre plutôt que d'augmenter les mesures et processus de contrôle?

Finalement, s'il est vrai que certains fonds ont des frais de gestion élevés et qu'une partie importante de ces frais sert parfois à assurer la rémunération du courtier et du représentant, il faut éviter de tomber dans le piège de croire que l'interdiction réglerait toute la question.

Les entreprises et professionnels du secteur financier effectuent un réel travail et sont en droit de s'attendre à recevoir une rémunération pour celui-ci. Si la rémunération n'est plus intégrée aux frais du fonds, elle sera ajoutée à celui-ci. Actuellement, la majorité des fonds offrent une commission de suivi équivalente à 1% de l'actif sous gestion sur une base annuelle. Certains fonds rémunèrent plus, d'autres moins.

Le passage à une pratique à honoraire n'aura pas pour incidence de réduire de manière marquée cette rémunération. Il est même tout à fait possible que le contraire se produise. Nous y reviendrons ultérieurement.

Nous souhaitions simplement, dès la première question, souligner que, bien que les frais totaux des fonds doivent être une préoccupation pour les clients, les inscrits et les ACVM, ce n'est pas en excluant la rémunération des frais des fonds que cet enjeu se règlera. Car, quoi qu'on en dise, un plus un donnera toujours une somme de deux.

Enjeu #2 : L'intégration des commissions limite la connaissance, la compréhension et le contrôle des coûts de la rémunération des courtiers chez les investisseurs.

Cette affirmation est, à notre avis, nettement prématurée.

S'il est vrai que l'intégration de la rémunération pose des défis en matière de communication, de compréhension et de connaissances, nous soumettons que les réformes fraîchement implantées que sont MRCC2 ainsi que la phase 3 de l'information au moment de la souscription n'ont certainement pas encore atteint leurs objectifs mais que, selon nos observations ainsi que nos échanges avec nos représentants et nos clients, lorsque ce sera fait, une bonne partie de l'enjeu #2 sera réglé.

Si ce n'est pas le cas, les ACVM auront alors la possibilité d'effectuer une intervention ciblée pour combler l'écart, lequel aura pu être mesuré avec précision et documenté adéquatement. À l'heure actuelle, il nous semble trop tôt pour affirmer que MRCC2 et POS3 ne suffiront pas.

Relativement à la difficulté pour les investisseurs de comprendre les coûts réels de leurs fonds, nous invitons les ACVM à réfléchir au déploiement d'un MRCC3 qui viserait à répondre aux éléments suivants :

- Divulgation des frais du gestionnaire de fonds;
- Divulgation de la rémunération reçue par le courtier;
- Divulgation des taxes;
- Amélioration de la présentation des trois éléments précédents puisque nous réalisons que les investisseurs peinent à se retrouver dans la catégorisation actuelle de la divulgation de MRCC2;
- Revue de la méthode de calcul obligatoire (actuellement selon les flux de trésorerie) car les investisseurs peinent à la comprendre et à la rendre applicable à leur situation. Une méthode basée sur la période de détention aurait de meilleurs résultats et serait mieux harmonisée avec les méthodes utilisées par les gestionnaires de fonds dans leurs communications aux clients.

Une réforme ciblée de la sorte aurait de meilleurs résultats sans les inconvénients reliés à l'abandon des commissions intégrées.

Finalement, nous sommes en désaccord avec l'affirmation que l'intégration de la rémunération dans le produit réduit la capacité de l'investisseur de contrôler ce coût.

En effet, nous avons toujours été enclins à consentir des rabais de commissions aux clients lorsque la situation s'y prêtait (actif sous gestion élevé, demande de service basse, etc.) ou à avoir des discussions avec nos clients lorsque ceux-ci le demandaient.

La question des frais et de la rémunération est d'actualité de sorte que de plus en plus de clients en parlent et exigent que les sommes versées soient adéquates à cet égard. Une petite révolution est en marche et la discussion est clairement ouverte à ce sujet.

Également, plusieurs gestionnaires de fonds ont revu à la baisse la rémunération sur plusieurs produits et cette tendance s'accélère.

Nous croyons donc que l'éducation des investisseurs progresse et que les pratiques de l'industrie s'améliorent. Cela résulte en un meilleur contrôle des investisseurs sur les frais qu'ils assument.

Si une réforme sur ce point est souhaitable, c'est pour forcer les courtiers qui n'offrent pas la possibilité aux clients de contrôler ces frais à le faire. Nommons à ce chapitre plusieurs courtiers en ligne ou institutions financières qui n'offrent aucun espace de discussion au client. Ce sont ces pratiques qu'il faut revoir et non pas l'intégration des commissions qui ne représente qu'un mode de paiement.

Enjeu #3 : Les commissions intégrées qui sont versées ne concordent généralement pas avec les services fournis aux investisseurs.

Nous sommes à la fois en accord et en désaccord sur cet enjeu.

Là où nous sommes en accord, c'est à propos des investisseurs modestes qui reçoivent de la part de nos professionnels des conseils en matière d'investissement, de fiscalité, de budget et de sécurité financière pour n'en nommer que quelques-uns. Ces investisseurs n'auraient pas la capacité de se permettre de tels conseils ou refuseraient de le faire si nous devions exiger des honoraires alors qu'actuellement, l'intégration de la rémunération dans le produit nous permet de leur offrir ces services qui leur sont grandement utiles et qui, au final, pourront faire d'eux des investisseurs plus aguerris et riches.

Là où nous sommes en accord, c'est à propos des investisseurs qui ont le malheur d'avoir un représentant que nous pourrions qualifier de vendeur. Celui qui ne fait que « vendre » des produits mais n'assure aucun accompagnement, aucun suivi et donne trop peu de conseils. Ce représentant est clairement trop payé pour le travail effectué.

Là où nous sommes en accord, c'est à propos des clients dans plusieurs institutions financières qui ne voient un conseiller, et souvent pas le même d'une rencontre à l'autre, que sporadiquement et qui n'ont aucun suivi dans le temps sur l'atteinte de leurs objectifs financiers. En effet, il est difficile pour un conseiller qui doit rencontrer cinq clients par jour de consacrer plusieurs heures à la préparation de la rencontre et à la rencontre en elle-même.

Là où nous sommes en accord, c'est à propos des clients de courtiers en ligne qui ne se voient offrir que des fonds avec pleine commission de suivi alors qu'aucun service conseil ou accompagnement n'est offert.

Là où nous sommes en accord, c'est à propos des clients à forte valeur ajoutée qui ne se font offrir aucun rabais sur les commissions de suivi alors qu'ils ont des sommes investies très considérables. À notre avis, de tels clients devraient avoir droit à des rabais afin de refléter la valeur des services rendus. C'est une pratique que nous avons et encourageons.

Toutefois, là où nous sommes en désaccord, c'est dans la formulation du document de consultation qui généralise la situation, masquant ainsi la réalité de nombreux professionnels qui travaillent fort pour aider leurs clients à améliorer leur situation.

Nos représentants sont dédiés à leurs clients. Ils les accompagnent dans de nombreuses sphères de leur vie où les finances ont un petit ou un gros impact. Ils demeurent leur conseiller des années durant, du premier dollar jusqu'à l'atteinte de leurs objectifs financiers.

Ils reçoivent leur client au bureau mais se déplacent très souvent à la rencontre de ceux-ci, selon leurs disponibilités, le soir ou le weekend, chez eux dans leur cuisine ou leur salon et parfois à des dizaines ou centaines de kilomètres de leur lieu de travail.

Nos représentants sont des travailleurs autonomes qui assument un risque d'affaire. Si les marchés chutent, leur rémunération suit la même direction dans les mêmes proportions. Ils doivent assumer leurs dépenses (salaires, bureaux, télécommunications, transport, frais de représentation, etc.) et font parfois vivre de véritables petites entreprises.

Nos représentants demeurent à la page et s'assurent de suivre des formations pertinentes pour garder leurs connaissances et compétences à jour. Ils sont également en compétition les uns avec les autres mais également contre les grandes institutions financières qui disposent de moyens autrement plus robustes que les nôtres pour attirer les clients.

Nos représentants deviennent bien souvent des confidents, des relations privilégiées et des centres de référence important dans la vie des clients.

Voilà pourquoi nous ne pouvons souscrire à l'énoncé de l'enjeu #3 tel que libellé puisque, si nous sommes d'accord sur le fait que certains représentants ou courtiers n'offrent pas une prestation de service adéquate et en proportion de la rémunération reçue, nous croyons que les ACVM auraient tort de généraliser et de mettre tous les courtiers et tous les représentants dans le même sac.

Question 2 : Existe-t-il d'autres enjeux ou problèmes importants liés aux commissions intégrées? Veuillez, si possible, présenter des données qui illustrent votre argument.

Nous sommes d'avis que tous les éléments ou enjeux liés aux commissions intégrées ont été abordés par les ACVM ou le sont par Mérici dans le cadre de ce mémoire.

Question 3 : Les commissions intégrées comportent-elles des avantages importants – accès aux conseils, efficience et rentabilité des modèles d'affaires, concurrence accrue – qui l'emporteraient parfois ou toujours sur les enjeux ou les problèmes qui y sont liés? Veuillez, si possible, présenter des données qui illustrent votre argument.

Oui et nous tenons à remercier les ACVM pour cette question qui ouvre la discussion sur les avantages des commissions intégrées car ils sont, à notre avis, bien réels et nettement supérieurs à tous les inconvénients énoncés.

La simplicité

L'intégration des commissions offrent d'abord un avantage de simplicité évident, tant pour le client, le conseiller que le courtier. Les gestionnaires de fonds ont déjà en place tous les outils afin de percevoir la rémunération du courtier et la leur transmettre, ce qui allège la charge administrative de ce dernier qui est déjà substantielle.

Pour le client, il n'a pas à autoriser la vente d'unités pour couvrir les honoraires, laquelle peut parfois se faire à contretemps relativement aux conditions de marché ou pour des raisons fiscales. Il n'a pas non plus à faire de chèque au courtier si le paiement devait être directement.

Nos clients apprécient cette simplicité et demandent à ce que la structure de rémunération actuelle soit maintenue. Un sondage mené auprès de nos clients démontre que l'option des frais intégrés obtient l'adhésion de 81.6% de ceux-ci.

L'accès aux conseils et leur abordabilité

Cet enjeu touche peu ou pas les investisseurs fortunés qui ont les moyens de payer directement un professionnel pour l'obtention de conseils ou services en matière de gestion financière.

Qu'en est-il des investisseurs débutants ou modestes? Particulièrement les investisseurs n'ayant que quelques milliers de dollars à investir? Leur demander d'assumer des frais ou honoraires de quelques centaines de dollars pourrait leur paraître disproportionné ou simplement impossible.

Il est relativement rare qu'un investisseur débute avec une somme importante à investir. Souvent, il commencera avec quelques centaines ou milliers de dollars ou encore à l'aide d'un prélèvement périodique. Le fait d'avoir à débourser un honoraire ou un frais pour le conseil pourrait miner de manière importante sa capacité d'épargne ou le diriger vers d'autres produits financiers moins optimaux pour lui. À la limite, le matelas ou le compte chèque pourrait devenir l'option de rechange pour certains.

L'abolition des commissions intégrées forcerait les réseaux de distribution à passer à une rémunération à honoraire, laquelle peut prendre plusieurs formes :

- Honoraires basés sur un pourcentage de l'actif sous gestion : On y retrouve l'avantage de la stabilité comme avec les commissions de suivi. Par contre, toute la perception, l'administration, les rapports, factures, reçus, relevés fiscaux, le paiement des taxes et la remise incomberait désormais aux courtiers. Cela engendrerait une augmentation des coûts de ces derniers qui devront hausser les frais ou honoraires pour compenser.

  On peut espérer que cette augmentation serait justement compensée par une diminution équivalente du ratio de frais de gestion des fonds mais il s'agit-là d'un espoir à propos duquel nous n'avons aucune garantie. Si la même logique s'applique dans notre industrie que celle qui a court avec les fluctuations des devises par rapport aux biens achetés à l'étranger, nous croyons que l'investisseur ne sera pas gagnant et que les marges des gestionnaires augmenteront.

- Honoraires horaire : Cette formule prévoit que le client assume les frais du conseil selon un tarif horaire déterminé. Cette option serait nettement désavantageuse pour les petits investisseurs car ils ont souvent peu de moyens et demandent beaucoup d'accompagnement afin de leur offrir un service adéquat. Il n'est pas exagéré d'affirmer qu'un représentant consciencieux consacrera au minimum entre 10 et 15 heures en début de relation à un nouveau client. Multiplions ces heures par le tarif moyen d'un professionnel (100$) et nous avons une facture importante à assumer alors qu'il n'y encore rien d'investi ou presque. De quoi rebuter beaucoup d'investisseurs potentiels.

C'est ironique et contre-productif car, sans minimiser le besoin ou l'importance des conseils pour toutes les catégories d'investisseurs, s'il existe un moment où l'obtention de conseil et d'accompagnement peut faire toute la différence, c'est au commencement. C'est à ce moment qu'on fixe des objectifs, qu'on apprend à investir, qu'on s'éduque, qu'on apprend à faire un budget, qu'on évalue nos besoins et nos ressources et qu'on établit un plan de match pour la suite des choses.

Si cette étape est négligée ou repoussée, nous craignons fortement que le niveau d'épargne, de protection et d'éducation des investisseurs n'en soit gravement atteint.

L'intégration des commissions permet aux investisseurs d'avoir un accès au conseil facilement à un coût abordable, dès le premier dollar investit.

Efficience des réseaux de distribution

Le modèle d'intégration de la rémunération actuellement en place est efficient pour le réseau de distribution. Il permet aux représentants et aux courtiers de consacrer le plus de temps possible aux clients et à leurs besoins puisque ce sont les gestionnaires de fonds qui perçoivent et transmettent la rémunération.

L'abolition des commissions intégrées forcerait les réseaux de distribution à passer à une rémunération à honoraire et/ou d'avoir recours à des frais liés aux comptes ce qui demande plus d'administration et donc, augmente la lourdeur ainsi que les coûts.

Nous constatons que la rémunération intégrée est très efficace sur ce point et permet de limiter la pression sur les opérations du courtier, déjà fortement sollicitées par les exigences réglementaires actuellement en place.

Notons également que le recours à une solution mitoyenne consistant à ce que la perception de l'honoraire soit confiée au gestionnaire, qui ensuite la transfèrera au courtier n'est pas aussi optimale, bien qu'elle constitue une option moins dommageable que l'abolition complète.

En effet, selon cette option, le courtier conserve la responsabilité du paiement des taxes auprès des ordres de gouvernement. Comme la perception s'effectue par les gestionnaires, la réconciliation des comptes n'est pas évidente. Également, la réconciliation des historiques et des rapports de rendement est grandement complexifiée par cette mécanique.

Nous avons eu la chance depuis plus d'un an de tester, pour un nombre restreint de clients cette option. Nous en venons à la conclusion qu'au mieux, il y a encore beaucoup à faire pour la rendre efficiente si nous devions la généraliser pour l'ensemble de nos clients.

Stabilité des réseaux de distribution

Le recours aux commissions intégrées permet aussi d'assurer une stabilité aux réseaux de distribution.

En effet, l'existence de la commission de suivi permet l'apport d'un revenu stable et raisonnablement prévisible qui permet aux courtiers et aux représentants de se consacrer à leur tâche principale : le service au client.

Nonobstant cela, les courtiers et représentants assument un risque d'affaire puisque la commission de suivi est appelée à varier en fonction du comportement des fonds et des marchés mais, malgré cela, elle répond très bien au besoin de stabilité des réseaux de distribution.

Soutien à la relève

Nous aborderons plus en détail l'enjeu des commissions de vente ultérieurement. Néanmoins, il convient de souligner que leur existence constitue souvent, pour les nouveaux représentants qui œuvrent dans les réseaux indépendants à titre de travailleur autonome, un outil qui leur permet de toucher un revenu décent jusqu'à l'atteinte d'un niveau de maturité dans leurs affaires où d'autres modes de rémunération seront possibles.

L'abolition des commissions intégrées représenterait un obstacle important pour ces professionnels et pourrait mettre en péril leur survie professionnelle ainsi que le renouvellement de la profession en coupant une source de revenu stable, prévisible et immédiate.

En effet, les représentants qui débutent dans l'industrie commencent bien souvent avec un actif sous gestion à zéro et recrutent au départ de plus petits clients ou comptes. Croire qu'ils pourraient, dans ces conditions, subvenir à leurs besoins sur la base d'honoraires relève de l'utopie.

Éviter les abus

Les ACVM semblent considérer que l'abolition des commissions de suivi et leur remplacement par d'autres structures de rémunération aurait pour avantage principal un meilleur appariement entre le coût pour le client et le niveau de service obtenu.

En tout respect, nous croyons que le système actuel constitue un bien meilleur rempart puisque les commissions intégrées, bien qu'elles puissent faire l'objet d'améliorations ou d'un meilleur encadrement, offrent un certain nivellement ou plafonnement que ne permettent pas les honoraires ou autres modes de rémunération.

Nous croisons de plus en plus de clients de nos concurrents qui se sont fait « vendre » des offres de service ou des « paniers » dont les frais de conseil sont de 1.25% ou 1.50% de l'actif sous gestion ou même plus. Les coûts des produits et frais de tenue de compte s'ajoutant à ces frais.

C'est une différence importante quand on considère que, règle générale, un fonds d'obligations permet au conseiller de toucher une commission de suivi de 0.50% et qu'un fonds équilibré ou d'action sera en moyenne de 1% de l'actif sous gestion.

Également, le recours aux honoraires pourrait faire augmenter considérablement le coût du conseil pour le client sur certaines classes d'actifs comme les fonds d'obligations ou de marché monétaire.

Croire que tous les clients seront suffisamment informés, outillés et en mesure de défendre leurs intérêts dans le cadre d'une discussion sur les honoraires avec leur courtier et leur conseiller, ce serait faire preuve de candeur.

Peu de clients sont à l'aise dans ce genre de discussion et beaucoup risquent d'accepter une mauvaise entente de rémunération soit par ignorance ou pour éviter la confrontation.

Nous soumettons donc que la structure actuelle avec les commissions intégrées offre un avantage considérable pour éviter les abus.

Des intérêts qui sont liés et non pas en conflit

Tel que nous l'avons brièvement abordé précédemment, l'intégration des commissions dans les frais du produit peut également avoir des avantages en liant les intérêts du client et du courtier/représentant.

Si nous sommes ouverts à débattre des frais de souscription différés ou réduits, nous affirmons que la commission de suivi, elle, s'apparente en plusieurs points à un honoraire basé sur un pourcentage des actifs investis.

Le représentant a intérêt à ce que son client obtienne une croissance intéressante et à minimiser les risques et les pertes car sa rémunération est directement liée à l'actif sous gestion.

Ce mode n'est donc aucunement conflictuel, au contraire. C'est une situation gagnante pour tous.

Lutte aux paiements alternatifs

Bien que ce ne soit pas totalement impossible dans le système actuel car aucun système n'est à l'épreuve de tous les risques, nous craignons qu'une abolition des commissions intégrée ne puissent inciter des représentants à accepter de leurs clients un paiement direct qui ne serait pas déclaré au courtier et aux autorités.

Un tel comportement contreviendrait clairement aux règles et normes en vigueur mais, lorsqu'il devient plus complexe d'être rémunéré dans le système légitime ou qu'il est difficile d'être justement rémunéré dans ce système, la tentation peut être plus grande.

Malheureusement, nous n'avons pas les outils en mains pour contrer cette pratique et, même si nous convenons que le risque est faible, il ne faut pas l'ignorer pour autant.

Question 4 : Dans le cas de chacun des produits d'investissement suivants, placés au moyen d'un prospectus ou sur le marché dispensé sous le régime d'une dispense de prospectus :

- OPC
- Fonds d'investissement à capital fixe
- Billet structuré

Devrait-on abandonner les commissions intégrées? Dans la négative :

Non.

a) Sur quel fondement devrait-il être exclu?

Les fondements sont exactement les mêmes pour ces produits et sont largement repris dans le cadre du présent mémoire.

Les enjeux d'accès au conseil, de stabilité de l'industrie, de relève, de simplicité opérationnelle et de simplicité pour le client en sont des exemples.

b) Quel serait le risque que des arbitrages réglementaires soient faits sur le marché dispensé si les commissions intégrées n'étaient abandonnées que pour les produits placés au moyen d'un prospectus?

Le risque serait bien réel.

Sans énoncer qu'une hécatombe aurait lieu ou que nous pourrions voir un exode massif des actifs depuis les produits où les commissions intégrées seraient abolies vers ceux où elles seraient encore permises, il y aurait accentuation des risques.

Le courtier ou le conseiller qui a la possibilité de recommander plusieurs produits différents analyse ceux-ci en fonction de plusieurs critères.

Au premier rang doivent figurer l'intérêt du client, ses besoins et sa situation.

Toutefois, des critères de simplicité opérationnelle ou de rémunération peuvent intervenir dans le processus risquant de désavantager les produits où les commissions intégrées ont été interdites. Ce risque sera variable en fonction de la nature des représentants et des courtiers.

Également, le risque que certains courtiers ou conseillers délaissent, plus ou moins progressivement certains produits pour se concentrer sur d'autres est réel et ne doit pas être négligé par les ACVM.

Question 5 : Y a-t-il des types particuliers d'OPC, de fonds d'investissement à capital fixe ou de billets structurés pour lesquels les commissions intégrées ne devaient pas être abandonnées? Pourquoi?

Il ne devrait pas y avoir des produits pour lesquels elles sont abandonnées et d'autres pas. Nous ne voyons pas de justification suffisante, autre que le syndrome du « pas dans ma cour », pour justifier une différenciation de ce type.

Au surplus, une telle différenciation aurait pour effet d'exacerber certaines pressions à la vente de certains produits et créerait une distorsion de toute pièce favorisant ou défavorisant certains produits.

Nous croyons que les régulateurs ne devraient ni permettre ni encourager que de telles distorsions soient créées ou existent.

Question 6 : Y a-t-il d'autres types de produits d'investissement pour lesquels les commissions intégrées devraient être abandonnées? Pourquoi?

Comme nous sommes opposés à l'abolition des commissions intégrées, il serait ridicule de répondre oui à cette question et de pointer du doigt un produit en particulier.

Toutefois, nous invitons les ACVM à la plus grande prudence et à considérer que le secteur des valeurs mobilières ne vit pas dans une bulle hermétique à toute concurrence.

L'abolition des commissions intégrées dans le secteur des valeurs mobilières alors que ces dernières seraient toujours autorisées dans d'autres produits comme les fonds distincts constituerait un problème de taille.

Nous avons déjà soumis à plusieurs reprises qu'il existe un arbitrage réglementaire entre les fonds distincts et les produits sous l'égide de la Loi sur les valeurs mobilières. Le CCRRA a d'ailleurs mené une consultation sur le sujet en 2016.

Plus de 90% de nos représentants détiennent également un permis en assurance de personnes. Une grande proportion de ceux-ci offrent déjà, à des niveaux variables, des fonds distincts à leurs clients.

Abolir les commissions intégrées pour les valeurs mobilières sans harmoniser le tout avec le secteur de l'assurance créerait une distorsion importante et pourrait avoir une influence sur le comportement des conseillers détenant un double permis.

Croire que ce risque n'est que théorique ou qu'il serait possible d'encadrer efficacement les professionnels pour éviter que ce risque ne se matérialise serait une erreur. Le risque est bien réel et un système pour éviter les arbitrages de produits basés sur la réglementation ou la rémunération seraient, au pire, inefficace ou, au mieux, efficace mais lourd, complexe et coûteux.

Question 7 : Adhérez-vous à la proposition d'abandonner tous les paiements faits par d'autres personnes que l'investisseur pour la souscription ou la détention de titres de fonds d'investissement ou de billet structurés? Pourquoi?

Non.

Par soucis d'alléger la lecture de notre mémoire, nous vous référons à nos réponses et commentaires précédents et suivants qui détaillent largement cette position.

Nous ajouterons simplement que l'utilité de cet enjeu nous semble faible : peu importe que le client paie directement le courtier ou que des frais soient perçus par le manufacturier du produit pour ensuite être transmis au courtier, c'est toujours le client qui paie.

Terminons en soulignant que les enjeux du conflit d'intérêt et de la transparence ne seraient pas réglés pour autant, de l'aveu même des ACVM dans le document de consultation[6], ce qui élimine l'un des principal avantage ou but recherché par les ACVM dans le cadre de la présente consultation.

Question 8 : Devrions-nous envisager d'abandonner d'autres frais ou paiements relativement à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés, notamment :

a. le versement de sommes d'argent et la fourniture d'avantages non pécuniaires par les gestionnaires de fonds d'investissement aux courtiers et aux représentants en vertu de la partie 5 du Règlement 81-105;

Non.

Le Règlement 81-105 encadre très bien ces pratiques. L'abandon ou l'interdiction de ces versements ou fourniture d'avantages aurait pour effet de transférer des charges additionnelles depuis les gestionnaires vers les courtiers, sans garantie que les frais des gestionnaires assumés par les clients diminuent et avec la certitude que les courtiers devront augmenter leurs revenus pour couvrir le manque à gagner, particulièrement en matière de formation.

b. les commissions d'indication de clients;

Non.

Dans la mesure ou les ententes d'indication et les commissions qui y sont afférentes sont correctement divulguées, nous sommes d'avis que le Règlement 31-103 encadre adéquatement la pratique et qu'il n'y a pas lieu de les interdire.

c. les commissions de placement?

Non.

Si, en plus d'abolir les commissions intégrées, les ACVM interdisent les commissions de placement, tous les effets négatifs que nous craignons seraient décuplés et l'accès au conseil pour les investisseurs serait encore plus réduit.

Pourquoi? Ces types de frais et de commissions présentent-ils un risque d'arbitrage réglementaire et, dans l'affirmative, de quelle ampleur?

Nous croyons que les risques sont faibles et que la règlementation actuellement en vigueur sur ces éléments est déjà très robuste.

Question 9 : Si le versement de sommes d'argent et la fourniture d'avantages non pécuniaires aux courtiers et aux représentants pour le soutien d'activités de commercialisation et de formation en vertu de la partie 5 du Règlement 81-105 sont maintenus après l'abandon des commissions intégrées, devrions-nous envisager de modifier la portée de ces versements et avantages? Dans l'affirmative, pourquoi?

Le Règlement 81-105 est déjà bien appliqué et connu de l'industrie. À défaut de soulever des éléments problématiques à ce sujet, nous ne voyons pas pourquoi il devrait être revu.

Question 10 : En ce qui a trait aux paiements de transfert internes :

a. Le Règlement 81-105, qui régit les paiements au sein de fournisseurs de services financiers intégrés, assure-t-il un traitement égal entre les fonds en propres et les fonds de tiers?

Nous avons des doutes importants à ce sujet ayant été confronté à certaines situations qui nous ont été rapportée ou que nous avons observées. Malheureusement, nous manquons de données pour appuyer nos doutes.

Ce dont nous ne doutons pas en revanche, c'est que les groupes intégrés vous répondront qu'il n'existe aucun problème à ce chapitre.

Il serait donc intéressant que les ACVM effectuent un travail d'analyse spécifique sur ce point.

b. Devrait-on abandonner les paiements de transfert internes à des courtiers membres de fournisseurs de services financiers intégrés qui sont liés à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés? Pourquoi?

Oui, ces paiements devraient être abandonnés et remplacés par un paiement en bonne et due forme entre les branches du groupe intégré afin d'éviter tout risque de confusion ou de maquillage et afin que tous les joueurs, intégrés ou non, jouent selon les mêmes règles.

Dans quelle mesure les fournisseurs de services financiers intégrés font-ils directement ou indirectement des paiements de transfert internes à leurs courtiers membres et à leurs représentants afin de les inciter à distribuer leurs produits?

Nous l'ignorons, étant un courtier indépendant.

c. Devrait-on abandonner certains types de paiements de transfert internes qui ne sont pas liés à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés par un investisseur?

La question nous semble pertinente mais devrait faire l'objet d'une analyse spécifique de la part des ACVM plutôt que d'être intégrée dans la présente consultation.

Question 11 : Si nous décidions d'abandonner les commissions intégrées, devrions–nous autoriser les gestionnaires de fonds d'investissement ou les émetteurs de billets structurés à faciliter le paiement de la rémunération du courtier par l'investisseur en la prélevant sur l'investissement de celui-ci et en la remettant en son nom au courtier?

Oui.

Ce serait une mesure d'atténuation intéressante, bien qu'imparfaite.

En effet, cette méthode offre des avantages au courtier pour la gestion des honoraires ou commissions en comparaison avec la situation où cette méthode serait totalement proscrite.

Néanmoins, elle représente des inconvénients importants relativement à la réconciliation des comptes, des transactions, du paiement des taxes et de la transmission des informations au client dans le cadre de MRCC2 qui nous font préférer nettement les commissions intégrées actuelles.

Nous avons actuellement un certain nombre de comptes clients qui fonctionnent de cette manière. Ce sont des comptes à forte valeur ajoutée pour lesquels nous avons consenti une réduction de notre rémunération.

Ce sont les défis rencontrés relativement à ces comptes qui nous permet d'affirmer que la solution proposée à la question 11 n'est pas magique et comporte des obstacles qu'il ne faut pas négliger.

Question 12 : Compte tenu des données et des éléments probants fournis dans la présente partie, la proposition d'abandonner les commissions intégrées répondrait-elle aux trois principaux enjeux de protection des investisseurs et d'efficience du marché traités dans la partie 2?

Non.

Nous croyons qu'il n'y a pas de relation cause à effet entre les enjeux soulevés et la proposition d'abandonner les commissions intégrées.

À la lecture du document de consultation et des nombreuses statistiques ou données qui y sont citées, nous relevons toutefois un certain nombre de réalités qui pourraient expliquer l'émergence des enjeux soulevés et auxquelles les ACVM auraient avantage à s'intéresser plus spécifiquement afin de rencontrer ses objectifs.

Concrètement, nous soumettons les trois éléments suivants :

- Le marché est largement dominé par des groupes intégrés, des institutions de dépôts et des assureurs, tant au niveau des manufacturiers que de la distribution.

  Il s'agit, à notre avis, du cœur des enjeux soulevés par les ACVM.

  Toutes les données invoquées démontrent clairement la domination des groupes intégrés, des institutions de dépôt et des assureurs sur le marché et ce, tant en nombre de conseillers, d'actif sous gestion que du nombre de clients.

  La structure de ces groupes est beaucoup plus imposante que celle d'un courtier indépendant. Elle commande plus d'administration, de structures de supervisions et chaque entité du groupe doit contribuer au succès de la « famille ». Sans compter que le groupe doit satisfaire des actionnaires parfois exigeants et/ou des impératifs de relations publiques.

Cette réalité a un coût qui est inévitablement refilé aux investisseurs, soit par des frais plus élevés ou par une offre de service diminuée.

Nous accueillons régulièrement des clients provenant d'institutions financières qui nous disent qu'ils ont envie de plus qu'un rendez-vous annuel de vingt minutes où un conseiller, souvent différent de la rencontre précédente, repasse en vitesse les chiffres et leur recommande un produit de la maison.

Nous accueillons régulièrement des clients provenant d'institutions financières qui ont peu d'actifs et qui ont fait un rendement anémique pendant des années parce qu'ils se faisaient recommander des CPG ou autres produits garantis alors que leur profil d'investisseur aurait permis de considérer des options plus avantageuses pour eux.

Nous soumettons donc, qu'afin de régler les enjeux légitimes soulevés par les ACVM, il conviendrait de s'attarder d'avantage aux structures de distribution, à l'offre de service, aux conflits d'intérêts et à la concentration du marché plutôt que de cibler les commissions intégrées.

- Les investisseurs des marchés modestes font peu appel aux conseils et ont plus fortement souscrit des produits de dépôt plutôt que des produits d'investissement susceptibles d'accroître leurs actifs

  Voilà une triste réalité : les investisseurs qui auraient le plus besoin d'accompagnement, de conseils et d'éducation sont ceux qui y ont le moins recours.

  Il est possible que ce soit le cas car ils croient que le conseil est inaccessible et réservé aux plus fortunés. Nos nouveaux clients sont souvent très surpris que nous les acceptions dès le premier dollar alors que plusieurs de nos concurrents ont une barrière importante à l'entrée en termes d'actifs sous gestion.

  Nous proposons aux ACVM de s'attaquer à cette réalité spécifique. Il est impératif que les investisseurs modestes aient accès aux conseils. Pour cela, il faut s'assurer qu'il existe des réseaux de professionnels qui acceptent de les servir et de les accompagner. Chez Mérici, c'est ce que nous faisons : l'actif médian de nos clients se chiffre à 33 609.24$. Nous sommes à l'aise avec cette réalité car notre mission est de permettre à la moitié modeste de rejoindre la moitié plus fortunée et d'accueillir de nouveaux clients modestes pour perpétuer ce cycle.

  Il est donc erroné de lier le manque de conseils ou de services aux commissions intégrées. Nous soumettons que les enjeux de l'éducation et de l'accessibilité aux conseils devraient être priorisés.

  Pour cela, il faut miser sur l'éducation de masse à l'école et auprès des travailleurs ainsi que sur les pratiques commerciales de certains réseaux de distribution qui refusent les clients modestes ou les « servent » en ne leur conseillant que des produits de dépôt.

- Les investisseurs autonomes paient pour des conseils qu'ils n'obtiennent pas

  Nous sommes partisans des commissions intégrées car elles permettent aux investisseurs d'avoir accès aux conseils de manière simple et efficace pour tous.

Il n'existe, à notre avis, aucune justification pour permettre à des réseaux de distribution de percevoir une commission pour un service qui n'est pas rendu.

Nous avons toujours eu du mal à nous expliquer comment un courtier en ligne pouvait distribuer des fonds et toucher une commission de suivi alors que c'est le client qui transige seul sur une interface informatique et qu'il ne reçoit peu ou pas d'accompagnement ou de conseil ni suivi dans le temps.

Ce genre de pratique précise devrait être interdite et non pas l'intégration des commissions dans son ensemble.

Ces trois éléments soulevés, nous tenons à revenir sur certaines données citées dans le document de consultation.

Le recours au FNB

Nous avons ressenti un réel malaise devant ce qui nous a semblé être de l'enthousiasme pour les FNB de la part des ACVM dans le document de consultation.

Nous reconnaissons que les FNB peuvent avoir des avantages importants en termes de réduction du coût pour les investisseurs.

Toutefois, ils ont aussi des limites et des inconvénients qu'il ne faudrait pas oublier sous prétexte de leur coût plus faible, ce qui n'est pas toujours évident par ailleurs.

Par exemple, un FNB traditionnel n'offre aucune protection en cas de baisse importante de marché. Un gestionnaire de qualité parviendra à le faire au moins partiellement.

Nous reconnaissons que tous les gestionnaires ne sont pas d'égale qualité. C'est le travail du courtier et du représentant de sélectionner les meilleurs et de les proposer aux clients.

Les FNB ont une place sur le marché canadien et peuvent répondre à un besoin. Il ne faudrait toutefois pas franchir le pas de croire qu'ils répondent aux enjeux soulevés sous prétexte qu'ils ne versent pas de commissions intégrées.

« La majeure partie des actifs des OPC sont encore détenus dans des séries classiques comportant des commissions intégrées »

Le contraire aurait été surprenant puisque les commissions intégrées existent depuis près de 30 ans et ont été largement utilisées par l'industrie pour plusieurs excellentes raisons.

S'il est juste de souligner que les actifs avec option de souscription avec frais prélevés à l'acquisition est en forte augmentation, nous croyons que ce n'est pas en soi un problème.

Il existe une pratique courante dans l'industrie qui consiste à recommander au client de souscrire à un fonds sous l'option des frais d'acquisition mais de fixer ces frais à 0%. Ce faisant, le client investi 100% de son argent et le courtier ne touchera que la commission de suivi.

C'est une pratique que nous avons chez Mérici et la quasi-totalité des actifs souscrits sous l'option des frais d'acquisition ont, dans les faits, générés zéro dollar de commission.

C’est une façon pour le courtier et le conseiller de recevoir une commission de suivi sans avoir à en assurer l’administration. Au final, la rémunération reçue s’apparente à un honoraire basé sur un pourcentage des actifs détenus par le client sans le tracas administratif de la gestion des honoraires.

Concernant la mention au document de consultation à l’effet que l’actif sous gestion comportant des frais d’acquisition reportés était en croissance, nous aurions apprécié que ce fait soit ventilé de manière à séparer les souscriptions de l’appréciation des actifs attribuable aux marchés.

De notre côté, nous remarquons une nette baisse du recours aux frais de souscription différés ou réduits chez nos représentants et la part de revenus que ces actifs génère est en constante diminution depuis plusieurs années.

Ceci dit, nous soumettons qu’il n’est pas déraisonnable qu’un client disposant de peu d’actifs à investir puisse recourir à cette structure de frais pour permettre à son représentant de toucher une rémunération raisonnable compte tenu des services rendus.

Par exemple, un client modeste qui a une somme de 10 000$ à investir ne génèrerait, sous cette option de souscription, qu’une commission de 500$. Quand on considère que le représentant a rencontré le client, parfois plus d’une fois, déterminé ses besoins, ses rêves et sa situation, a recommandé une stratégie d’investissement adaptée, a effectué le suivi des transactions et continuera de conseiller le client dans le temps, nous ne croyons pas que ce soit déraisonnable.

En effet, un représentant consciencieux aura consacré entre 5 et 10 heures à ce nouveau client, assumé ses dépenses et touché, au mieux entre 80% et 90% de la commission générée.

Nous croyons que le choix de la structure de frais et de rémunération devrait être laissé aux clients et aux représentants, à condition que le choix soit fait de manière libre, éclairé et que le client dispose des informations requises pour donner son consentement. Ce que devrait permettre l’information au moment de la souscription et des normes professionnelles rigoureuses.

Question 13 : Pour répondre à ces préoccupations, les ACVM pourraient-elles prendre d’autres mesures que l’abandon des commissions intégrées, conjointement ou séparément?

Oui.

Nous soumettons ici quelques pistes de solutions ciblées qui pourraient permettre de rencontrer les objectifs des ACVM et régler les enjeux soulevés :

- **Encadrement des commissions intégrées**

  Sans les interdire, les ACVM pourraient choisir d’intervenir et d’encadrer plus strictement le recours aux commissions intégrées.

  Il pourrait, par exemple, être interdit d’y avoir recours si le courtier ou le représentant n’offre pas un support et des conseils au client pendant toute la période de détention des parts ou encore fixer un seuil minimum de services à offrir pour avoir le droit de recourir aux commissions intégrées.

  Le but serait de limiter ou d’interdire le recours aux commissions intégrées pour les courtiers qui n’offrent aucun service de conseil ou aucun suivi suffisant et qui, dans le système actuel, sont trop rémunérés pour le travail réellement accompli.

Il serait également possible de plafonner les commissions de suivi et de vente afin d'éviter que des produits n'attirent les recommandations des conseillers que parce qu'ils rémunèrent mieux.

Finalement, il serait opportun d'interdire, dans les groupes intégrés qui distribuent leurs produits à l'intérieur et à l'extérieur du groupe, que deux structures de rémunération existent : celle pour l'interne étant souvent plus généreuse que celle pour l'externe afin de favoriser la « famille ».

Bref, sans interdire les commissions intégrées pour ne pas détruire un système de distribution qui a ses avantages, il est possible d'en limiter considérablement les défauts ou abus en ciblant des pratiques pour les encadrer ou les interdire.

- **Introduire une obligation professionnelle de concordance entre la rémunération reçue et la nature des services rendus**

Les ACVM ont démontré une préoccupation importante à l'égard de l'écart possible entre la prestation réelle de service et la rémunération reçue, soulignant qu'il arrive que le courtier et le représentant soient trop rémunérés relativement aux services réellement reçus par le client.

Cette préoccupation est fondée en certains cas mais ne doit pas être généralisée.

Il serait possible, pour les ACVM, d'imposer aux courtiers et aux représentants une obligation de concordance entre la nature et la qualité des services rendus et la rémunération reçue, qu'elle soit payée directement par le client ou par l'intermédiaire des manufacturiers de produits.

Il existe au Québec, une obligation déontologique analogue pour plusieurs professions encadrées par le Code des professions.

Par exemple, le *Code de déontologie des avocats*[7] prévoit, à son article 102 que :

> 102. Les honoraires sont justes et raisonnables s'ils sont justifiés par les circonstances et proportionnés aux services professionnels rendus. L'avocat tient notamment compte des facteurs suivants pour la fixation de ses honoraires:
>
> 1° l'expérience;
> 2° le temps et l'effort requis et consacrés à l'affaire;
> 3° la difficulté de l'affaire;
> 4° l'importance de l'affaire pour le client;
> 5° la responsabilité assumée;
> 6° la prestation de services professionnels inhabituels ou exigeant une compétence particulière ou une célérité exceptionnelle;
> 7° le résultat obtenu;
> 8° les honoraires prévus par la loi ou les règlements;
> 9° les débours, honoraires, commissions, ristournes, frais ou autres avantages qui sont ou seront payés par un tiers relativement au mandat que lui a confié le client.

Bien entendu, des adaptations seraient requises afin de rendre le tout applicable à la prestation de conseils en services financiers mais l'idée générale demeure que le représentant est un professionnel qui devrait être reconnu à ce titre et qu'il peut être guidé par des principes dans l'établissement de sa rémunération plutôt que par une règlementation rigide et limitante.

Un mécanisme d'arbitrage en cas de désaccord entre le client et son courtier quant à la rémunération pourrait être mis en place afin de dénouer les litiges pouvant survenir.

On ne peut d'un côté souhaiter et exiger que les représentants agissent en professionnels et de l'autre, limiter, encadrer et restreindre leur capacité d'action sans des motifs extrêmement sérieux.

Un tel encadrement de nature déontologique de la rémunération évacuerait donc les questions de pure mécanique comme celle des commissions intégrées pour se concentrer sur la relation entre la rémunération et la prestation de service, ce qui est réellement au cœur des préoccupations des ACVM.

- **Professionnalisation de l'industrie**

  Cette suggestion s'inscrit dans la continuité de la précédente.

  Les ACVM cherchent depuis plusieurs années à mieux encadrer les activités des inscrits et à limiter les comportements déviants, souvent en ayant recours à des règles prescriptives ou lourdes d'application générale et parfois intrusives dans le cadre des affaires.

  Nous soumettons qu'à nos yeux, le représentant est un professionnel doté de jugement et capable d'exercer ce dernier dans le cadre d'une prestation de services à un client.

  Il nous faut miser sur cet aspect qui met la responsabilité professionnelle de l'individu en avant plan et condamne tout comportement déviant.

  Malheureusement, la pression à la vente dans certaines structures de distribution ou l'appât du gain peuvent interférer avec ce principe. C'est pourquoi il faut mieux encadrer et protéger la liberté professionnelle du représentant et la responsabilité de ce dernier afin qu'il dispose d'une marge suffisante pour œuvrer dans le seul intérêt de son client et en soit ultimement responsable.

  Il nous faudrait également revoir les conditions d'accès à la profession et au maintien de la certification afin que les standards établis reflètent l'importance du rôle joué par les professionnels de la finance personnelle et de la liberté professionnelle qui leur est accordé.

  Un rehaussement de la sorte et une officialisation du statut de professionnel pour les représentants seraient un gage d'une plus grande qualité de services pour le client et d'une meilleure imputabilité pour les inscrits.

  Il supposerait toutefois une grande remise en question des processus au sein de plusieurs groupes intégrés ou institutions financières mais nous croyons sincèrement qu'une telle réforme aurait de bien meilleurs résultats sur les enjeux soulevés et que les clients en bénéficieraient grandement.

- **MRCC3**

  Nous avons vécu (et vivons toujours) la mise en application de la réforme MRCC2. Cette dernière a engendré de nombreux défis qui ont mobilisé beaucoup de ressources au cours des dernières années.

Une fois nos appréhensions passées, nous croyons que la divulgation de la rémunération et du rendement à nos clients est somme toute positive et de nature à améliorer la confiance et le niveau de connaissances du public, ce qui est éminemment positif.

Néanmoins, nous considérons que la réforme MRCC2 a des failles au niveau du contenu de la communication aux clients et de sa forme.

Nous appelons donc les ACVM à évaluer la possibilité de mettre en chantier un MRCC3 qui nous permettrait de divulguer aux clients l'ensemble des frais assumé par ce dernier, incluant les frais du gestionnaire de fonds, et corrigerait quelques aspects négatifs ou mal compris des clients, comme la méthode de calcul du taux de rendement ou la ventilation des frais déclarés.

Une telle mesure ciblée serait plus simple à mettre en place, ne menacerait pas la structure de l'industrie et aurait des effets beaucoup plus tangibles sur l'information et le pouvoir des clients sur leurs affaires.

- **Information au moment de la souscription, phase 4**

Bien que la réforme de l'information au moment de la souscription prévoit la remise de l'aperçu du fonds avant la souscription afin que le client ait un temps suffisant pour en prendre connaissance, notamment relativement à la rémunération reçue, nous suggérons qu'une étape supplémentaire soit ajoutée ou que l'obligation dans le cadre de la phase 3 soit précisée.

Il devrait être obligatoire que les frais et la rémunération reçue soit clairement mentionnés au client avant la souscription et qu'une preuve de cette mention soit consignée au dossier.

Une telle mesure, relativement facile à mettre en place, règlerait une fois pour toute l'enjeu de la transparence et du libre consentement du client relativement à la rémunération du courtier et du représentant et placerait tous les joueurs sur une même règle claire.

- **Renforcement de la gestion des conflits d'intérêts**

Nous sommes conscients qu'il y a là un enjeu adressé par 33-404 et nous invitons les ACVM à intégrer les conclusions de 33-404 avant de prendre une décision quant à la présente consultation.

Toutefois, nous soumettons que la divulgation et la gestion des conflits d'intérêts dans certains groupes intégrés n'est peut-être pas suffisante pour permettre au client d'en saisir les conséquences et d'apprécier celles-ci relativement à sa situation personnelle.

Il serait opportun que les ACVM mènent une étude spécifiquement sur cet enjeu afin de mieux encadrer cette situation, sans pour autant augmenter inutilement le fardeau des indépendants qui ne sont pas dans une telle situation de conflit d'intérêts.

- **Augmenter les mesures d'éducation du public en matière de finances personnelles**

Voilà une proposition consensuelle et évidente mais également incroyablement longue et difficile à mettre en application.

Nous en sommes conscients.

Néanmoins, nous croyons qu'elle est essentielle et que des efforts conséquents doivent y être consacrés.

L'éducation des investisseurs demeure le meilleur rempart pour éviter un grand nombre d'abus et pour faciliter la prise en main de leurs affaires, avec des résultats.

Il faut augmenter l'éducation financière dans les écoles, du primaire aux études supérieures, auprès des travailleurs, des aînés et favoriser l'émergence d'une culture saine et positive relativement aux finances personnelles dans le grand public.

Plusieurs régulateurs ont déjà des initiatives en ce sens mais nous croyons qu'il faut faire encore plus.

Nous croyons également que de vrais bons professionnels de la finance personnelle sont des vecteurs d'éducation de masse et qu'il est important de valoriser ce rôle. Les ACVM et la société civile doivent être clairs auprès des professionnels inscrits qu'ils ne sont pas des « vendeurs » mais des conseillers qui doivent favoriser concrètement l'éducation des investisseurs.

Il faut également mettre à la disposition des professionnels des outils afin de leur permettre de jouer ce rôle.

C'est un travail de longue haleine qui est ardu et complexe. Néanmoins, il nous apparait tellement essentiel que nous appelons à la mise en place d'actions concrètes en ce sens et nous annonçons que nous sommes intéressés à y participer.

- **Transférer la responsabilité des frais de souscription différés du client vers le courtier et le représentant**

  Cette proposition ne fait pas l'unanimité auprès de nos conseillers et nous y voyons des enjeux opérationnels importants.

  Toutefois, nous trouvons l'idée que ce soit le professionnel qui reçoit une commission de vente qui soit responsable de la rembourser si son client retire ou transfère ses actifs, comme cela est courant dans le domaine de l'assurance.

  Ainsi, celui qui a reçu est également celui qui devra donner, si besoin.

  Cette proposition a aussi le mérite d'enlever un poids sur les épaules du client, poids qui ne devrait pas s'y trouver à notre avis.

  Finalement, cette mesure favoriserait certainement la mise en place d'efforts par le courtier et le représentant afin d'assurer l'entière satisfaction du client, afin de le fidéliser et de s'assurer du maintien du lien d'affaire.

  Pour toutes ces raisons, et malgré nos réserves, nous croyons que cette idée vaut la peine d'être explorée. Le cas échéant, nous pousserons notre analyse et serons heureux de vous faire part de nos observations.

- **Harmonisation de la règlementation encadrant le domaine des valeurs mobilières et celles encadrant les institutions financières ainsi que le domaine de l'assurance**

Nous sommes conscients que ce dernier point peut excéder les compétences des ACVM. Néanmoins, certains membres des ACVM ont juridiction pour agir et tous peuvent exercer des pressions pour que les autorités compétentes prennent action et que le public soit mieux protégé.

Nous soumettons donc que le secteur des valeurs mobilières n'évolue pas en vase clos ou en silo. Le monde des services financiers est très inter-relié entre les valeurs mobilières, les produits bancaires et les produits d'assurance.

Toute intervention d'encadrement dans un secteur risque d'avoir des effets sur les autres secteurs. Le cas de cette consultation ne fait pas exception.

Nous croyons qu'un certain nombre de conflits d'intérêts, de confusion chez les clients et d'arbitrage trouvent leur source dans le manque d'harmonisation et de concordance entre les différents secteurs de l'industrie financière et qu'il serait bénéfique pour les investisseurs qu'un grand chantier de concordance soit envisagé pour tenter de clarifier le tout.

Pourraient être au menu : les conflits d'intérêts, l'arbitrage réglementaire, les structures de rémunération, le rôle du conseil, les normes sur l'intérêt du client, le traitement fiscal des revenus générés, la concurrence, la relève, la formation, les titres professionnels, l'encadrement professionnel et la déontologie pour ne nommer que ces quelques sujets.

Si nous avons réellement à cœur la protection du public et l'efficience des marchés, ce chantier sera un incontournable.

Question 14 : Le passage à des mécanismes de rémunération directe risque-t-il d'entraîner d'autres conflits d'intérêts qui ne seraient pas encadrés par la réglementation actuelle des valeurs mobilières?

Oui.

Si on accepte la position définie par les ACVM, il existe un conflit d'intérêt quant au choix du produit d'investissement selon la rémunération qu'il procure.

L'abolition des commissions intégrées modifierait cette réalité sans pour autant l'anéantir.

Des conflits d'intérêts pourraient subsister quant au choix des produits d'investissement comme de favoriser les produits de la « famille », choisir des produits qui ne sont pas encadrés par la réglementation en valeurs mobilières ou favoriser la vente de « paniers » ou de « package » de services.

L'existence de conflits d'intérêts est inhérente à la relation entre un client et un professionnel. Le client veut le meilleur service qui soit, le plus adapté et le plus efficace au plus faible coût possible alors que le professionnel a intérêt à « vendre » plus de service et à prolonger la relation pour améliorer sa rémunération.

Cette réalité est vraie dans beaucoup de domaines. Cela ne signifie pas pour autant qu'une intervention large et ambitieuse est nécessaire car la définition de normes précises et peu intrusives peut très bien permettre de baliser, encadrer et régler un bon nombre de conflits d'intérêts inhérents à la relation professionnelle.

C’est pourquoi nous croyons que l’abolition des commissions intégrées ne règlerait pas ce problème mais que d’autres mesures pourraient mieux y parvenir.

Question 15 : Selon vous, quel effet l’abandon des commissions intégrées aurait-il sur l’expérience des investisseurs et les résultats qu’ils obtiennent? Plus particulièrement :

- **Les investisseurs recevront-ils des conseils et des services financiers qui concordent davantage avec les honoraires qu’ils paient?**

Pas forcément. Certains courtiers fonctionnent déjà à honoraires et exigent, pour une prestation de services tout à fait comparable à la nôtre, des honoraires équivalents, avant taxes, à 125% ou 150% des commissions que nous recevons actuellement.

Tout système de rémunération peut mener à des abus, que ce soient les commissions intégrées ou les honoraires.

- **Quel effet la proposition aura-t-elle sur le développement des conseils automatisés? Cet effet est-il susceptible d’être avantageux pour les investisseurs?**

Nous avons de la difficulté à évaluer cet effet. Le développement des services automatisés est déjà en cours et semble vouloir s’accélérer bien que plusieurs études de marché semblent démontrer que l’engouement est limité à certains segments de consommateurs.

Il est possible que le développement des conseils automatisés se poursuive de la même manière et soit peu impacté par l’abolition des commissions intégrées.

Ceci dit, nous croyons que les conseils automatisés sont peu personnalisés et ne permettent pas de cibler adéquatement les besoins réels et les enjeux sous-jacents de l’investisseur. Seul un être humain adéquatement formé et attentif peut y arriver.

C’est pourquoi il faut demeurer prudent et ne pas succomber au chant des sirènes de la technologie car, si cette dernière peut être très utile, elle ne peut tout faire et il ne faut pas entraver inutilement le travail des professionnels humains au nom du « progrès ».

- **Y a-t-il des chances que les conseils discrétionnaires gagnent en popularité au Canada comme cela a été le cas dans les autres marchés qui ont délaissé les commissions intégrées et, le cas échéant, ce changement serait-il positif ou négatif pour les investisseurs?**

C’est une possibilité car la gestion discrétionnaire permet au gestionnaire d’effectuer des modifications sans obtenir préalablement l’accord du client. Cela permet des économies de temps et donc, d’argent.

Toutefois, nous nous questionnons sur la capacité du marché à se transformer pour adopter la gestion discrétionnaire de manière substantielle, considérant les exigences élevées en matière de formation et de conformité que suppose ce mode de gestion.

Nous nous questionnons aussi sur les risques de la gestion discrétionnaire si elle devait être trop largement adoptée, le consommateur disposant de beaucoup moins de pouvoirs et de contrôles dans ce mode de gestion.

Il ne nous apparait pas évident que ce changement serait au bénéfice des investisseurs sans pour autant pouvoir affirmer le contraire.

- **Quel effet la proposition aura-t-elle sur la croissance du réseau des courtiers en ligne et des courtiers exécutants et le coût des fonds offerts dans ce réseau? Cet effet est-il susceptible d'être avantageux pour les investisseurs?**

Nous disposons de très peu de données sur la question de la croissance du réseau des courtiers en ligne et des courtiers exécutant.

Nous espérons cependant que ce genre de courtiers auront la décence de requérir des honoraires raisonnables eut égard aux services réellement rendus aux clients.

- **Quel effet la proposition aura-t-elle sur le coût et l'étendue des conseils fournis à des segments particuliers d'investisseurs?**

Question large s'il en est une!

Nous croyons que les investisseurs modestes auront un accès plus difficile à certains produits d'investissement et aux conseils.

Les investisseurs intermédiaires courent les mêmes risques, dans une moindre mesure.

Les investisseurs fortunés devraient, théoriquement, pouvoir profiter d'une réduction de leurs frais.

Toutefois, nous remarquons que des clients dont les actifs se chiffrent dans les dizaines de millions de dollars auprès d'un courtier doivent payer un honoraire de 1% ou parfois plus sur la valeur de leurs actifs alors que chez Mérici, nous offrons régulièrement à des investisseurs dépassant à peine 500 000$ des rabais de commissions sur ce que nous recevons, faisant ainsi passer notre rémunération sous le 1% des actifs sous gestion.

Cet exemple démontre que ce n'est pas le mode de perception de la rémunération qui est en cause que l'appétit de certains courtiers/représentants ainsi que l'ignorance ou la complaisance de certains clients.

Dans tous les cas, la fragilisation de l'industrie causée par l'abolition des commissions intégrées risque de mettre en péril l'accès au conseil et la pérennité de ce dernier pour une large majorité des investisseurs.

Question 16 : Quels sont les types de mécanismes de paiement susceptibles de découler de cette proposition, si elle est adoptée? Plus particulièrement :

- **Les mécanismes de paiement proposés par les courtiers différeraient-ils selon le segment d'investisseurs? Dans l'affirmative, expliquez en quoi et pour quelles raisons.**

Les ACVM recevront autant de réponses différentes à cette question qu'il y aura de courtiers répondants.
Cette question est éminemment liée aux modèles d'affaire de chaque courtier et toutes les réponses sont possibles.
Certains auront un mode de rémunération uniformisé, d'autres segmenteront et d'autres offriront un choix aux clients.
La réponse à cette question est donc impossible et les ACVM ne peuvent s'attendre à une réponse ou une adaptation simple et uniformisée de l'industrie sur ce point.
Toutefois, nous craignons qu'en termes généraux, le conseil devienne beaucoup plus dispendieux pour une large majorité d'investisseurs, à l'image de ce qui s'est produit dans d'autres juridictions.

Question 17 : Pensez-vous que la proposition entraînerait une carence en matière de conseils?

Oui, cela nous apparait presque inévitable.

Plus particulièrement :

- **Quels segments du marché risquent d'être touchés? Prière de considérer la segmentation en fonction du patrimoine, de facteurs géographiques (taille et emplacement de l'agglomération, par exemple, éloignée, petite, moyenne ou grande), de l'âge, des connaissances technologiques, du nombre de titres de fonds que détiennent les ménages, etc.**

Les premiers segments du marché touchés seraient sans doute les investisseurs modestes (moins de 100 000$), les investisseurs en région rurale ou éloignée, les investisseurs plus âgés, isolés ou vulnérables et les investisseurs ayant une situation complexe sans avoir des actifs importants.

Tous ces segments d'investisseurs ont en commun qu'ils demandent du temps et ont une rentabilité plus limitée, selon des critères purement économiques.

Les investisseurs modestes, ayant peu d'actifs à investir, n'ont pas besoin de moins de conseils et d'accompagnement, au contraire. Ils ont souvent besoin de plus de suivis et d'éducation pour leur permettre d'atteindre un niveau d'actifs plus important. Néanmoins, le revenu généré par ce segment est limité par la taille modeste de ses actifs. Il s'agirait donc d'une « victime » naturelle à un resserrement de l'accès au conseil.

Les investisseurs en région rurale ou éloignée devront se résigner à se déplacer pour obtenir des conseils car il ne sera plus acquis qu'un représentant acceptera de faire de longs déplacements pour aller à leur rencontre. Ces déplacements prennent du temps et engendrent des coûts. La rentabilité de ce segment de clientèle pourrait s'en trouver diminuée.

Les investisseurs plus âgés, isolés ou vulnérables pourraient également subir des conséquences négatives d'un resserrement de l'accès au conseil. Ces clientèles demandent souvent un niveau de service et d'expertise plus grand ou la mise en place de plan ou mesures additionnelles pour la gestion de leurs actifs ou leur protection.

Bref, avec l'adoption de la proposition, c'est tout le calcul de la rentabilité de chaque segment de clientèle qui devra être réévalué et, comme en toutes choses, ce sont toujours les moins nantis, les plus éloignés et les plus vulnérables qui risquent d'écoper.

- **Souscrivez-vous à notre définition de « carence en matière de conseils »?**

Oui. C'est une définition que nous jugeons acceptable.

- **Devrions-nous faire une différence entre la carence en matière de conseils « en personne » et la carence en matière de conseils en général?**

Oui et non.

La carence en matière de conseils en personne est une sous division de la carence en matière de conseil simple.

Il peut y avoir absence de carence en matière de conseil simple parce que des conseils sont accessibles à un prix convenable par un moyen technologique par exemple.

Toutefois, tous les consommateurs ne s'accommodent pas de la même manière des outils technologiques et ils ne devraient pas avoir à faire les frais de cette réforme.

Également, nous demeurons fortement convaincus qu'un accès au conseil en personne, lorsqu'il répond aux règles de l'art, permet de mieux accompagner l'investisseur.

Un professionnel bien formé et dévoué saura décoder des situations complexes ou qui n'auront pas été abordées de front par le client. Il saura déceler des enjeux qui sont peut-être inconnus ou négligés par le client. Il saura confronter le client lorsque nécessaire.

D'ailleurs, plusieurs études démontrent[8] clairement la valeur du recours à un conseiller pour les investisseurs.

Le conseil en ligne ne peut faire cela.

- **Quels types de conseils ou de services actuellement offerts seraient le plus touchés par la proposition?**

Les conseils en personne, les conseils de niveau plus avancés (planification fiscale, successorale, de retraite, etc.), l'accompagnement du client dans les événements de sa vie (divorce, mariage, naissance, etc.), l'éducation et la pédagogie faites par les inscrits auprès de leurs clients et la prise en charge des enfants ou des proches des clients nous semblent au premier rang des services touchés par la proposition.

Ajoutons qu'il existe un risque réel de constater une diminution de la durée et de la fréquence des rencontres et des suivis avec les clients.

Comme nous l'avons abordé, c'est toute la rentabilité des dossiers clients qui sera réévaluée car les revenus pourraient être appelés à diminuer sensiblement et, corollairement, les dépenses d'administration pourraient, elles, augmenter.

- **Y a-t-il des interactions potentielles entre la présente proposition, les réformes en cours telles que la deuxième phase du MRCC et d'autres réformes éventuelles comme celles énoncées dans le Document de consultation 33-404 des ACVM qui pourraient avoir un effet sur l'importance d'une possible carence en matière de conseils?**

Oui, nous en voyons plusieurs relativement aux enjeux touchant les conflits d'intérêt ainsi que la connaissance, la compréhension et le contrôle des coûts par les investisseurs.

En fait, ces interactions sont telles que nous n'hésitons pas à qualifier la présente proposition de prématurée puisqu'il serait plus sage d'attendre que les réformes déjà adoptées donnent des résultats afin de mesurer l'écart restant entre la situation actuelle et l'objectif souhaité. Autrement, il y a un risque d'aller trop loin et d'accabler inutilement les clients et l'industrie.

Il ne sert à rien d'appliquer une nouvelle couche de peinture si la précédente n'est pas sèche.

Si les ACVM ajoutent trop de pression en termes réglementaires à une industrie déjà fortement réglementée, compétitive et sous pression, les risques de voir des joueurs se retirer ou tomber au combat est réel.

Cela aurait un impact immédiat sur la compétitivité de l'industrie et sur l'accès au conseil pour les investisseurs.

L'un des piliers de la protection des investisseurs est l'efficience des marchés, laquelle passe par une offre suffisante et compétitive. Toute intervention perturbant l'équilibre de cette offre doit être analysée avec grand soin car il est beaucoup plus long de construire une industrie que de la démolir.

- **Comment pourrions-nous atténuer une éventuelle carence en matière de conseils, de conseils en personne ou de services financiers?**

En évitant de bousculer, sans raison essentielle et sans tenter d'user de stratégies alternatives, une industrie déjà fortement sollicitée par des années de réformes et de changements alors qu'elle est constamment soumise à une forte compétition.

Autrement, le risque de voir l'offre de conseil diminuer est réel.

Il serait dommage de devoir recourir à des subventions étatiques comme au Royaume-Uni pour tenter de combler une carence en matière de conseils qui aurait été créé par… une intervention quasi-étatique.

- **Pensez-vous que les conseils en ligne pourraient atténuer une carence en matière de conseils? Dans l'affirmative, expliquer de quelle manière.**

Partiellement et auprès de certaines clientèles ciblées.

Les clients à l'aise avec les technologies ou disposant d'un profil plus autodidacte pourraient s'accommoder de telles solutions.

Nous soumettons toutefois que ce segment d'investisseur le fait déjà dans une bonne proportion et a accès à ces solutions.

Il ne faut pas négliger les obstacles pour un grand nombre d'investisseurs à recourir à des conseils en ligne : aucun accès ou accès limité à la technologie, connaissance ou habiletés insuffisantes, méfiance ou absence de confiance, préférence réelle pour une intervention humaine et besoin d'interaction, etc.

Le régulateur ne devrait pas avoir à choisir pour l'investisseur par quel canal il pourra ou devra obtenir ses conseils. Le régulateur doit s'assurer qu'un maximum de canaux existent et qu'ils répondent à des normes minimales pour la protection des investisseurs.

- **Pensez-vous que le fait que les courtiers appartenant à une institution de dépôt ou à un assureur détiennent une part importante du marché de la distribution des titres de fonds au Canada influera sur la probabilité qu'apparaisse une carence en matière de conseils ou sur l'importance de celle-ci?**

Pour répondre à cette question, il faut mettre en contexte un certain nombre d'éléments :

Une part des courtiers appartenant à une institution de dépôt ou à un assureur travaillent en succursale ou dans un réseau captif et ont des exigences précises quant au nombre de clients qui doivent être servis, le temps qui doit leur être accordé et le nombre de client à voir chaque jour;

Une autre part des courtiers appartenant à une institution de dépôt ou un assureur ont, à des degrés divers, des pratiques qui peuvent s'apparenter aux courtiers indépendants;

L'accès aux conseils est déjà restreint dans plusieurs réseaux intégrés pour des impératifs de rentabilité : temps limite à un rendez-vous client, nombre de rendez-vous à faire par jour, taille minimale du compte, etc.;

Les courtiers indépendants sont parmi ceux qui offrent le plus grand accès au conseil au plus grand nombre;

Les courtiers appartenant à une institution de dépôt ou un assureur ont une capacité d'adaptation plus grande à une abolition des commissions intégrées car ils pourront, en collaboration avec leurs entités mère ou sœurs, faire évoluer leur modèle de manière à ce qu'une branche ou une autre de l'organisation prenne en charge le client ou les dépenses;

Les courtiers indépendants n'ont pas cette flexibilité organisationnelle.

Donc, si nous résumons, l'accès au conseil est parfois déjà limité chez les courtiers appartenant à une institution de dépôt ou un assureur et ceux qui offrent le meilleur accès au conseil seraient également les plus impactés par l'adoption de la proposition.

Toutefois, nous reconnaissons que, notre poids dans la balance étant modeste, la réduction de notre offre de conseil aurait un effet limité sur les statistiques, d'autant plus que ces dernières ne mesurent pas la qualité et la pertinence des conseils obtenus.

Ceci étant, nous ne voyons pas dans cette dernière déclaration une justification à l'adoption de la proposition. Diminuer ce qui est déjà marginal a un effet très limité d'un point de vue macro mais une réelle différence dans la vie de milliers d'investisseurs.

Nous affirmons fièrement notre conviction à l'effet que si plus de courtiers et de représentants avaient la possibilité de travailler avec moins de contraintes liées aux ventes et à la production, l'accès et la qualité du conseil s'en trouverait améliorée.

Il faut donc éviter à tout prix de détruire ce qui existe, même si nous pourrions être considérés comme marginaux.

Les courtiers indépendants sont les « challenger » sur le marché, ceux qui empêchent les groupes intégrés d'être trop confortables et qui poussent à une compétition accrue. Nous croyons que notre rôle est essentiel à la bonne santé du marché.

Question 18 : Étant donné les changements que nous avons constatés dans le secteur ces dernières années (réduction des frais, introduction de séries de fonds pour les investisseurs indépendants, simplification des séries de fonds, réductions automatiques des frais, facilitation de l'accès aux options de souscription à honoraires, etc.), quelle est la probabilité que le secteur des fonds d'investissement délaisse les commissions intégrées en l'absence de mesures réglementaires? Plus particulièrement :

- **Le secteur continuera-t-il à délaisser les commissions intégrées si les ACVM ne donnent pas suite à la proposition? Plus particulièrement :**

Nous croyons que c'est une tendance lourde qui ne s'arrêtera pas, au contraire.

Les investisseurs et les distributeurs sont de plus en plus exigeants en matière de frais et de rendements. Alors qu'il y a quelques années, ce genre de question était souvent de second ordre, c'est maintenant l'un des premiers sujets de discussion avec nos clients. C'est très bien ainsi et nous croyons que cela demeurera.

L'industrie démontre actuellement aux ACVM qu'elle est suffisamment mature et efficiente pour adresser elle-même ces enjeux d'un point de vue global.

Sur une base plus précise, le recours aux honoraires par une part grandissante de courtier et de représentants continue et ceux qui utilisent les structures de frais d'acquisition le font habituellement avec un frais de 0%, ce qui s'apparente dans les faits à l'imposition d'un honoraire sur l'actif sous gestion dans la poursuite de la relation.

Question 19 : La figure 8 illustre-t-elle fidèlement les options de souscription offertes aux investisseurs selon le réseau, la taille du compte ou le type de société?

Non.

Nous comprenons que les ACVM ont préparé ce tableau avec les données dont elles disposaient mais le portrait est incomplet.

Nos réponses antérieures le démontrent amplement par les exemples que nous avons choisi ou l'explication de nos processus d'affaires.

Pour éviter d'alourdir le texte, nous vous y référons.

- **Selon vous, les options de paiement et les modèles d'entreprise évoluent-ils en ce moment?**

Oui.

Le recours aux honoraires est plus grand ainsi que l'option avec frais d'acquisition à 0%.

Les options de frais de souscriptions différés ou de frais réduits sont quant à eux en diminution.

Nous notons toutefois, chez certains courtiers et spécialement ceux régis par l'OCRCVM, une importante augmentation des barrières à l'entrée (augmentation de la taille minimale du compte) ou des exigences envers les inscrits (augmentation des grilles de revenus générés pour toucher un même salaire).

- **De quelle manière évolueraient-ils au fil du temps si les ACVM décidaient de ne pas mettre en oeuvre la proposition?**

Nous croyons que la tendance amorcée est une tendance lourde qui poursuivra son chemin et pourrait même s'accélérer.

Question 20 : Nous constatons que la distribution de séries à honoraires demeure relativement limitée au Canada par rapport à d'autres marchés. Existe-t-il des obstacles propres au Canada (sur le plan structurel, opérationnel ou réglementaire, ou du point de vue de la demande des investisseurs, par exemple) qui limitent l'utilisation de ces séries par les courtiers?

La demande des investisseurs n'est pas encore très forte mais elle tend à augmenter.

Il faut aussi considérer que l'utilisation des structures avec frais d'acquisition à 0% offre, dans les faits, une forme de compte à honoraires pour le client.

Il existe aussi des enjeux opérationnels qui rendent la gestion de ces comptes plus lourde pour les courtiers, que ce soit en matière de perception des honoraires, de paiement des taxes ou autre.

Question 21 : Veuillez décrire les répercussions de l'abandon des commissions intégrées sur la concurrence et la structure du marché, et indiquer si vous acquiescez ou non à l'analyse présentée à la partie 4. Plus particulièrement :

- **Pensez-vous que la proposition aura des répercussions sur le niveau de regroupement ou d'intégration au sein du secteur? Qu'en est-il de la concentration des actifs des investisseurs du marché de masse placés dans des produits gérés par des courtiers appartenant à des institutions de dépôt?**

Il existe un risque réel que l'adoption de la proposition augmente la pression au regroupement où à l'intégration de joueurs du secteur. Ce phénomène est déjà une réalité et les réformes réglementaires des dernières années ont joué un rôle dans celui-ci.

Toute nouvelle réforme s'ajoute aux précédentes, à la différence que celle-ci est majeure et pourrait avoir un effet encore plus grand.

En ce qui a trait à la concentration des actifs des investisseurs des marchés de masse auprès des courtiers appartenant à des institutions de dépôt, le moins qu'on puisse dire est que l'adoption de la proposition n'aura pas pour effet d'inverser cette tendance et d'ouvrir le marché.

C'est même un renforcement et une accélération de cette réalité que nous risquons d'observer.

- **Quelles répercussions d'éventuels regroupements pourraient-ils avoir sur les résultats obtenus par l'investisseur et l'efficience du marché?**

Chaque regroupement engendre un risque de diminution de la compétition. La compétitivité des marchés est l'un des piliers de l'efficience des marchés qui est, à son tour, l'un des piliers de la protection des investisseurs.

Arrivé à un certain point, la concurrence pourrait être si faible que les groupes intégrés ou les institutions de dépôt pourront réduire leur offre sans crainte de la concurrence et maximiser la vente de produits maisons ou de dépôts. Ce serait alors l'investisseur qui serait perdant.

- **Selon vous, quelles occasions la mise en œuvre de la proposition offrirait-elle et quels défis poserait-elle aux divers groupes de parties prenantes du secteur?**

  - **les courtiers indépendants;**

Le défi sera d'adapter nos modèles et processus d'affaire pour limiter l'augmentation des coûts et encaisser la diminution de revenus. C'est un défi de taille qui n'est pas négligeable et il est possible que certains courtiers indépendants n'y parviennent pas.

Il est possible que la voie pour la survie passera par une augmentation des coûts pour les clients.

Les courtiers qui y parviendront et pourront survivre à ce qui arrivera pourraient toutefois bénéficier d'un marché à concurrence réduite, au niveau des indépendants.

Toutefois, les institutions de dépôt et les assureurs risqueront de s'être renforcées et pourront livrer une bataille encore plus rude aux indépendants.

  - **les sociétés de fonds indépendantes;**

Le danger est que, si les courtiers indépendants tombent ou sont absorbés par des groupes intégrés, ces derniers pourront favoriser la vente de leurs produits maison, ce qui nuira invariablement aux sociétés de fonds indépendantes.

Dans leur cas, nous ne voyons aucun scénario où ils peuvent tirer bénéfice de l'adoption de cette proposition.

- **les fournisseurs de services financiers intégrés;**

Ils devront adapter leurs processus et modèles d'affaires mais ont beaucoup plus d'outils et de latitude pour y parvenir que les indépendants.

À terme, un resserrement du marché pourrait leur bénéficier car ils sont en position de jouer au consolidateur et ensuite de profiter de la concurrence réduite pour favoriser les produits de la « famille ».

- **les courtiers en épargne collective;**

Au sens large, les plus impactés en comparaison avec les membres de l'OCRCVM qui ont accès à une gamme plus étendue de produits financiers.

Toutefois, les réalités des divers courtiers étant parfois bien différentes, il nous semble hasardeux de prophétiser sur cette catégorie.

- **Quelle est la probabilité qu'apparaisse de l'arbitrage réglementaire sur les produits financiers similaires, tels que les fonds distincts et les produits d'institutions de dépôt, et quelle en serait l'ampleur?**

La probabilité existe déjà puisque l'arbitrage réglementaire est déjà présent et le risque d'accentuation est bien réel.

Nous entendons déjà de nombreux représentants qui sont également conseiller en sécurité financière nous affirmer qu'ils pourraient revoir leur processus ou recommandation si la proposition était adoptée.

Nous estimons que leur discours est sincère et crédible et qu'il ne s'agit pas d'une menace sans fondement.

En ce qui concerne les institutions de dépôt, les données fournies par les ACVM dans le document de consultation démontrent déjà que les produits de dépôts occupent une place majeure dans les actifs des ménages canadiens, particulièrement des ménages de masse.

Croire que c'est, dans tous les cas, parce que c'est le meilleur produit pour le client et son besoin relèverait de la candeur.

Il existe déjà des pressions dans les institutions de dépôt pour la vente de tels produits afin de satisfaire les besoins de l'institution en matière de capitalisation.

Ces produits ont aussi souvent la commode caractéristique « d'attacher » le client pour une période déterminée, d'être peu coûteux pour l'institution et facile d'administration.

Toute pression dans le secteur des valeurs mobilière accentuera forcément l'attrait des produits de dépôt face aux fonds communs ce qui limiterait la capacité des investisseurs à obtenir des rendements intéressants et à atteindre leurs objectifs.

- **De quelle manière les courtiers en épargne collective et les agents d'assurance qui sont titulaires des deux permis seraient-ils touchés?**

Il est possible que nous assistions à un transfert d'actif depuis les fonds communs vers les fonds distincts ou, plus subtilement, à une diminution des volumes de souscription en fonds communs pour constater une augmentation de ceux en fonds distincts.

Pour les courtiers qui ont aussi des activités en assurance de personne, l'effet serait relativement limité.

Toutefois, il existe des courtiers comme Mérici qui ne sont pas des agents d'assurance et qui ne subiraient que les effets négatifs de l'adoption de la proposition sur ce point.

- **La proposition favorisera-t-elle l'émergence de nouveaux fournisseurs à faible coût sur le marché? Pour quelles raisons et de quelle manière?**

De tels fournisseurs essaient déjà de percer le marché. Certains avec succès, d'autres non et ce, pour plusieurs raisons.

Indépendamment de l'adoption de la proposition, cela continuera.

Nous ignorons si l'adoption de la proposition aura pour effet d'accélérer ce mouvement ou d'augmenter le taux de survie des jeunes pousses.

- **L'interaction entre la présente proposition et les celles énoncées dans le Document de consultation 33-404 des ACVM vous incite-t-elle à changer vos réponses aux questions ci-dessus et, le cas échéant, de quelle manière?**

Nos réponses demeurent les mêmes à la différence que si la totalité de 33-404 et la présente proposition étaient toutes deux adoptées, nous ne parlerions pas de défis, de difficultés ou d'enjeux de compétition.

Nous aurions possiblement un langage qui comprendrait des mots comme fermeture, vente, consolidation, intervention réglementaire outrancière et maladroite, etc.

Heureusement, nous avons cru comprendre que les ACVM reconnaissaient la relation forte entre 33-404 et la proposition et que les prochaines étapes de ces deux documents seraient évaluées conjointement.

Il s'agit là d'une sage décision.

- **L'abandon des commissions intégrées aurait-il pour effet de réduire le nombre de séries de fonds et la complexité des frais comme nous le prévoyons?**

Possiblement mais pas totalement.

Il existe beaucoup de séries de fonds pour des raisons de structures de rémunération mais il en existe plusieurs également pour des questions fiscales.

Bien qu'il puisse sembler logique d'affirmer qu'il y en a trop et qu'il est vrai que ce n'est pas toujours facile de s'y retrouver, ces séries ont une raison d'être et sont parfois très utiles pour certains clients dans certaines situations.

L'argument de la simplification est séduisant mais ne devrait pas être retenu comme une fin en soi. Si la simplification enlève des opportunités de personnalisation et d'adaptation, nous croyons qu'il y a plus à perdre qu'à gagner.

- **Les fournisseurs de services financiers intégrés seraient-ils avantagés du fait qu'ils peuvent faire de la vente croisée et de l'interfinancement entre leurs secteurs d'activité? Dans l'affirmative, de quelle manière?**

Oui. La question nous semble complète en elle-même et suffit à se répondre.

Un groupe intégré a le bénéfice de servir un même client sous plusieurs faces de sorte que, si un produit convient moins ou est plus difficile à « vendre » il sera possible de lui en proposer un autre.

La possibilité de maintenir en vie une entité par le biais de l'interfinancement donne aussi un avantage compétitif sur la durée que n'ont pas les courtiers indépendants.

- **Quels effets le développement des conseils en ligne pourrait-il avoir sur la concurrence? Sont-ils susceptibles d'être importants et positifs?**

Ils ont un effet réel mais limité car tous les clients ne sont pas encore à l'aise avec cette option. Toutefois, nous constatons une augmentation de leur concurrence et nous croyons que cela ira en augmentant.

Nous voyons cela d'un bon œil. Les clients qui font le choix de recourir à ces courtiers ou aux conseils en lignes se sentent souvent mieux servi par ces outils.

À l'inverse, nous demeurons convaincus qu'une majorité d'investisseurs apprécient et continueront d'apprécier un service humain et accessible.

Le soleil brille pour tout le monde et c'est au client de choisir l'offre qui lui convient. Pas au régulateur de créer une distorsion dans le marché et de moduler l'offre.

Question 22 : Quelles répercussions la proposition aurait-elle sur les procédés administratifs des gestionnaires de fonds d'investissement ou des courtiers en épargne collective? Plus particulièrement :

- **Quelles répercussions opérationnelles ou technologiques particulières devrions-nous prendre en compte?**

Il est difficile de prévoir dans le moindre détail toutes les répercussions qu'aurait l'adoption de la proposition sur nos processus. Nous notons toutefois les éléments génériques suivants :

- Modifications aux logiciels de traitement des transactions et de la réconciliation des opérations pour intégrer le traitement des honoraires
- Embauche de ressources additionnelles au niveau de la comptabilité, des opérations et de la facturation
- Gestion et remise des taxes à la consommation applicables aux honoraires
- Modification aux formulaires utilisés, formation et encadrement additionnel pour assurer le suivi

- Modification des processus de vérification visant à assurer le respect du cadre établi pour les conventions d'honoraire, leur exécution et le paiement
- Coûts de vérification accrus tenant compte de l'augmentation de la complexité de la comptabilité et de la perception des honoraires
- Ajout de ressources pour assurer la conversion des comptes actuels vers des comptes à honoraires
- Mise en place (ou tentative) de mesures d'atténuation afin d'éviter les risques d'arbitrage réglementaire et la fuite d'actifs

Question 23 : À l'heure actuelle, le paiement des commissions intégrées oblige le courtier et le gestionnaire de fonds d'investissement à mettre en oeuvre des mécanismes de contrôle et de surveillance (auxquels se rattachent des coûts de conformité) pour atténuer les conflits d'intérêts inhérents.

- **Le passage à des mécanismes de rémunération directe rendrait-il inutiles certains de ces mécanismes?**

Pas forcément. Nous considérons qu'au mieux, ils seraient modifiés pour effectuer l'encadrement du nouveau modèle de rémunération.

Les seuls éléments qui pourraient être abandonnés sont des éléments qui requièrent peu de temps ou de ressources car ils sont automatisés en grande partie.

- **Dans quelle mesure, le cas échéant, le recours aux mécanismes de rémunération directe par les représentants actuellement (par exemple, lorsqu'un représentant fournit des services selon un mécanisme de rémunération à honoraires) rend-il inutiles certains de ces mécanismes de contrôle et de surveillance?**

Il ne les rend pas inutile, nous adaptons simplement nos processus de vérification.

Nous tenons à souligner que l'abandon des commissions intégrées ne signifie pas, dans notre cas, un allègement de la surveillance et des coûts de conformité.

De plus, notons que nous considérons qu'il existe un risque que le représentant soit plus fortement tenté d'accepter un paiement accessoire non-déclaré de la part de son client afin de combler un manque à gagner suivant l'abolition des commissions intégrées.

Ce genre de paiement est interdit mais nous considérons que la proposition des ACVM augmente la possibilité de ce genre d'incident.

Question 24 : Les commissions intégrées, en particulier les commissions de suivi, procurent une source de revenus stable aux courtiers et aux représentants. Si elles sont abandonnées, les mécanismes de rémunération directe compenseront-ils la perte de ces revenus?

Non.

Il y aura la perte des commissions issues des fonds en frais de sortie reportés qui ne pourra être compensée.

Également, même en supposant qu'il sera possible de générer un même montant en honoraire que ce qui est actuellement perçu en commissions de suivi, les frais d'administration supplémentaires encourus viendront réduire notre marge de manœuvre.

La seule solution pour maintenir ces marges serait d'augmenter l'honoraire perçu. Le client serait donc désavantagé.

Question 25 : Mis à part les barèmes de commissions et les salaires, à quels autres modes de rémunération des représentants les courtiers pourraient-ils avoir recours si nous abandonnions les commissions intégrées? De quelle manière ces méthodes sont-elles susceptibles d'évoluer au fil du temps?

Nous avons tenté d'imaginer des méthodes alternatives qui allieraient la nouvelle réalité créée par l'adoption de la proposition et notre modèle d'affaire, nos valeurs et les besoins de nos gens.

Outre les barèmes de commissions, lesquels pourraient être reconvertis sur des structures à honoraires, nous voyons mal, à ce stade, comment y parvenir.

En tant que courtier indépendant, il est exclu de rémunérer à salaire nos représentants qui sont des travailleurs autonomes ou de nous approprier le fruit de leur labeur au-delà de ce en quoi nous y avons contribué.

Question 26 : Quelles répercussions la proposition aura-t-elle sur les représentants du secteur, en particulier sur ce qui suit?

Considérant notre statut de courtier indépendant, nous analyserons cette question en fonction de notre réalité.

- **le cheminement de carrière;**

  C'est un élément qui sera grandement perturbé.

  Déjà qu'il n'est pas facile, pour un indépendant, de réussir à s'établir dans le domaine, d'y survivre et de prospérer, l'abolition des commissions intégrées viendrait grandement compliquer les choses.

  Dans l'immédiat, le cheminement de carrière de tout représentant risquerait de régresser ou, au mieux, de stagner. En effet, la perte de revenus et l'augmentation des coûts viendront miner le cheminement de carrière des représentants actifs.

  Également, la progression dans la carrière risque d'être beaucoup plus lente et le statut de précarité, prolongé puisqu'il sera impossible de toucher des commissions de vente provenant de frais de souscription différés. Quand on commence à 0, ne vivre que sur un revenu correspondant à un pourcentage de l'actif sous gestion, c'est difficile. 1% de 0, ça donne 0.

- **l'attrait de la profession;**

Actuellement, dans les conditions que nous avons, c'est un défi. Nous avons une profession qui propose des éléments intéressants à d'éventuels professionnels : liberté, possibilité de bien gagner sa vie si on réussit à s'installer, etc.

Mais la précarité du statut de travailleur autonome en rebute plus d'un. Ajouter un degré de difficulté additionnel en modifiant les structures de rémunération constituerait un obstacle majeur qu'il sera difficile de surmonter.

- **le profil type de la personne intéressée par la profession;**

Le profil type de gens intéressés et qui nous intéressent demeurera sensiblement le même à une différence près : ils devront avoir plus d'audace, de cran, de courage, de patience et, obligatoirement, des réserves pour pallier au démarrage plus lent de la carrière.

- **le recrutement;**

Considérant l'ensemble de nos réponses précédentes, vous aurez compris que c'est déjà un énorme défi et qu'il sera encore plus énorme advenant l'adoption de la proposition.

- **l'attrait relatif d'une carrière dans des branches d'activité concurrentielles des services financiers.**

Cet attrait sera diminué, compte tenu de l'augmentation des difficultés et des risques, sans amélioration des conditions ou de la rémunération.

Question 27 : Les mesures d'atténuation que nous avons exposées sont-elles réalisables? Quel serait leur degré d'efficacité pour garantir :

- l'accès des investisseurs aux conseils;
- un choix de mécanismes de rémunération pour tous les segments d'investisseurs;
- des règles du jeu équitables entre les produits d'investissement concurrents?

En tout respect, si certaines mesures pourraient avoir des effets positifs, d'autres relèvent de la pensée magique.

La possibilité d'avoir recours à des ententes avec les gestionnaires de fonds afin qu'ils perçoivent, au nom des courtiers, les honoraires convenus et en fasse par la suite la remise aux courtiers nous semble une mesure d'atténuation réaliste.

Toutefois, elle n'est pas parfaite et engendre un certain nombre de complication au niveau de la réconciliation, de la vérification, de la comptabilité, des paies et de la divulgation aux clients.

Il serait donc faux de croire qu'il s'agit d'une solution parfaite qui n'engendre aucun inconvénient ou coûts supplémentaires.

La mention au document de consultation que « certaines de ces répercussions pourraient être dans une certaine mesure atténuées par des innovations technologiques » nous semble facile et naïve.

S'il est vrai que certaines sociétés canadiennes ont développé des outils technologiques pour offrir du conseil en ligne, il n'est pas du tout évident que ce contenu est accessible à tous, adapté ou qu'il s'intègre dans les processus d'affaire déjà solidement implantés.

Dans les années 1960, beaucoup étaient convaincus que nous aurions des voitures volantes en l'an 2000. Nous avons un peu l'impression que les ACVM pêchent par excès de confiance en la technologie.

Question 28 : Quelles autres mesures les ACVM devraient-elles envisager en vue d'atténuer les conséquences involontaires susmentionnées?

Dans l'éventualité où la proposition était adoptée, voici des mesures d'atténuation qui pourraient être utiles :

- Une période de transition exceptionnellement longue, entre 5 et 7 ans pour permettre la conversion des modèles d'affaires et des blocs d'actifs
- La mise sur pied d'un fonds destiné aux courtiers pour la conversion des systèmes, la formation et la compensation de la perte de revenus
- La mise sur pied d'un fonds destiné à la relève chez les représentants, lequel pourrait être utilisé pour faire la promotion de la profession, la formation et pour aider financièrement les représentants débutants à démarrer leurs activités
- La mise sur pied d'un fonds destiné à la relève chez les courtiers indépendants afin de garder la propriété des entreprises chez nous et d'éviter la consolidation de l'industrie par faute de relève ou de moyens

Question 29 : Outre les répercussions potentielles relevées dans la partie 4, quelles autres conséquences involontaires potentielles, notamment opérationnelles et fiscales, les parties prenantes et les investisseurs du secteur des fonds pourraient-ils subir à la suite de l'abandon des commissions intégrées? Plus particulièrement :

- **Le paiement de la rémunération du courtier dans le cadre des mécanismes de rémunération directe entraînerait-il des répercussions fiscales défavorables pour les investisseurs? Plus particulièrement, le versement, par les investisseurs, de la rémunération du courtier au moyen de rachats périodiques de titres de fonds effectués par le gestionnaire de fonds d'investissement entraînerait-il des conséquences fiscales? Veuillez fournir des explications.**

Potentiellement, oui. Toute transaction de vente dans le compte du client, que ce soit parce qu'il retire son argent ou pour payer des honoraires peut potentiellement avoir des conséquences fiscales comme le déclenchement de gains en capital ou l'augmentation du revenu imposable par exemple.

De plus, le courtier devra percevoir les taxes sur les honoraires pour chacun des clients.

Il n'est aucunement garanti que les frais du fonds du manufacturier seront parfaitement diminués pour tenir compte de la réduction des frais, incluant taxe, frais d'administration et autres. Le client pourrait donc payer plus cher au final.

- **Si le passage aux mécanismes de rémunération directe mène à la rationalisation des séries de fonds, cette rationalisation pourrait-elle avoir des conséquences fiscales défavorables pour les investisseurs?**

Oui car elle pourrait leur retirer des options leur procurant un avantage fiscal ou une flexibilité fiscale importante, parfois même essentielle dans le cadre d'un plan d'investissement ou de décaissement de retraite.

Il est difficile de déterminer les conséquences précises puisque, au-delà de la volonté affichée des ACVM de réduire le nombre de séries, nous n'avons pas d'indication sur quelles séries seraient touchées.

- **Quelles mesures réglementaires ou autres, s'il y a lieu, pourraient contribuer à atténuer les répercussions opérationnelles et fiscales potentielles?**

Dans le cadre de l'abolition des commissions intégrées et la réduction des séries existantes, nous ne voyons malheureusement aucune mesure d'atténuation efficace ou réaliste à l'exception d'une seule : octroyer aux détenteurs de parts d'une série particulière un droit acquis afin de ne pas mettre à mal la stratégie établie dans leur plan d'investissement ou de décaissement.

Question 30 : En ce qui a trait à la perte d'une forme d'interfinancement provenant des investisseurs fortunés au profit des investisseurs moins aisés dans le même fonds à la suite du passage aux mécanismes de rémunération directe :

- **dans quelle mesure (en la quantifiant, si possible) cette perte augmenterait-elle le coût de la prestation de conseils et de services aux investisseurs moins aisés dans le cadre des mécanismes de rémunération directe?**

Il est difficile d'établir un scénario parfaitement quantifié mais il est possible d'envisager que, pour le marché de masse, il faille doubler ou tripler les coûts, voire même plus, pour tenter de s'approcher de la valeur réelle des services rendus.

Prenons par exemple un client modeste qui débute ses activités d'investisseur. Le représentant consciencieux lui consacrera entre 10 et 15 heures au début de la relation pour le rencontrer, comprendre ses besoins, sa situation et ses objectifs, analyser les informations collectées, lui préparer un plan personnalisé, le rencontrer de nouveau, mettre en place le plan convenu et en assurer le suivi.

Si ce client modeste a investi une somme de 5 000$ (ce qui est déjà bien pour un investisseur débutant) qui génère un honoraire de 1% par année, ce client paiera au courtier 50$ l'année 1 de sa relation avec son représentant et son courtier.

Considérant le temps investi par le représentant et les coûts assumés par celui-ci, il ne serait certainement pas déraisonnable d'affirmer que, dans le cas de ce client, il faille décupler les coûts pour obtenir une rémunération un peu plus adéquate.

Ici, nous souhaitons tout de suite désamorcer le contre argument voulant qu'un nouvel investisseur n'a peut-être pas besoin d'autant d'égards et de services de la part de son représentant.

C'est là où nous insistons : il nous parait essentiel de consacrer du temps et des ressources à tous nos clients, particulièrement les plus modestes pour les aider à faire croître leurs actifs et leurs connaissances.

- **l'existence de cette forme d'interfinancement indique-t-elle que les investisseurs fortunés paieraient indirectement des honoraires qui ne correspondent pas aux services qu'ils reçoivent (autrement dit, les honoraires qu'ils versent excèdent-ils le coût réel des services et des conseils qu'ils reçoivent)?**

En partie, oui.

Cependant, nous pratiquons et encourageons le recours aux rabais de frais de gestion et de conseil pour les investisseurs plus fortunés de sorte qu'ils ne paient pas des frais disproportionnés eut égard aux services rendus.

- **quelles mesures pourraient atténuer les effets potentiels de la perte de l'interfinancement sur les courtiers, les représentants et les investisseurs?**

Même si ces mesures ne nous plaisent pas, voici ce qui nous pourrions envisager :

- l'arrêt ou la diminution de service pour les investisseurs du marché de masse
- l'établissement d'un investissement minimum à 50 000$ ou 100 000$ par client afin d'obtenir du service
- la subvention des conseils au marché de masse par l'état

Question 31 : Quelles mesures les participants au secteur des fonds pourraient-ils adopter de façon proactive pour atténuer les conséquences involontaires pouvant découler de l'abandon des commissions intégrées?

Il nous semble prématuré de nous prononcer sur ce point. Nous tenterons de mitiger les dommages et conséquences si et quand un projet de règlement défini nous sera soumis.

Question 32 : Pour chacune des options de transition, veuillez indiquer les changements opérationnels ou structurels que votre entreprise (gestionnaire de fonds d'investissement ou courtier) pourrait devoir apporter à ses systèmes et processus, ainsi que les conséquences financières qui en découleraient. Dans la mesure du possible, veuillez fournir des données sur les coûts estimatifs.

- **Existe-il des coûts ou des difficultés propres à des domaines d'activité en particulier?**

Il nous est impossible, à ce stade et en l'absence du détail de la proposition réglementaire, de chiffrer des coûts précis.

De plus, les possibilités de développements suite à 33-404 s'ajoutent à la présente proposition et pourraient avoir des impacts concomitants ou qui s'additionnent.

Avant d'émettre une opinion détaillée et de chiffrer les impacts, nous aurions besoin de plus de détails car, autrement, nous pourrions vous présenter de nombreux scénarios en matière de transition et de changements opérationnels ou structurels.

Notons toutefois qu'aucun changement ne pourra, selon notre analyse préliminaire, s'effectuer facilement ou à coût nul. Certains scénarios pourraient même menacer la continuité et la viabilité de nos opérations.

- **Quelle serait la période de transition appropriée?**

Sous réserve de notre réponse à la sous-question suivante, nous considérons qu'une période de transition de 5 ans serait nécessaire pour planifier et exécuter adéquatement un tel changement de modèle.

Les ACVM ont consenti 3 ans pour l'implantation de MRCC2 qui n'impactait pas autant les opérations et la structure des inscrits.

De plus, il n'y a aucune situation d'urgence justifiant de précipiter l'exécution de la proposition.

Nous soulignons tout de même que c'est à contrecœur que nous envisageons une telle transition et appelons les ACVM à la prudence et à la considération des éléments que nous soulevons dans le cadre de notre mémoire.

- **Les calendriers de rachat établis sous les options de souscription avec frais d'acquisition reportés et avec frais d'acquisition réduits devraient-ils être maintenus jusqu'à la réalisation prévue des rachats ou prendre fin à la date de transition?**

Oui.

Autrement, quelqu'un aura à assumer la facture reliée au choix des ACVM. Il serait inéquitable qu'une souscription valablement effectuée voit ses conditions modifiées par une intervention réglementaire.

Question 33 : Quelle option de transition préférez-vous? Pourquoi? Devrions-nous examiner d'autres options?

Sous réserve du délai qui devrait être plus long, la première option nous semble plus appropriée pour les raisons suivantes :

- Simplicité logistique de tout transférer d'un seul bloc plutôt que d'effectuer un nombre indéterminé de transitions, lesquelles pourraient, par ailleurs, créer des iniquités entre nos clients.
- La grande activité des ACVM en matière réglementaire nous fait craindre que de nouvelles réformes ou projets émergent et viennent impacter, à nouveau, nos processus d'affaires. Dans ce contexte d'incertitude, nous préférons opérer la transition en une seule fois plutôt que de la gérer en plusieurs séquences, possiblement au milieu d'autres réformes propulsées par les ACVM.

Question 34 : Comme il est exposé dans l'Annexe B, les ACVM n'ont pas retenu l'option du plafonnement des commissions intégrées, soit comme solution autonome aux enjeux principaux exposés dans la partie 2, soit comme mesure provisoire en vue de l'abandon des commissions intégrées. Les ACVM devraient-elles poursuivre leur réflexion sur un plafonnement des commissions à titre de mesure transitoire? Pourquoi?

Oui car il s'agit d'une mesure beaucoup moins invasive et dommageable, à la fois pour l'accès au conseil que pour le maintien des structures de distribution actuelle tout en adressant une partie importante des enjeux soulevés par les ACVM.

Nous invitons fortement les ACVM à reconsidérer cette option et, le cas échéant, nous pourrions appuyer une démarche en ce sens.

Question 35 : Veuillez indiquer si vous estimez que les mesures analysées ci-dessus pourront, individuellement ou collectivement :

- **Régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2;**
- **Régler ou non tout autre problème ou enjeu que vous auriez relevé**

Il nous semble clair, ainsi que nous l'avons déjà énoncé dans le présent mémoire, que ces mesures auront un impact significatif sur les enjeux soulevés par les ACVM. D'ailleurs, le document de consultation énonce que « <u>bien qu'il faudra sans doute encore quelques années pour les évaluer pleinement</u>, nous prévoyons que ces réformes amélioreront considérablement la connaissance et la compréhension des investisseurs »[9] (nous soulignons).

Notons que les ACVM avouent ainsi que les effets de MRCC2 n'ont pas encore été pleinement déployés et mesurés, ce qui donne de la force à l'idée que la proposition d'abandonner les commissions intégrées est possiblement prématurée.

Nous soumettons qu'il serait erroné de regarder chacune des réformes de manière isolée relativement aux trois enjeux soulevés. Nous croyons qu'elles ont des interactions importantes entre elles et que ces interactions peuvent augmenter les impacts attendus de chacune des réformes.

Nous soumettons également que, bien au-delà des mesures règlementaires concrètes, les réformes récentes ou en cours d'analyse ont un impact significatif sur la culture de conformité de l'industrie, le comportement des inscrits et l'éducation des investisseurs.

Ces derniers éléments sont certainement plus intangibles et difficiles à mesurer mais peuvent certainement avoir un impact marqué sur le règlement des enjeux soulevés par les ACVM et ce, de manière plus durable qu'une simple disposition réglementaire.

À titre d'exemples, soulignons les nombreuses réductions de frais de la part de plusieurs gestionnaires de fonds, l'annonce de nouvelles lignes de conduites en matière de distribution chez plusieurs courtiers, le recul du recours aux frais de souscription différés, l'augmentation du recours aux honoraires ou aux produits comportant moins de frais.

Il existe un réel mouvement au sein de l'industrie et ce dernier rejoint les objectifs des régulateurs. Ce mouvement a besoin d'accompagnement et de temps. Pas d'obstacles ou de précipitation, lesquels pourraient le faire dérailler en éjectant certains acteurs qui agissent le plus positivement en son sein.

Si nous avons exprimé des réserves par le passé face à certaines initiatives réglementaires ou projets et que certaines de ces réserves ou critiques demeurent, nous croyons que nous aurions avantage à travailler à l'amélioration et l'affinement du cadre actuel pour adresser les enjeux soulevés plutôt que d'ébranler fortement l'industrie et de créer des impacts potentiellement dévastateurs.

Les mesures citées à la partie 6 augmentent considérablement la transparence et l'éducation des investisseurs. Nous n'avons jamais autant discuté de frais et d'offre de service avec nos clients et dans le grand public que depuis les dernières années. Nos clients comprennent de mieux en mieux les enjeux et ce à quoi ils peuvent s'attendre.

Si des écarts demeurent, il serait plus approprié de cibler les « poches de résistance » et d'adopter des mesures ciblées vers les réseaux récalcitrants plutôt que sur l'ensemble de l'industrie.

La préoccupation importante des ACVM concernant les conflits d'intérêts nous semble sincère et nous ne doutons pas que des données préoccupantes puissent exister pour soutenir cette préoccupation.

Toutefois, encore sur ce point, nous croyons que les initiatives en cours permettront, au minimum, de diminuer cette problématique et que des mesures plus ciblées concernant certaines pratiques ou réseaux de distribution auraient plus d'impact pour régler cet enjeux.

En effet, nous n'observons pas, dans nos activités, que nos représentants sont davantage portés à recommander des produits en fonction de la rémunération reçue. Ils fondent plutôt leurs recommandations sur les besoins du client, sa situation, la performance du produit, les frais de celui-ci et sa convenance.

Nous ne pouvons nous empêcher de nous demander si les données analysées par les ACVM ne sont pas « contaminées » par des pratiques ayant cours chez un nombre restreint de courtiers mais qui représentent des volumes très importants.

Ce questionnement est également valide pour l'enjeu numéro 3 puisque nous constatons que nos représentants travaillent fort pour leurs clients et offrent un large éventail de services pour la rémunération reçue.

Question 36 : Existe-t-il des solutions ou des mesures de rechange, sur le plan réglementaire ou sur le marché, susceptible de régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2. Dans l'affirmative, veuillez fournir des explications.

Oui.

Nos réponses précédentes abondent en ce sens et nous vous y référons dans le souci d'alléger le texte de notre mémoire.

Soulignons cependant qu'il y a place à l'amélioration de mesures actuellement en vigueur, comme la possibilité d'implanter un MRCC3 divulguant l'ensemble des frais aux investisseurs ou l'imposition d'un devoir formel de concordance entre la rémunération reçue et les services rendus, tel que nous l'avons déjà suggéré.

Conclusion

Nous tenons à remercier les ACVM de l'opportunité qui nous a été donnée de participer à la présente consultation et spécifiquement l'équipe de l'Autorité des marchés financiers pour la manière exemplaire avec laquelle elle lui a donné vie.

Nous espérons avoir la chance de poursuivre le dialogue sur ce sujet et beaucoup d'autres avec les ACVM car, au-delà du temps investi dans la rédaction de ce mémoire, rien ne vaudra une bonne discussion franche, ouverte et constructive où les échanges permettent de trouver de bonnes solutions aux enjeux.

Soyez assurés de notre entière disponibilité et de notre collaboration afin d'assurer la protection des investisseurs et l'efficience des marchés.

Meilleures salutations,

Michel Boutin
Président

Me Maxime Gauthier
Chef de la conformité

Références :

[1] Document de consultation 81-408, pages 38 et 40, Tableaux 9 et 10
[2] Document de consultation 81-408, page 40
[3] Document de consultation 81-408, page 41
[4] Document de consultation 81-408, page 39
[5] Sondage sur les modes de rémunération auprès des clients de Mérici
[6] Document de consultation 81-408, page 25
[7] Code de déontologie des avocats, D. 129-2015, a. 102; N.I. 2016-01-01 (NCPC)
[8] À cet effet, citons les études de CIRANO du professeur Montmarquette et de madame Viennot-Briot et vous joignons en annexe, avec sa permission, une présentation effectuée par M. Pierre Lortie de Dentons Canada qui illustre clairement les impacts et avantages du conseil.
[9] Document de consultation 81-408, page 95

ANNEXE 1 : Présentation de Pierre Lortie, Dentons Canada

Financial Advice: A key enabler of individual thrift, wealth accumulation and economic growth

Presentation by **Pierre Lortie**
Senior Business Advisor
Dentons Canada LLP

The New Paradigm of Financial Advice: New Technologies, New Regulations, New Business Models

Toronto – March 30-31, 2017

Financial Advice and Wealth Accumulation

- Wealth accumulation is the dominant motivation for households to invest in financial instruments.
- The structural modifications in the design of public and private pension programs have shifted investment performance, inflation, longevity and markets risks onto the cohorts of future retirees.
- The common conclusion of studies about the retirement income prospects of future retirees is "that the decline in post-retirement living standards is largely a problem for people with middle and upper-middle levels of earnings."[1]
  - 39% of households made up of working 35 of 64 years old are primarily relying on voluntary savings and private wealth to sustain their living standards at retirement.[2]
- In terms of adequacy of retirement income, it is the wealth these households will accumulate that is the determinative factor and it is precisely this segment of Canadian households which most needs professional financial advice.

The litmus test for the regulation of retail financial services and the quality of financial advice is whether it promotes and facilitates wealth accumulation by households

Financial Advice and Wealth Accumulation

"For many people, being asked to solve their own retirement savings problems is like being asked to build their own cars."

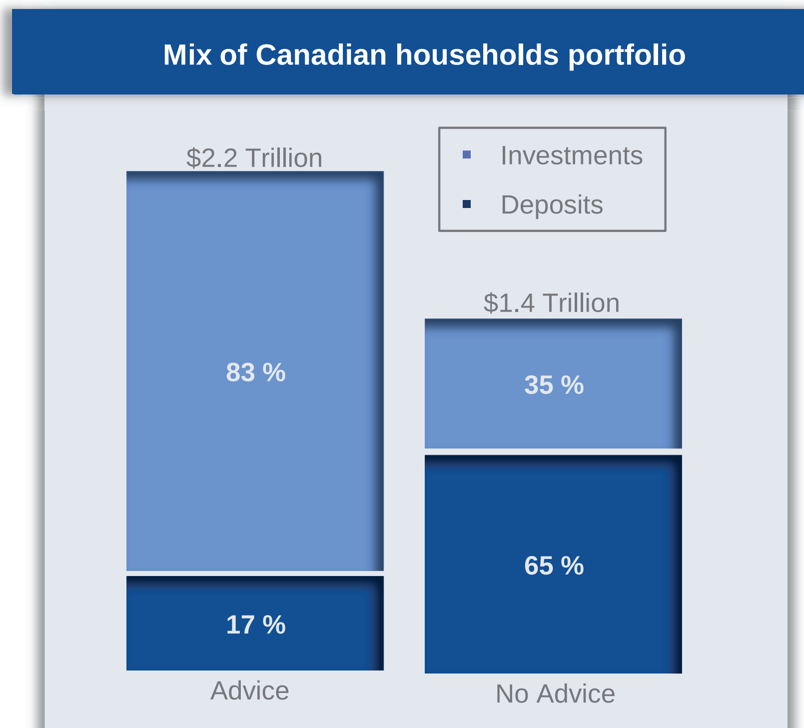
-Richard Thaler, University of Chicago

"Lower-for-longer interest rates have made it more difficult for Canadians to finance their retirement through savings… But the difficult reality is that savers must adjust their plans. That may mean some combination of putting aside more funds, working a little longer than planned or changing the mix of investments"

Stephen S. Poloz
20 September 2016

Financial Advice and Wealth Accumulation

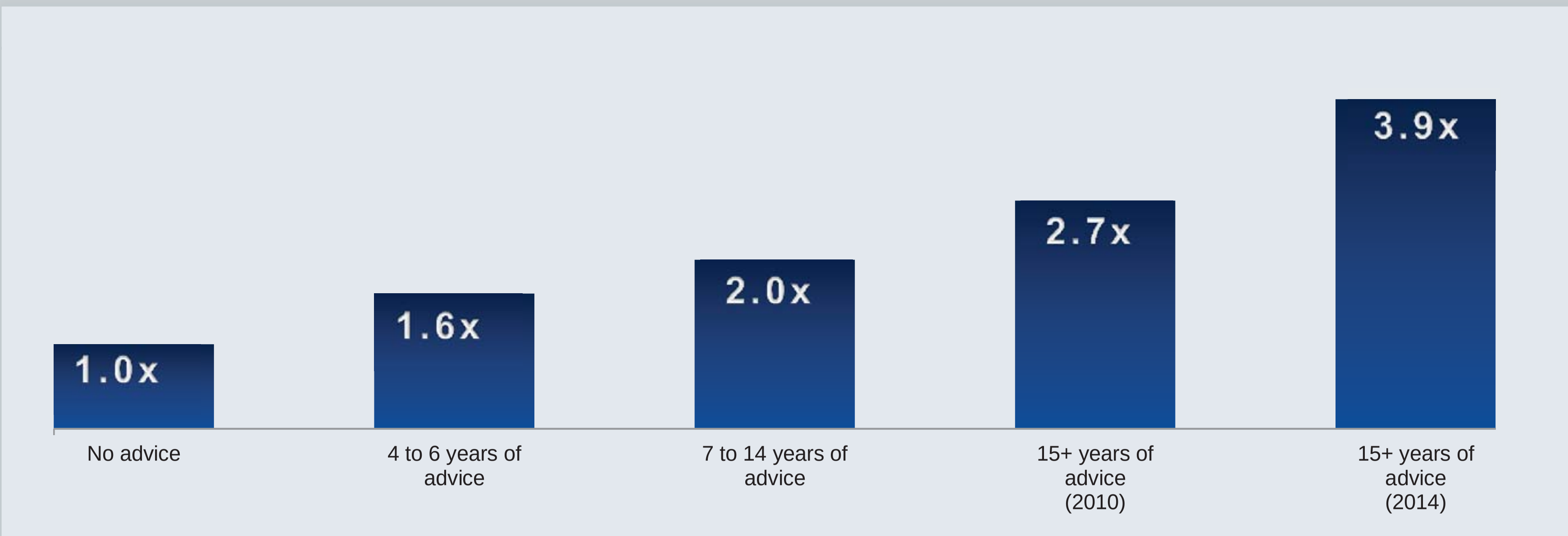
- The traditional view is that dispersion in wealth at retirement is driven mainly by savings decisions when young.[3]
- Recent studies demonstrate that:
  - Rising income from investments rather than rising income from work has fueled the surge in income inequality.[4]
  - A powerful force driving this outcome is the allocation of savings between riskless and risky assets, and that the choice of risky assets drives the returns on individual portfolios.[5]
- A large majority of individual investors are "risk adverse". Their willingness to hold risky assets is heavily dependent on financial advice and their level of trust in their financial adviser.
- Analysis of the impact of the 2001 regulatory changes for mutual fund dealers and their financial advisers in Canada (except Québec) shows that:
  - They created an advice gap and reduced households' likelihood of using an adviser.
  - Financial advisers influence savings behavior, risky asset holdings, and trading activity.[6]



Financial Advice and Wealth Accumulation

Canada

- Robust econometric evidence shows that individual investors assisted by a financial adviser accumulate more financial assets.[7]



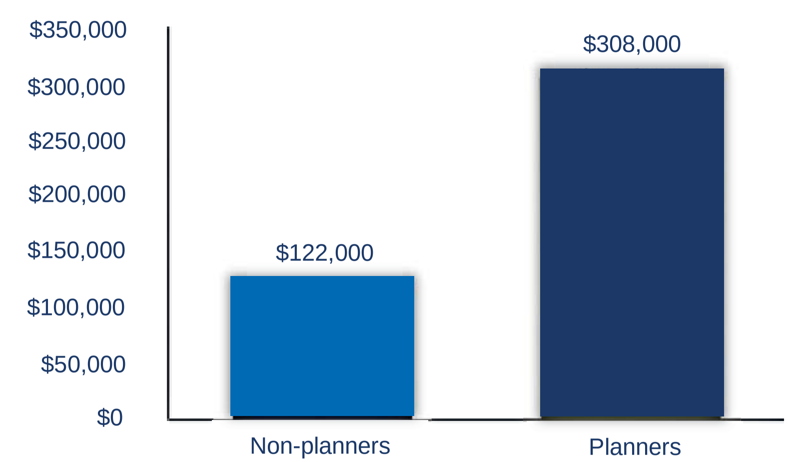
- What happens when households discontinue their financial advice assistance to branch on their own? This proves to be a costly decision.
  - Between 2010 and 2014, households that have discontinued the financial advice service had accumulated 45 percent less asset value than was the case for those who retained a financial adviser.[8]

Financial Advice and Wealth Accumulation

United States

- The evidence based on the extensive database of the U.S. National Longitudinal Survey of Youth shows that financial advice has a strong positive impact on net worth and retirement savings (controlling for income earned in prior 14 years).[9]
- Households that used a financial adviser:
  - Were 5 times more likely to have calculated their retirement needs, a key factor associated with much improved wealth holdings;
  - …and who knew their retirement needs saved significantly more than households without a plan and **"generated more than 50 percent greater savings than those who estimated retirement needs on their own without the help of a planner."**[10]

Retirement planning and wealth holdings



Median Net Worth, 2004 US HRS, age 51-56 [11]

Financial Advice and Wealth Accumulation

- Individuals who work with a financial adviser are more likely to have a plan for retirement and stick to it, more likely to feel confident about their retirement preparations, and more likely to have retirement goals. This explains, in part, why:
  - Financial advice has a strong positive impact on wealth accumulation,
  - The positive impact grows with the duration of financial advice assistance, and
  - Households feel much more secure with respect to their financial situation.
- Studies that seek to determine the value of advice by comparing the performance of mutual funds sold by advisers to market indexes are misdirected. These studies generally:
  - Posit that the value of advice stems from superior "stock picking" and "market timing" that would out-perform the market. In efficient markets, this cannot consistently be the case.
  - Lack specific data on financial advisory portfolios which prevents them from quantifying the net investment results achieved by advised clients.
  - Do not account for the value of the emotional benefits stemming from the satisfaction and security of having and following a savings and wealth accumulation plan and the value of psychic costs mitigation, such as reduced anxiety over investment performance or retirement preparedness.

Financial Advice and Wealth Accumulation

- Financial anxiety is the number one source of stress.
  - In Canada and the U.S.A., more than 70 percent of adults "feel stressed about money at least some of the time".
  - Half of the people stressed over financial matters acknowledge that it distracts them at work. Leading to disengagement, higher absenteeism and lack of productivity.[12]
- Research reveals that:
  - "Controlling for all other explanatory variables, having a financial adviser increases the probability of a respondent declaring confidence in achieving a comfortable retirement by more than 13 percent relative to a non-advised respondent."[13]
  - Employees who engage with a financial adviser have a significantly higher overall sense of financial well-being[14] and are more likely to experience positive emotions about their finances.

Individual emotional state vis-à-vis ones' financial situation[15]

	Advice	No Advice
Informed	64%	39%
Relieved	52%	30%
Calm	60%	35%
Confident	61%	37%
Optimistic	63%	41%

Financial Advice and Wealth Accumulation

"The essential difference between emotion and reason is that emotion leads to action while reason leads to conclusions."

-Donald Calne, Neurologist

Within Reason Rationality and Human Behavior

"Clearly, financial consumers are ill-equipped to face their ever-increasing responsibilities. Surveys conducted in OECD countries and some non-OECD economies show that not only do consumers have low levels of financial literacy preventing them from making good and informed financial decisions, but they also often overestimate their financial skills, knowledge and awareness."[16]

Financial Advice and Wealth Accumulation

- The complexity of the decisions to establish the amount of savings and the investment practices required to ensure adequate retirement income increases the likelihood that behavioral factors influence retirement wealth accumulation.
- Individual investors are hindered by innate proclivities and limitations when investing on their own. Many:
  - Lack the numeracy skills and financial sophistication to navigate the increasingly complex financial markets;
  - Are constrained in the time they can or want to allocate to household finances;
  - Over estimate their financial knowledge and investment savvy;
  - Are hampered by pervasive behavioral biases, their financial decisions being influenced by heuristics, psychological proclivities and emotion coping mechanisms that generally lead to welfare-reducing decisions;
  - Are prone to "reckless conservatism", reluctant to take the investment risk needed to achieve at least their long-term saving goals.
- Evidence from 13 countries shows that financial literacy affects retirement planning and the causality goes from literacy to planning.[17]

Financial Advice and Wealth Accumulation

- Planning effectively for retirement requires making long-range planning decisions, which by their very nature, offer feedback at low frequencies.
- Psychologists tell us that in order to learn from experience, two ingredients are necessary: frequent practice and immediate feedback.
- Without the benefits of feedback on the long-term impact of their saving and investment decisions, households lose the opportunity to learn and hone their skills through repeated actions.
- Consequently, professional advice concerning saving and investment decisions takes critical importance.

"Because investors are willing to trade-off broker services and after-fee returns, it is welfare reducing to move investors with a revealed preference for interacting with brokers to lower-fee funds in the direct channel that lack these services."[18]

The Peculiar Economic Nature of Financial Advice

- Financial advice is a "credence good". It differs from consumer goods and services because:
  - The benefits are abstract and delayed in time;
  - Consumers are unable to assess with confidence the quality of the advice and the reasonableness of the cost of the services they received, even after repeated purchases: How does an investor distinguish "actively doing nothing" from "failing to do something"?
  - Confronted with this uncertain outcome, a large proportion of individuals will shun financial advice if they are required to pay up-front for a service they fail to understand the value.[19]
- The economic characteristics of credence goods have strong consequences on the optimal structure of the financial advice industry and market dynamics.

❑ On the supply side:

  - The bundling of fees with the financial products encourages the development of a diverse horizontal industry structure where manufacturers distribute their financial products through unrelated financial intermediaries, thus promoting market transparency, competition at both the product and distribution levels and a focus on investment performance; and,
  - Circumvents the main resistance of a large segment of households to invest through the advice channel thus promoting a larger access to financial advice

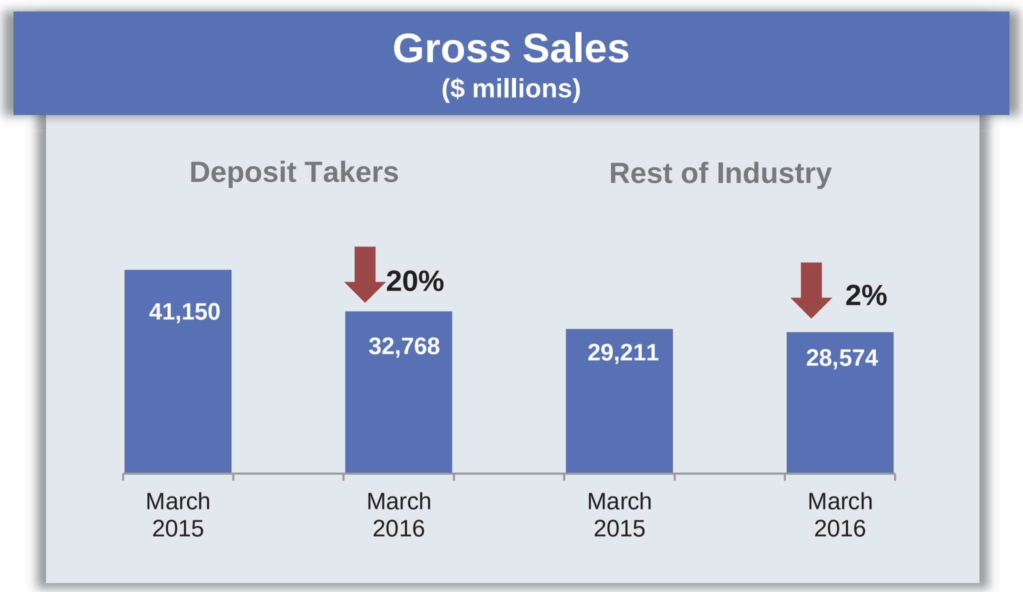
❑ On the demand side:

  - Recognition of investor reluctance to pay upfront fees for financial advice is a recurring theme of recent major policy reviews and surveys in Australia, Canada, Europe, New Zealand, Sweden and Singapore.

The Peculiar Economic Nature of Financial Advice

- The Supply Side

- Unbundling fees by regulatory fiat will have consequential perverse effects on the Canadian retail market for financial advice. Such a policy:
  - Promotes the accentuation of the vertical structure and would accentuate the concentration of the Canadian financial industry; and,
  - Severely hinders the financial viability of a horizontal financial advice industry structure.
- A vertical setting has a powerful influence on fund flows:
  - Limits the breadth of advice since financial advisers tent to recommend in-house products as a matter of course. Empirical evidence suggests that funds sold through affiliated dealers perform worse.
  - Tendency to privilege bank deposits rather than higher yielding financial assets. Currently, one-third of financial wealth of Canadian households is held in deposits. Basel III incentivizes sale of daily interest accounts and GICs by deposit takers to manage capital requirements.



The Peculiar Economic Nature of Financial Advice

- The Demand Side

Household surveys

- Household surveys show that only 34 percent of American households[20] and 30 percent of Canadians 35+ invest with an adviser:[21]
- Why do households abstain from seeking professional financial advice?
  - 48 percent of respondents say they do not know which sources of financial advice to trust.
  - 40 percent of respondents think that financial advice is too expensive.
  - 33 percent report that they do not have time to meet with an adviser.
- Experimental studies find that:
  - Only 65 percent of respondents opt for advice in making financial decisions, even when it is costless.
  - About 66 percent of respondents say they would only follow the advice if it was in line with their own ideas, and
  - Unsolicited advice has no effect on investment behavior.[22]

The Peculiar Economic Nature of Financial Advice
- The Demand Side

- Given the inability of individual investors to ascertain whether or not a recommendation is the best in the circumstances, trust becomes the key determinant of the propensity to seek professional advice and plays an essential role in client-adviser relationships and financial decision-making. Empirical results show that:
  - Investors cite "trust" as the most important determinant in seeking a financial adviser.[23]
  - Individual investors are generally risk adverse. The evidence shows that households with lower financial capability need to trust their financial adviser in order to invest in risky assets.[24]
  - Comparisons of the attitudes of individual investors who have or do not have a financial adviser show that having a financial adviser increases dramatically:
    i. the trust towards a financial adviser (about 30 percent more likely than a similar non-advised respondents);
    ii. the confidence levels towards financial advisers (70.8 percent have high confidence versus 31.2 percent for non-advised respondents;
    iii. significantly increases the investor’s confidence that he or she will have enough money to retire comfortably.[25]
- Survey data reveals that financial trust measures an underlying construct that is distinct from financial literacy and risk tolerance that affect financial behavior.

The Peculiar Economic Nature of Financial Advice

- The Demand Side

- To be successful, financial advisory services must take the form of a relational exchange imbued with a high degree of contextual understanding, not the transaction form implicit in the CSA analyses.

- Compared to transaction exchanges, relation exchanges have "a longer duration, a higher degree of contextual understanding and a stronger ingredient of trust, loyalty and cooperation."

- Empirical results show that these particular qualities of relational exchanges generally characterize the relationship between financial advisers and their retail clients:

- The value of financial advice cannot be explained by asset performance alone. It stems from its ability to counterbalance human idiosyncrasie which needs to rest on a relational exchange to be effective:
  - By instilling and encouraging more disciplined savings and investment behavior and better balanced and diversified portfolios.
  - A large body of evidence shows that the capacity to plan for retirement is strongly associated with financial literacy and sophistication[26] and closely tied to working with an adviser.[27]
  - This conclusion is confirmed by the results of consumer surveys that report that large majority of investors (82 percent) credit their financial adviser with helping them achieve savings and investment habits.[28]

The Principal-Agent Conundrum

- There is no denying that the principal-agent relationship between a financial adviser and his clients expose them to both adverse selection and moral hazards.
- Several academic studies suggest that concerns about commission-based pricing may be overstated and not as problematic an issue as asserted by the CSA.
  - An analysis of a sample of 12,000 individual investment accounts for a 34-month period at a large retail German bank, leads to the conclusion that the "empirical evidence is broadly in line with honest financial advice." [29]
  - Using detailed data on Canadian financial advisers and their clients, the study shows that conflicted behavior is limited to a small fraction of advisers. Most advisers invest their personal portfolios just like they advise their clients, in line with their beliefs about their investment choices and own practices.[30]
  - A rigorous examination of the investment portfolios of Canadian households at three large Canadian financial institutions found that the composition of the advisers' portfolio "is far and away the strongest predictor of the risk taken in their client's portfolios even after controlling for advisor and client characteristics." [31]
  - A study of 401k plans in the United States reaches a similar conclusion: the composition of client 401k plans was similar to their financial adviser's plan. [32]
- These results suggest that most advisers give the advice they give not because of conflicts of interest, but because they personally believe that their recommendations will outperform other options, as evidenced by the fact that they – themselves – acquire the same financial products for their own portfolio.

Conclusions and Policy Implications

- While market risks and the moral hazard inherent to the principal-agent relationship are real, non-participation in financial markets and poor investor savings practices and investment decision-making have much larger negative impact on household wealth accumulation and society, in general.
- The Conference Board of Canada simulated the economic impact over the long term of a scenario whereby 10 percent of Canadians without a financial adviser obtained financial advice and adopted the saving pattern of presently "advised" investors.[33] The results are to the effect that:
  - Five years after the increase in the advised population, real GDP and real disposable income are augmented, "business investment is boosted" and potential output is higher over the long-term, representing a permanent increase in income and profits in the economy.
  - Would cause annual household net savings in 2025 to be $812 million larger than in 2014, the base year.

> *"The government is not going to introduce a general ban against third party remuneration nor ban commission-led sales of financial advice and products. The ambition is to reach a balanced solution, which supports good advice to customers at the same time that household needs to access financial services are met in a good way."*
>
> Per Bolund
> Sweden Minister of Financial Markets and Consumer Affairs
> May2016

Conclusions and Policy Implications

- In the Canadian environment, there is no evidence that adoption of a mandatory unbundling policy will:
  - Bring about the desired change in behavior;
  - Broaden access to financial advice;
  - Reduce or contain the cost of financial advice and, more generally,
  - Help Canadians accumulate more wealth than would be the case otherwise; and,
  - Assist retirees make an efficient draw-down of their wealth.
- Accordingly, the CSA's policies for the regulation of retail financial advice should aim at:
  - Emphasizing the need for the financial advice industry to achieve and maintain high levels of competencies and trust in the quality of its services, a key determinant of the demand for professional financial advice.
  - Promoting easy and affordable access to professional financial advice by individual investors on terms that meet their expressed preferences.
  - Strengthening consumer protection through full cost disclosure and timely performance reports to individual clients.
  - Encouraging competition within the industry and market efficiency through the promotion of industry-wide price transparency.

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Thank you

About Pierre Lortie

Pierre Lortie is a Senior Business Advisor at Dentons LLP. He is a Director of Groupe Canam, ECN Capital and Executive Chairman of the Board of Quest Rare Minerals Ltd.

Pierre is a Governor of the Council of Canadian Academies, a Director of the Canadian Academy of Engineering and of several scientific research and not-for-profit organizations.

Pierre combines senior business and government experience. A former President and COO of Bombardier Capital, Bombardier Aerospace, Regional Aircraft, Bombardier International and Bombardier Transportation. He is also a former Chairman, President and CEO of Provigo Inc, President and CEO of the Montréal Stock Exchange and Senior Partner of SECOR Inc.

Mr. Lortie received an M.B.A. with honours from the University of Chicago, a license in applied economics from the Université Louvain in Belgium, and a Bachelor's degree in applied sciences (engineering physics) from Université Laval. He was awarded a Doctorate Honoris Causa in civil law from Bishop's University. He was elected Fellow of the Canadian Academy of Engineering in 1988 and appointed Member of the Order of Canada in 2001.

Pierre has several publications on financial regulatory matters to his credit.

The Canadian Advocacy Council for Canadian CFA Institute Societies
ADVOCATING THE CFA INSTITUTE'S CODE OF ETHICS AND STANDARDS

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (the "Consultation Paper")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the **CAC**) appreciates the opportunity to provide the following comments on the Consultation Paper. We support the intent of the Consultation Paper on discontinuing embedded commissions to the extent that such measure reduces conflicts, improves disclosure of adviser fees and compensation and puts investor interests at the forefront of our capital markets.

[1] The CAC represents more than 15,000 Canadian members of the CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 135,000 members in 151 countries and territories, including 128,000 CFA charterholders, and 145 member societies. For more information, visit www.cfainstitute.org.

Part 1: Introduction

We generally support the proposals in the Consultation Paper which appear to be evidence-driven as a result of thoroughly studying embedded commissions and making appropriate recommendations based on the research data. It is important that the CSA set finite periods for determining next steps in implementation. In implementing these proposals, we believe that addressing conflicts of interest, improving disclosure of fees, and focusing on the end investor's interest at all times, are paramount. Going forward, further education of advisers relating to disclosure to clients of the total cost of investments, not solely adviser pay, may also be warranted.

In our view, an orderly and measured transition period is particularly significant to minimize product and fee arbitrage. Finally, it is important that enforcement measures for non-embedded commissions are effective and promote sound practices.

Part 2: Key Investor Protection and Market Efficiency Issues Raised by Mutual Fund Fees and Related Evidence

1. Do you agree with the issues described in this Part? Why or why not?

We are generally in agreement with the issues described in Part 2. As holders of the CFA designation, we commit ourselves to maintaining the highest standard of ethical judgement. Conflicts of interest, conflicts arising in an agency relationship and prioritizing the interests of the client ahead of oneself, are all ethical concepts specifically addressed within our code of ethics.

In a rational market, economic incentives drive behaviour. The financial industry would benefit from a structure of economic incentives that promotes transparent, simple fee structures, full attribution of all costs to the end investor related to their financial advice, and a structure that promotes competition in the distribution of investment fund products to investors.

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

Based on the data cited in the Consultation Paper, fee structures are difficult for investors to understand. Asymmetries in knowledge between a financial representative and an investor may exacerbate this problem and can lead to agency conflicts (as found in the research conducted by Brondesbury Group).

Whenever possible at the point of sale, fees ought to be presented in dollar value rather than percentages (e.g. $1,000 for every $100,000 invested vs. 1%). The cumulative impact of compounded fee structures (e.g. DSC) should also be illustrated to the investor along with the difference between returns net of fees and returns gross of fees. When the cost of advice is embedded in, and deducted from, the value of the portfolio, the conversation about fees with the investor at the point of sale (including the impact of fees on returns over time) is often not as encompassing as it ought to be. Research suggests that the size of embedded commission is not proportional to investor outcomes or the degree of advice provided, and often financial advice is only given at the point of sale (Stephen Foerster et al). In addition, products structured with deferred sales charge (DSC) may cause other unintended consequences in portfolio management such as holding DSC products longer than intended due to the avoidance of penalty fees on redemption. In the same vein, investors may also stay with underperforming managers longer than intended in order to avoid penalty charges at redemption (Douglas Cummings et al).

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

Access to financial advice is important for investors in our capital markets. We believe that regulators should not attempt to set prices for the cost of this advice. Nevertheless, the advice given ought to prioritize and focus on the best interest of the client. In the current structure, the best interest of the client is often in direct conflict with the adviser's compensation structure. In fact, to the extent that embedded commissions make up a material fraction of an adviser's compensation, the current incentive structure can actually penalize the adviser for acting in their client's best interest. We think that better alignment of interests of the adviser and the client would facilitate more optimal outcomes for everyone in the industry. In instances where conflicts exist, the client's interest ought to be placed ahead of the adviser, without exception.

Furthermore, we think the argument raised by the mutual fund industry on access to advice has not been validated through research or empirical evidence to date. We think that any advice gap created by anticipated regulatory change is first and foremost a transitory issue that could effectively be dealt with through timelines on implementation of the proposed changes that allow new and existing business models to emerge and respond to a new compensation scheme for the industry.

There are some limited benefits to the current system, mostly surrounding the negotiation (relating to competitive knowledge of the fee marketplace), and operational aspects of collection and payment of client funds to investment intermediaries (salespeople, fund distributors etc.). However, we believe these benefits are small and are outweighed by the disadvantages to investors on embedded commissions. Generally, there is a systemic need to raise the standard of care for representatives, and to align their compensation with the pursuit of investor goals.

Part 3: Overview of the Proposed Option to Discontinue Embedded Compensation

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**

- **structured note**

should the product be subject to the discontinuation of embedded commissions? If not:

> **a. What would be the policy rationale for excluding it?**
> **b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?**

For each of these three products, we believe embedded commissions should be discontinued "across the board" to avoid regulatory arbitrage between those sold without embedded commissions vs. products sold with embedded commissions. To the extent possible and if enacted, we would encourage the CSA to work with their CCIR colleagues to harmonize regulation, disclosure and implementation timelines to minimize or eliminate the potential for regulatory arbitrage for products under the insurance regulatory regime (i.e. segregated funds).

Irrespective of whether the proposed investment product is subject to a prospectus or prospectus exemption, products with a similar investment purpose and similar investor target market ought to be subject to similar regulations and disclosure of fees and related sales commissions in order to prevent regulatory arbitrage. This ought to be the case despite any differences in terms of how the investment strategy of these products is ultimately offered and packaged to clients.

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

To our knowledge, there are no types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions. Nevertheless, given that we are not a manufacturer or distributor of any of the listed products, we acknowledge that there may be scenarios or types of products which may warrant consideration for exceptions. If such exceptions are warranted, we would encourage that the bar to permit such exceptions be set very high, if at all permitted.

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

As discussed in our response to question 4, we would encourage the CSA to work with their CCIR colleagues to ensure that regulatory arbitrage does not occur between those products covered by the securities regime and those covered by the insurance regime.

We would further encourage the CSA to examine the sale of investment fund-like products such as products offered by Mortgage Investment Corporations, private equity funds, venture capital funds, and other investment vehicles that fall outside the scope of products considered in this Consultation Paper, and consider whether the dealer and representative compensation regime proposed in the Consultation Paper should be further extended to include the above-mentioned investment fund-like products.

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

We generally agree with the CSA's proposed approach discontinuing all payments made by persons or companies other than those from the investor. However, among our membership it was highlighted with concern that the transition issues are complex in particular relating to existing multi-year compensation agreements. Accordingly, we would encourage flexibility as it relates to transition periods and mechanisms. A possible suggestion and effective transition mechanism would be proposing to investors for their consent an economically equivalent payment to their existing compensation scheme. We would also like to highlight that enhanced disclosure and fee transparency can be an effective tool in mitigating some existing conflicts during transition periods.

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

> **a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;**
> **b. referral fees; and**
> **c. underwriting commissions.**

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

We do not believe that such fees or payments should necessarily be discontinued, but improved disclosure and enforcement efforts should be used as tools to mitigate against any attempts at regulatory arbitrage in these areas. We would encourage the CSA to holistically review fees and payments in these areas at regular intervals for further regulatory action, should efforts at regulatory arbitrage proliferate.

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

Instead of identifying particular types of payments and benefits, any cost to the fund (and therefore the investor) that is outside the scope of the direct investment decision-making process, or is not incurred in the course of direct management of the fund, should be disclosed to the investor ex-ante, prominently and in plain language. We favour a principles-based approach over a rules-based approach in this regard relating to specific types of payments or non-monetary benefits. In our view, it is the intent of the payment or benefit that matters rather than their particular classification. We are generally not in favour of caps on these types of payments or benefits, but believe that improved transparency is helpful in understanding the total the cost of advice.

10. With respect to internal transfer payments:

- *How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?*

  We believe neither the current regime nor the proposed regime are entirely sufficient in this area. Internal transfers/payments that are similar in substance to non-investor paid ongoing compensation arrangements ought to be regulated in the same manner as any referral fee, requiring investor disclosure and consent.

  To the extent that any payment is being made within an integrated financial service provider that is tied to an investor's purchase or continued ownership of the fund, the payment ought to be budgeted, disclosed up front, and consent must be received from the investor at the point of sale. Generally, any payment made by any means that is not directly attributed to the investment decision-making process ought to be fully disclosed and attributed up front such that the total cost of advice is transparent and better understood by the investor.

- *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*

  While we cannot comment on the extent to which these payments occur beyond the data presented in Part 4 (see footnote 50 of the Consultation Paper) as we are neither a manufacturer nor a distributor of the considered products, we believe that payments that are substantively similar to those that are being discontinued in a non-integrated distributor-manufacturer arrangement should also be discontinued in an integrated context to ensure consistent and fair competitive dynamics and investor choice. To the extent a payment is substantively similar to a referral fee, it should be disclosed and consent must be received by the investor.

  In sum, we believe that all payments or incentives inside integrated financial services complexes should be regulated in the same manner as substantially similar payments or incentives made between non-integrated manufacturers and distributors, and their representatives respectively. Given that so much of the market is served by integrated financial service providers (see market share data in Part 4), this should be given a high degree of consideration and transition issues related to it should be fully and thoughtfully explored. Irrespective of the type of financial institution that an investor chooses to deal with, and irrespective of the channel that an investor deals through, the total cost of advice should be clear and consented to by the investor at the time the investment is made.

- *Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?*

  As we are neither a manufacturer nor a distributor of the covered investment products, we have no unique insight in response to this question.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

We are in favour of allowing investment fund managers to facilitate the collection of dealer compensation so long as it is clearly attributed, disclosed and agreed with the investor at the point of sale. We view this as a critical measure to ensure a successful transition to a new compensation regime in the industry. Nevertheless, we would also highlight that the transition to a new compensation regime does not come with insubstantial operational challenges for both investment fund managers and their service providers (i.e. custodians). Without this allowance, it may be impractical and overly burdensome to require all investors to pay all fees out of uninvested cash. Further, full transparency and attribution of all of the components of financial advice would facilitate better comparability across investment products and may lead to more competition, lower costs, and provide more efficient outcomes for investors.

Part 4: Regulatory Impact

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

The magnitude of the remarkable evidence gathered in the Consultation Paper provides hard-to-ignore evidence that sheds light on clear challenges in the current regime of embedded commission, inherent conflicts and a lack of investor awareness. Similar to the evidence provided in Part 2 of the Consultation Paper, the recent global study conducted by the CFA Institute on trust and loyalty corroborates the importance of fee disclosure. In particular, this study indicated that retail investors identified disclosure of fees and costs as the biggest attribute to working with an investment firm. Accordingly, clear and transparent disclosure of fees is critical for investment managers to deepen the trust with investors and articulate their value proposition.

Considering the evidence gathered in the Consultation Paper, it is clear that the CSA is aware of the experiences and consequences from foreign jurisdictions relating to a ban on embedded commission. In our review, the biggest area of uncertainty surrounds the

Canadian retail investor with less than $100,000 in financial assets. In our view, the propensity of this market segment to embrace a direct pay model should be surveyed and studied in advance of a complete ban on embedded commissions.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

We see three potential alternatives to the ban on embedded commissions:

1. Simplify fund fee and series structure

   We agree with the observation that the number of series and sales charges creates confusion for all industry participants. Currently mutual funds are sold under one of three types of sales charges: no-load, front-end load and back-end load. The front-end load and back-end load service charges could be banned leaving no-load service charges as the only option permitted. Similarly, the fund series structure should be simplified. In our view, only Series D (for DIY investor), Series F (for investors who prefer advice by a financial adviser) and Series A (for investors who rely on advice from banks, insurers and other large firms) could remain under such a change. For each of these series, the disclosures should clearly indicate all of the components of a management expense ratio (MER) including the management fee (both the investment management and trailing commission percentages), operating expenses and taxes.

2. Registrant Avenue

   Another alternative to the ban on embedded commissions is to allow them to continue while aiming to avoid conflicts and improve fee disclosure by creating a more clear differentiation between advisers and salespeople. For example, commission-based individuals who do not provide ongoing advice will serve as 'salespeople' while 'advisers' who truly help investors can be registered as advisers. This would be another approach to helping investors understand that the advice they are receiving is impacted by conflicts.

3. Enhanced disclosure – CRM2

   While CRM2 has taken a step in the right direction at informing investors on fees and costs associated with their investments, there are material elements of fee disclosure, i.e. MERs and TERs that are still missing from the investor's purview. This lack of transparency is a contributing factor to furthering conflicts. By requiring product manufacturers to comprehensively disclose all costs, for example, the amounts paid to dealers, regulators can enable investors to seek answers as to whether a riskier recommended fund has higher fees associated with it.

   With all of the above options considered, we still believe that a combination of discontinuing embedded compensation in its current form alongside implementation of targeted market reforms considered in other ongoing CSA projects is the best regulatory response available.

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

As outlined in the Consultation Paper, the current embedded fees can raise conflicts of interest. At the same time, the fees generated are typically predictable and are aimed at portfolio management with less active trading. In a direct pay arrangement, there may be incentives for generating higher fees by way of higher account activity or portfolio turnover. However, the issue of excessive portfolio turnover may be addressed under the current suitability requirements under securities law. As mentioned previously, transfer payments inside integrated manufacturer-dealer arrangements should also be closely watched such that they do not resemble existing embedded compensation arrangements.

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- *Will investors receive advice and financial services that are more aligned with the fees they pay?*

  Yes. With the removal of embedded commissions, investors will become aware of their options and be able to define the experience they want to have with their advisers. In the current environment of embedded commissions, one of the problems is that some investors will never become aware of the type of service they receive, what is paid for that service, and the comparative costs of alternatives.

- *What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?*

  The market segment defined as having less than $100,000 in financial assets is likely to see automated advice as a more attractive and cost effective option. It is certainly a new and viable option that was not available a few years ago. The choice of automated versus non-automated advice is certainly positive. However, the extent of this benefit is hard to quantify as the market segment is relatively small and developing at this time in comparison to traditional advice channels.

- *Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?*

  Similar to other jurisdictions, moving away from embedded commissions will lead to a shift towards discretionary advice in our view. At the bare minimum, this will help clarify the roles and responsibilities of professional advisers and ensure that consumers of financial services are better positioned to trust their financial service provider. As indicated in the 2016 CFA Institute Edelman Trust Barometer, consumers place less trust in the financial services industry when compared to the trust they place in the pharmaceutical and energy sectors.

- *What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*

  Similar to the point raised above, the change will help clarify the true intention and need of investors. Investors who truly want advice will seek investment managers, and investors who wish to take more responsibility will gravitate towards discount brokerage channels. Today, clients have a choice to use discount brokerage and purchase Series D mutual funds. The fact that this form of fund distribution has not garnered great attention or assets is a testament to the reality that most clients rely on investment advice from their advisers and do not have the skills or time for do-it-yourself investing.

- *What effect will the proposal have on the cost and scope of advice provided to specific investor segments?*

  In Canada, the embedded commission model has provided some consistency and uniformity to the marketplace, with the majority of trailing fees reported between 0.5% and 1.0%. It is not entirely evident how individual dealers will choose to charge clients in a regime post-ban. When reviewing the UK experience, it is clear that fees will increase, and more specifically increase for the less affluent investors whose costs of servicing are subsidized by embedded commissions. The following citation is taken from the "*Financial Advice Market Review, Final Report*" conducted by the Financial Conduct Authority published in March 2016:

  > "Respondents to the Call for Input also indicated that low levels of consumer demand for advice were contributing to the advice gap. The Review has concluded that such low demand is driven by several factors. These include high costs (especially relative to small amounts available to invest), limited confidence in engaging with financial issues, and a lack of trust following past instances of mis-selling".

  The proposed ban on embedded commissions is unlikely to materially affect costs for the investor segments with more than $100,000 in financial assets. However, the investor segment with less than $100,000 in financial assets may potentially face higher costs as they may not have sufficient assets to take advantage of ongoing advice under the assets under management fee model. As a result, consumers seeking support through guidance or limited forms of advice are either unable to or end up paying the cost of full advice even when their needs are comparatively simple. Additionally, the costs of supplying face-to-face advice are significant, meaning most firms are unable to provide advice at a price many consumers in this segment would consider reasonable. As a result, many consumers who want to receive this kind of support are left without it unless they are able and willing to pay for advice.

We encourage the CSA to allow sufficient transition time to assess the potential consequences of these changes on the less affluent segment of the market as the expectation for these participants to readily shift to discount brokerage or robo-advisory services may not be entirely prudent. Choices exist for the less affluent investor segments in the current competitive environment and mutual funds are currently the most widely accessible investment option for investors. We must ensure that advice remains accessible to those investors who choose to pursue it across wealth/investable asset segments.

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- *Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?*

  See comments below.

17. Do you think this proposal will lead to an advice gap? In particular:

- *Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.*

  The concept of an advice gap is not unique to investment management; the economic reality that those with more means can access better services and products is unavoidable. As well, it is inherently difficult to predict the long-term impact of discontinuing embedded commissions on households and how specifically that will occur.

  We do see a number of problems with the advice gap as a concept:

  First, the argument that a ban on embedded commissions will give rise to an advice gap begins with the premise that if people became aware of what they were paying for advice then they would change their behaviour. If that is indeed the case, then one must consequentially take the view that the current levels of transparency must be woefully inadequate.

  Second, the argument that a ban on embedded commissions will give rise to an advice gap further implies that if people were not prepared to pay for advice then they would be worse off. This raises an interesting question whether people can be relied upon to make good decisions when it comes to retaining advice. People deal with this trade-off in other financial aspects for example in the context of retaining lawyers and accountants who commonly charge for their services on an invoiced basis. Our suspicion is that the public is capable to handle this trade-off.

  Finally, if we were to lose our confidence in the public and believe, for the sake of argument, that people cannot be relied upon to make their own assessment on whether they need financial advice, that is the point where the advice gap argument falls apart. If the advice gap argument is used in the furtherance of an embedded commission advice regime, then one effectively holds the view that concealing information from people receiving advice is an appropriate means of compelling them to subscribe to the advisor's services. For this point and the foregoing, we find the advisory gap argument fundamentally flawed.

- *Do you agree with our definition of an advice gap?*

  We found the following definition of an advice gap:

  > "For clarity, the advice gap refers to those individuals in the U.K. who are unable, or perhaps unwilling, to pay for financial advice…The advice gap represents a huge level of consumer disenfranchisement from access to finance advice".
  > Pirker, Wall & Alte Group, "*Digital Wealth Management: Pursuit of the U.K.'s Advice Gap Heats Up*"(2017) at p. 10.

  While we believe this definition to be useful, we would point out that there is a material difference between being unable and unwilling to pay for advice. We would suggest that regulators concern themselves with the segment of the market that is unable to pay for advice much more than the segment of the market that is unwilling to pay for advice.

- *Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?*

  While it is understood that multiple channels may be impacted differently, our view is that the advice gap should be considered across multiple channels for advice in the aggregate. This is the most flexible interpretation that will allow new lower-cost advice models to emerge for underserved segments under a new regime.

- *What types of advice or services currently provided today would be most affected by the proposal?*

  The advice for retail and less-affluent investors will be affected most. There is a concern that those market segments will have less advice available under the new regime.

- *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*

  The proposals in the Consultation Paper share a common intent to increase transparency and allow better alignment between the advice fee and the scope and intent of that advice. Accordingly, the CAC is supportive of all three of the cited proposals.

We do feel that a discontinuation of embedded commissions complements well the transparency brought by CRM2 and the client expectations gap bridged by CSA Consultation Paper 33-404. The distinction drawn between "dealer" and "manufacturer" components of CRM2 appear to be causing some confusion in the market-place and some critics of the proposed best interest standard indicate that it may increase investors' trust in advisors who may not have interests aligned to handle the conflicts when selling embedded commission products. In both of these specific cases, removing embedded commissions would be of great help.

- *How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?*

  Our view is that an advice gap may emerge irrespective of payment mechanisms and certain clients will choose to self-serve to the extent that they can save on cost. There is a greater need to be open and transparent in the marketplace for financial services in order to ensure that clients determine for themselves whether they are receiving value from their advisors. In our view, conflicts in advice undermine the value of that advice. We anticipate that clients may place higher value in advice received in an advisory regime free of the conflicts that embedded commissions present.

  If a ban on embedded commissions leads to an advice gap in Canada, this gap could be mitigated by allowing a transitionary period for the affected consumers of financial service gaps to identify best alternatives. Similarly, financial service providers could also seek to find innovative fee or business model solutions during such a transition period.

- *Do you think that online advice could mitigate an advice gap? If so, how?*

  Online advice, and technology more broadly, could be a potential source of a lower cost alternative that meets clients' needs. This alternative remains in its early stages and pressure on in-person advisors raises the importance of getting the regulatory framework that oversees these types of services right in ensuring desirable client outcomes.

  Currently, there are some reduced trailer fee series of funds to lower-touch advisers, which may not provide investment recommendations or advice to clients, but provide other services including, online and phone access, transition capability, custody, account statements, tax reporting and access to investment research.

- *Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an* *advice gap to develop?*

The concentration of market share by major financial institutions in Canada could affect the "advice gap" in different ways and it is difficult to predict whether these major financial institutions will use their scale to lower the cost of services and expand the client base they serve or whether a lack of competitive forces will contribute to an increasing advice gap. Our recommendation is to monitor the outcome of new regulations on trailer fees on an ongoing basis and consider adjustments as needed.

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

In the absence of regulatory action, we believe it is unlikely that embedded commissions will be discontinued altogether. In fact, it may be that some recent movement away from embedded commission models may be reversed as regulatory inaction implies a go-forward position that these types of commissions are an acceptable form of compensation. The ability to pay fees bundled within a product may continue to appeal to certain investors who are not sufficiently educated to understand that these embedded fees represent a drag on performance and a conflict as it relates to the advice that the investor receives.

- *Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?*

  Likely not. Based on the data provided, the distribution channels and the fee models are quite established and hard to change without regulatory rule changes. While a growing number of cost sensitive options are available to investors, the majority of investors are still holding their financial assets with deposit-taker or insurer-owned firms who have not materially shifted their service offering. Further, as indicated in the 2012 *Ipsos Canadian Financial Monitor* study, deposit-taker and insurer-owned fund dealers dominate fund distribution in Canada. Specifically, of the 37% of households that owned investment funds, 87% purchased their funds through a deposit-taker or insurer-owned firm. In addition, the percentage of investment funds with trailing commissions has increased from 25% to 64% between the period of 1996 and 2011.

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

- *Do you see payment options and business models evolving at present?*

  As stated above, if the demand for alternatives exists, new technologies and business models will adapt to address potential gaps in the marketplace.

- *How are they likely to change over time if the CSA were to choose not to move* *forward with the proposal?*

While the emergence of new technologies and lower-cost investment vehicles may change investor behaviour, investor advocates have highlighted the inherent conflicts of embedded commissions for more than two decades. In fact, front and back-end fee loads have increased 93% and 19% over the past five years. Clearly in the absence of regulatory action or its anticipation there is no incentive for increased transparency, simpler options, and lower fees.

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Similar to Australia, the main difference between Canada and other developed economies may be the strong presence and market share of Canadian deposit-taking and insurance owned dealers. These business models are quite established in Canada and a ban on embedded commissions may serve as a major disruption for this group. Further, we note that the fee-based purchase options have been limited for mid-market households in Canada although there are indications that access to these options is increasing, which would bring Canada closer to other markets in this respect.

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- *Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?*

The impact of a ban on embedded commissions will likely depend on the time allowed for transition. The likelihood for consolidation will also depend on the extent that deposit taking and insurance owned firms are willing to adapt and embrace the new proposal. Overall, as Canada is a fairly consolidated market already, we do not see a major reversal as being tied to the embedded commission question either way. However, we could see, with respect to consolidation of investor assets at certain types of firms, some incremental diversification as new fee models allow new business models to emerge.

We examined a number of other sources including the "*Financial Advice Market Review, Final Report*" conducted by the Financial Conduct Authority published in March 2016. The source noted that:

> "Adviser numbers have declined over recent years, for a range of reasons. This includes the introduction of the RDR which the FSA expected would prompt some advisers to leave the industry". In 2011 there were 40,000 advisers and

> in 2013 there were only 30,000. "The majority of advisers exiting the market during this period were those employed by the banks and building societies. There are a number of reasons for these exits, including declining profitability of branch-based distribution models, a lesser role for branch-based activity, anticipation of the RDR and the consequences of episodes of mass mis-selling. Banks, insurers and other large firms have however, traditionally been more likely to serve mass market customers with lower level of wealth." (p.18).

- *What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?*

  A ban on embedded commissions would likely enhance the efficiency of advisers in their role as "asset allocators" as client investment recommendations would be based primarily on fulfillment of investment goals and performance as opposed to being affected by the adviser's economics (i.e. varying embedded commission rates). This most likely outcome would be beneficial to market structure. This dynamic would benefit investors in receiving better and fairer outcomes with fewer conflicts to navigate. It is difficult to predict or assess whether the foregoing will lead to a broader industry consolidation.

- *What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups? o Independent dealers? o Independent fund manufacturers? o Integrated financial service providers? o Mutual fund dealers?*

  All dealers would be required to develop and implement a fee-based account platform as well as establish policies and mechanisms for collection of fees directly from client accounts. Currently, fee-based accounts are mainly offered by IIROC dealers. We believe this would be an expensive undertaking which could prove costly for some independent or smaller MFDA dealers. Accordingly, fee-based advisors may elevate the minimum account sizes required.

  Based on the "*Financial Advice Market Review Final Report*" published in March 2016 by the Financial Conduct Authority in the U.K.:

  > "Over the last two years, the proportion of firms who ask for a minimum portfolio of more than GBP 100,000 has more than doubled from around 13% in 2013 to 32% in 2015. The FCA's recent survey of advisers also support this, suggestion that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e., less than GBP 30,000). This means that it may be less cost-effective for individuals with small pot sizes to obtain

> advice. This will inevitably affect commercial decisions about whether to offer services to consumers with lower amounts to invest". The costs of providing advice include: expenditure on marketing to attract customers, direct costs, such as staff training, the cost of technology, insurance costs, the direct costs of providing advice in line with regulation and regulatory fees and levies" (p.19).

- *Online/discount brokers?*

  There is some concern that reducing the offerings to a direct fee-for-service model may create a disincentive for investors to choose the advice model, whether or not they have sufficient knowledge and experience to invest without advice, which could also lead to a reduction in saving rates over time. This would need to be monitored to ensure that the online/discount brokerage channel continues to serve client interests appropriately.

- *What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?*

  We are concerned about how investors and market participants respond to additional regulations for mutual funds that are not concurrently introduced for other financial products. We assume that it is not the CSA's intention to create a disincentive for investors to invest in mutual funds or for advisors to recommend them, although this will be the result if certain changes identified in the Consultation Paper were implemented. We are similarly concerned that regulatory arbitrage may occur in the insurance realm. Whatever action is ultimately taken should be coordinated to ensure that insurance advisors are required to uphold the same standards. Please see our earlier comments also on potential coordination with CCIR.

- *What would be the impact on dually-licensed mutual fund dealers and insurance agents?*

  As stated above, dually-licensed mutual fund dealers would face inherent conflicts exacerbating the low level of investor trust in the industry as found by CFA Institute's research on trust in the financial services industry. We would encourage the CSA to work with their CCIR colleagues to minimize the incentives for existing mutual fund assets to move into insurance products (i.e. segregated funds) with embedded commissions. The most effective blunting of these incentives would be a coordinated ban on embedded commission in those products as well.

- *Will the proposal lead new, lower-cost entrants to the market? Why and how?*

  As with any regulatory change, new market participants and business models will be created to take advantage of opportunities. For example, this is most apparent when looking at the growth of IIROC dealers who advise clients on investing in ETFs. Similarly, this is evident by the level of capital raised in lower fee investment options.

- *Does the interaction between this proposal and the proposals set out in CSA CP 33- 404 change your responses to the questions above and, if so, how?*

  Given that the regulatory objectives of the Consultation Paper are to "raise the bar on industry professionalism and bolster investor confidence", consideration for adding further layers of regulation should take into account the actual benefits that investors may experience in practice. In our view, the two proposals are complementary in nature. The opponents of the proposed best interest standard cite that it is difficult to ensure investor expectations are met for a best interest standard given that the conflicts that exist are difficult to manage under the framework. We believe that discontinuing embedded commissions should assuage these concerns and allow advisors to reconcile the standard to which they are held, that is, the best interest standard, with the investments that they select, free of influence of disparate commissions.

- *Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?*

  Yes, it will likely reduce fund series and fee complexity. We believe that the increased fee transparency brought with the CRM2 rules has already started to reduce fund series complexity. We believe that banning deferred service charges and front load fees would also bring the industry closer towards this goal, but prefer the principles-based approach of banning embedded commission altogether rather than a prescriptive rules-based alternative.

- *Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?*

  Integrated financial service providers are distinctly advantaged in their multiple roles as product manufacturers and product dealers by the flexibility they have to shift fee economics between different areas of their business to optimize their overall profitability. In recent times, we have seen financial service providers that play these multiple roles being advantaged over independent competitors as they have greater latitude to adjust their fee economics to best position themselves under enhanced disclosures (CRM2). We believe this is a very important consideration.

- *What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?*

  The rise in online advice remains in its infancy but could benefit from updating the framework within the industry to ensure that automated advisory services are making recommendations based on the merit of products they select for clients. The emergence and acceptance of online advisory service providers indicates that investors can reap the benefits of financial advice without always having a face-to-face interaction with a professional.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- *Is there any specific operational or technological impact that we should take into consideration?*

  This is an area that will require particular consideration should the proposal proceed. Some contemplated direct-pay arrangements will require back-office coordination for fee payment and communications where none exist today. This means operational and technology enhancements would be required. The transition lead-times of key service providers (i.e. custodians) in this area can be long and they should be consulted and brought into the transition process to ensure successful transition for the industry.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- *Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?*

  It is possible that the fund manager could reduce their compliance and oversight costs given the simpler structure that a single-class, non-embedded commission model would bring. It is difficult to anticipate the impact on dealers given that there is a broad spectrum of business models and compliance efforts underway in that channel.

- *To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?*

  Even under the fee-based arrangement, not all conflict concerns can be eliminated. We think that some control and oversight measures will still be needed.

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

A number of professional services firms (fee-for-service financial planners, lawyers, accountants, etc.) operate under a direct pay arrangement and are able to ensure a steady stream of revenue to operate effectively for their clients and generate sufficient profits to cover their own costs as business owners. Beyond the investment profession, many businesses operate successfully under a direct pay model.

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

As we are neither a manufacturer nor a distributer of mutual fund products, we have no unique insight to provide with respect to this question.

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:

- *career path;*

  Judging by the experience in other jurisdictions that banned embedded commission such as in the U.K., the number of representatives in existing advice channels could initially drop. Elimination of some jobs, especially within deposit-taking and insurance-owned dealers is certainly possible. However, we would point to the myriad of differences in Canada's financial marketplace as reasons that our experience here could be meaningfully different.

- *attractiveness of the job;*

  An industry of high ethical standards can only be considered more attractive by those who themselves uphold a high level of professional ethics.

- *typical profile of individuals attracted to the career;*

  We aspire and look up to a number of other professions (legal, accounting, etc.) that have brought respect and trust on themselves by seeking to raise standards to minimize conflict. In this regard, we could look forward to the continued "professionalization" of investment advice in Canada.

- *recruitment; and*

  Over time, the proposed transition could result in a shortage of knowledgeable individuals able to provide advice.

- *relative attractiveness of careers in competing financial service business lines.*

  It could prompt financial services firms to recruit new talent to serve clients who are willing to pay for advice. We are concerned about the non-level playing field that may surface between financial institutions if additional regulations for mutual funds are not concurrently introduced for other financial products.

Part 5: Mitigation Measures

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

- *access to advice for investors*

  Investors with few financial assets already have little access to advice so they will likely see minimal impact. Medium-sized investors might be the segment experiencing a bigger impact.

  Technology is a potential problem-solver, which works effectively when mapping unambiguous processes in digital algorithms. It is likely that complex situations will face a lot more ambiguity and might be difficult to implement in algorithms in the short-term. Mitigation measures should cover the transition period which is absent in the current proposal. With respect to automatic deductions from investors' portfolios (i.e. periodic withdrawals), such measures run the risk of becoming opaque if the funds do not flow through the investors' hands in a transparent manner, but this could be addressed through guidance.

  Developing and implementing new technologies may take more time for smaller firms who already have limited financial resources. In addition, the fixed costs of technology may increase for certain existing firms and become an increasing barrier to entry for new ones, thereby reducing competition in the industry.

- *choice of payment arrangements for all investor segments, and*

  Although we believe that market forces will prompt innovation in fee structure, mitigation measures could include disclosure of previous embedded fees for comparison purposes. While some investors might be surprised at the amount of fees they were paying, others may use that information to put a price on the value of advice they were receiving.

  Further, advisors may be tempted to move a client towards a form of payment arrangement that costs more to the client. For example, advisers may move a client to a fee-based account if the client trades rarely or to a commission-based model if the client trades frequently.

- *a level playing field amongst competing investment products?*

  We think that sufficient co-operation with other regulatory bodies (specifically CCIR in insurance) could limit the risks of regulatory arbitrage as previously discussed.

  The insurance industry must be subjected to equivalent regulations. Advisors are often dual registered as investment advisors and insurance brokers, and may be tempted to avoid the new regulations by moving their clients to segregated funds.

28. What other measures should the CSA consider to mitigate the above unintended consequences?

We think the emphasis on transition mechanisms is key to absorb the shock of the new rule and regain a state of equilibrium for the industry and investors. Regulators should consider allowing exemptions to certain rules in order to facilitate transition. For example, permitting transfer of client assets from one series of funds to another through a process of opting-out. In addition, providing flexibility to close a series or create a new series of funds i.e. Series D.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

- *Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.*

  It seems evident that in instances where investors have to sell units to pay for fees, there will be tax consequences. Moreover, these tax consequences may not be readily understood by investors or even potentially some advisors.

  If the new process involves selling a part of every fund held in order the pay the dealer compensation, clients may be disadvantaged as it would be preferable the sell the funds with less capital gains [or with a loss] and defer the sale of those with large capital gains. Further, many investors invest small amounts monthly which may cause capital loss if an investor buys a fund within 30-days of sale.

  Generally, this is an area in which additional transitional investigation should be undertaken by regulators.

- *To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?*

  We do not see how this could attract negative tax consequences for investors as a transfer between series is normally not a taxable event/transaction. Regulators should seek confirmation from the tax authorities in order to be certain prior to forcing clients into a transaction that could generate a negative tax consequence for them. Families of funds generally mention in their prospectuses that a transfer between series is not a taxable event but they also mention that they do not take responsibility if such transfer incurs adverse tax consequences.

- *What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?*

  As discussed above, regulators should seek an opinion from the tax authorities on this point and involve industry in solving for the transition issues presented.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower wealth investors in a fund further to a transition to direct pay arrangements,

- *to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;*

  We do not believe that the loss of the so-called 'cross-subsidies' would drive up the cost of providing advice in the long-run or overall. Firms are already aggressively segmenting clients by investable assets and any cross-subsidy that once existed has been in decline due to a focus on the most profitable client segments. In our view, this transition will drive innovation to serve more client segments appropriate to their needs. Nevertheless, during the transition period, investors and industry participants could face temporary shocks, which amplifies the need for appropriate transition measures and management. Although we are skeptical that all of the extra burden will be absorbed by the industry as they find ways to monetize smaller accounts, it is unlikely that clients will ultimately be cut loose by existing advisors and have difficulty finding affordable advice because of the high administrative costs associated with transitioning clients off an existing advisory platform.

  We take the view that high net worth clients will have more leverage in negotiating fees than less wealthy clients, similar to today under the existing regime. Nevertheless, it is not clear that less wealthy clients are necessarily going to pay more in a direct pay arrangements considering the transparency of this fee structure. Ultimately, the end result could be a temporary reduction in income for both manufacturers and dealers as business models adapt.

- *does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?);* and

  It seems that cross-subsidization is an artifact of an industry cost structure based on the profitability of accounts, with increasing profitability on higher-value accounts. It would be logical to think that in a negotiated direct fee arrangement, a high net worth investor would pay less per assets under management than a less wealthy investor and/or has access to more sophisticated advice. There is a fixed and variable component to the cost of providing advice in all cases, which varies across business models. The extent to which the costs perfectly align with services provided has to some degree been a business decision to this point, whereas in the future it could be more of a collaborative discussion between adviser and client in the transparent context of fees paid.

- *what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?*

  Some measures that could mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy include long and smooth transition periods and investor education, particularly relating to the costs of providing advice, both fixed and variable.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

Some measures that participants in the fund industry could proactively take include working on development of alternative business models, increasing innovation and bringing value to their clients, and investor education about the costs of providing advice and existing fees paid. Regulators could ease specific regulations in order to facilitate transition. Another suggestion would be for dealers to immediately cease selling DSC funds and those other products with the most opaque fee structures in favor of other types/series of funds, to assist the investor education conversation about cost of advice and existing fee levels.

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- *Are there unique costs or challenges to specific businesses? What transition period would be appropriate?*

  While we are neither a manufacturer nor dealer of the products in question, change in operations and technology takes time and resources. The transition period should be sufficient for an orderly transition and be decided with the involvement of key stakeholders like custodians who will bear much of the brunt of increased operational and technological requirements.

- *Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?*

  Again, while not a manufacturer or dealer of the products in question, we think that existing redemption schedules for DSC and low-load purchase options could be maintained and allowed to sunset according to their existing schedules. Manufacturers who have paid commissions would be hard-pressed to demand repayment from dealers and their representatives on products recently sold if there was a 'big bang' transition away from series like DSC and low-load. Were DSC and low-load purchase options discontinued as of the Transition Date, regulators would need to facilitate a transition mechanism by which prepayments could be recouped, which could be complex to administer. While we are no fans of DSC and low-load purchase options, we do not necessarily see this as feasible for the industry to absorb without such a mechanism and thoughtful planning for the transition issues associated.

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

For the reasons outlined above, we think that Option 1 should be the preferred option, and be implemented in phases. The first phase should involve closing DSC series to new purchases. This phase should take place at the Transition Date, which would mean a six-year transition towards the full elimination of these series. The next step would be to stop the purchase of fund series with trailing commissions. We think that Option 2 could bring some unfairness to the process as more profitable clients would be the last ones to transition to the new structure.

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

We do not think that the CSA should consider using a fee cap as a transition measure. Dictating fee amounts is a move towards more prescriptive rules-based regulation whereas we believe principles-based regulation is the best regulatory response for the underlying issues that require addressing. We think that elimination of embedded commissions and the associated conflicts they present is the goal, not control or reduction of these fees. Fee caps would likely create even more of a challenge to the industry, and could cause further industry distortions and create barriers to entry for new business models.

Part 6: Related Regulatory Initiatives and Existing Tools

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

- *address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and*

  We think the initiatives discussed above will likely address the issues identified in

Part 2, but do so in an indirect way. It seems that results would not be certain and may not ultimately resolve all the issues fully. Firms may have different interpretations of conflicts of interest and different ways of addressing such conflicts, thereby making it difficult or impossible for regulators to enforce the rules. It may also lead to investor complaints and potential lawsuits, forcing the Courts to interpret the rules. We would encourage fulsome guidance alongside any regulation to ensure adherence to the standards that regulators implement.

- *address or not address any additional harms or issues that you have identified.*

  We think a principles-based *Best Interest Standard* should be the cornerstone of the advisory relationship with any client (please see the CAC's comments on this topic previous letters).

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

We cannot identify any other alternative options or measures than the ones already discussed above at this time. Should the decision to eliminate embedded commissions be taken, which we believe would be net-positive for the industry and investors, the focus of regulators should shift towards ensuring a smooth and orderly transition to such a model, where we believe there are material challenges that have not fully been addressed.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) *Michael Thom*

Michael Thom, CFA
Chair, Canadian Advocacy Council

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June 9, 2017

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Delivered to:

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Dear Sirs/Mesdames:

Re: CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* – published for comment January 10, 2017

Summary

Vanguard Investments Canada Inc. (Vanguard) is pleased to provide the various members of the Canadian Securities Administrators (CSA) with feedback on the above-noted highly significant Consultation Paper, for which we commend you.

Vanguard is a wholly owned indirect subsidiary of The Vanguard Group, Inc. (VGI) and manages more than CAD $12 billion in assets invested in publicly offered Canadian-domiciled exchange-traded funds (ETFs), as of May 31, 2017. VGI is the world's largest mutual fund manager, one of the world's largest investment management companies and a leading provider of company-sponsored retirement plan services. VGI manages USD$4.2 trillion in global assets, including over USD$700 billion in global ETF assets (as of March 31, 2017). VGI has offices in the United States, Canada, Europe, Australia and Asia. The organization offers more than 360 funds, including ETFs, to its more than 20 million investors worldwide.

VGI operates under a unique operating structure. Unlike firms that are publicly held or owned by a small group of individuals, VGI is owned by Vanguard's U.S.-domiciled funds and ETFs. Those funds, in turn, are owned by VGI clients. Vanguard considers that this unique mutual structure aligns Vanguard's interests with those of its investors and drives the culture, philosophy, and policies throughout the Vanguard organization worldwide, including in Canada.

Vanguard's mission worldwide is "To take a stand for investors, to treat them fairly, and to give them the best chance for investment success." The very essence of our firm is that investors interests must be paramount in all that we do. For this reason, we support a ban on embedded commissions in Canada. We are supportive of this initiative, as we believe the market operates in the best interests of investors where product providers compete on the price and quality of their products in order to secure distribution; and where dealers and advisors are not unduly influenced, or may be perceived to be influenced, by the payment of embedded commissions when recommending investment products to clients. In our view, a ban on embedded commissions will:

- Remove product bias or perceived bias on the part of the dealer and advisor, thereby enhancing investor protection by ensuring investment decisions are based on the suitability of the product rather than the compensation paid to the dealer and advisor.
- Increase cost transparency, product access and cost competition leading to a wider range of investment products, including greater access to low-cost investment products, to investors through all channels including advisors, planners and discount brokerages; and
- Provide the opportunity for advisors to highlight their value proposition and enable investors to clearly understand the costs for the services they are receiving.

At Vanguard, we firmly believe in the value of advice and we are supporters of the fee-based model for advisors, as this model provides investors with full transparency in terms of fees and removes potential or perceived conflicts of interest in portfolio construction or asset allocation decisions by the advisor. The value a skilled advisor provides his or her client is through the development of a carefully planned investment policy, including the right asset mix based on an investor's individual goals, risk tolerance, and time horizon, as well as disciplined rebalancing and behavioural guidance, while minimizing taxes and investment costs.

Our business has been built on diversification, discipline, low-cost investing, and working with our advisor partners to give them and their clients the best chance for investment success. At Vanguard, we support initiatives that benefit investors, and as such, we are pleased to provide our response to the CSA's paper and in particular, the questions highlighted below.

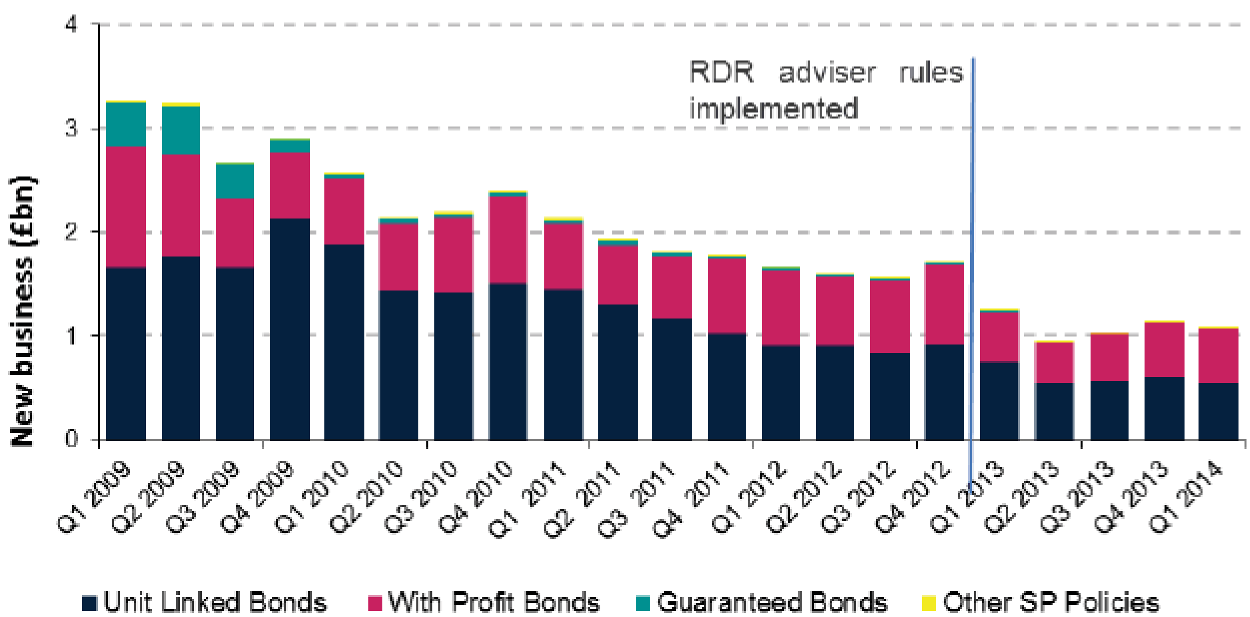
<u>Question 15</u>

What effect do you think the removal of embedded commissions will have on investor experience and outcomes?

As you are aware, there has been an increasing global trend to ensure greater transparency for costs associated with investing in the U.S., U.K., Netherlands and Australia. Here in Canada, we support and applaud the recent CSA initiatives, including CRM2, that we believe will enhance transparency to Canadian investors, while also solidifying the relationships between advisors and their clients.

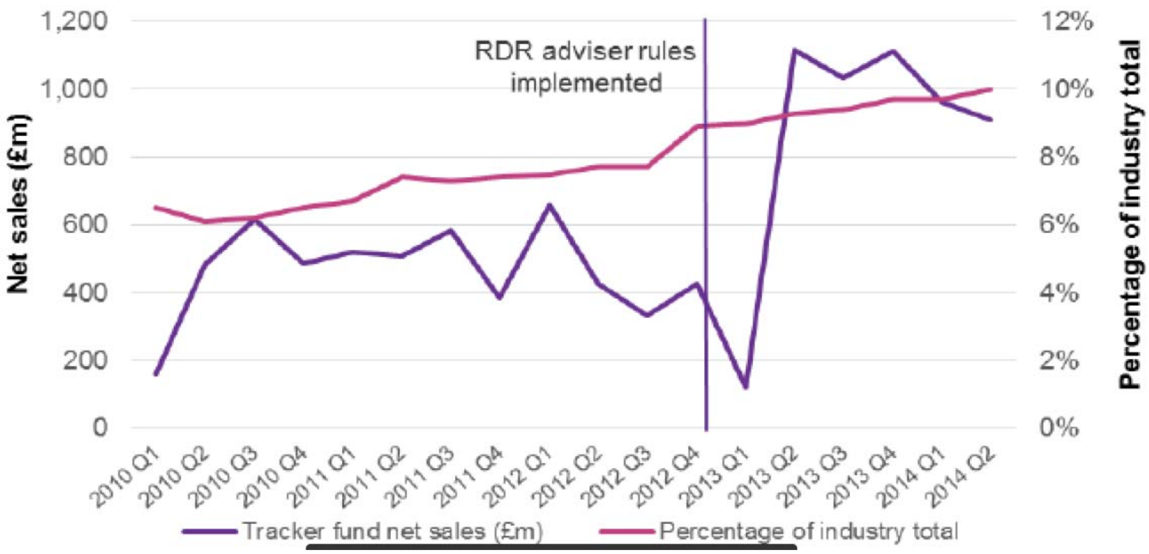
In the U.K. market, following the Retail Distribution Review (RDR), there is evidence that the removal of commission payments by product providers has enabled investors to better compare pricing across platforms and that product prices have fallen by at least the amounts paid in commission pre-RDR. In fact, fund product charges in the U.K. have been reduced by approximately 75 basis points since the implementation. Even if the aggregate cost following implementation equates with current product charges, the increase in cost transparency will be in investors' best interests, and we believe that, over time, the distribution costs will decrease with competition. The charts below illustrate the decline in higher cost investment bonds in the U.K. following RDR, followed by a chart showing the corresponding increase in the purchase of lower-cost index funds. We note that, in the example below, an investment bond is different from a sovereign or corporate debt bond, and can be purchased from an insurance company or through a financial advisor.

- Decline in sale of investment bonds (high commission paying product) - p75 of Europe Economics report https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf



Source: Association of British Insurers (2014). Note data refer to ABI members only.

- Rise in net sales and percentage of total funds under management for index funds post-RDR (lower-cost product) - p75 of Europe Economics report https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf



We believe that investors should be able to discern the cost of the services they are paying for and expect that the elimination of embedded commissions will aid this objective. While it remains to be seen if this leads to an actual lower cost to the end investor, it does ensure that investors have full cost transparency to make an informed decision.

Studies have shown that Canadian retail investors feel it is important for investment firms to fully disclose fees and other costs (90%). In fact, generating returns was not ranked as high a priority as fee transparency, with 82% of Canadians indicating its importance when working with an investment firm.[1]

Question 17

Do you think this proposal will lead to an advice gap?

A U.K. report (*Review of the RDR Implementation Review* published on December 16, 2014, https://www.fca.org.uk/publication/research/post-implementation-review-rdr-phase-1.pdf) from the Financial Conduct Authority found that there was "little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing to take on more clients", in the U.K. post-RDR. However, there has been evidence that some investors have reevaluated whether they are receiving value for their money and deciding, in some cases, that they are not.

We are sensitive to the issues raised by the CSA and a recent report by the *Financial Advice Market Review* in the U.K. (https://www.fca.org.uk/publication/corporate/famr-final-report.pdf) in reference to mass market investors, those with assets under $100,000, and their potential difficulty in obtaining the amount of financial advice they desire, at a price they want to pay.

While we disagree with the notion of an "advice gap", as we feel that new lower-cost competitors and online digital platforms and robo-advisors would enter the market and service this group of mass-market investors, we do feel it is important that any ban on embedded commissions be accompanied by a corresponding effort to educate investors on the changes and promote lower-cost and technology-enabled advice, to ensure that access to advice does not change.

Wider use of online advice and robo-advisor platforms will become more important for the industry, in addition to industry initiatives promoting technological innovation, such as the recent launch of the OSC LaunchPad, OSC Fintech Advisory Committee and CSA sandbox. Ultimately, we believe the interests of investors are served when there is a greater focus on lower fees and accessibility to a wide and diverse range of investment products.

Question 18

Given some of the changes we have seen in the industry over the past few years, what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action?

In our view, we believe that significant change away from embedded commissions is unlikely to occur organically. Additional delays run the risk of exacerbating the three key investor protection and market efficiency issues identified in the CSA consultation paper.

Our studies have shown that Canadian financial advisors are seeing a greater shift in their industry to fee-based platforms with many believing this is better for their business and for their clients.[2] However, this shift is limited. It is also important to note that while F-series funds are lower cost and more transparent than regular funds, they are still significantly higher cost than ETFs in Canada. Currently, the average management expense ratio of a Vanguard ETF is 0.15% versus 1.00% for the average F-series fund, which results in a significant difference, in performance, over time.

Vanguard's own experience in Canada is that we have seen great success with fee-based representatives who value our low-cost approach (in relation to commissioned A-series funds and fee-based F-series funds). We expect that a broader menu of products (including lower-cost ETFs) will be selected by advisors as a result of increased transparency on fees. The removal of embedded commissions will put all investment products on equal footing and result in a better system for investors – who focus on value for money from their financial advisor and a better system for their financial advisor, who focuses on offering the most suitable solutions to clients.

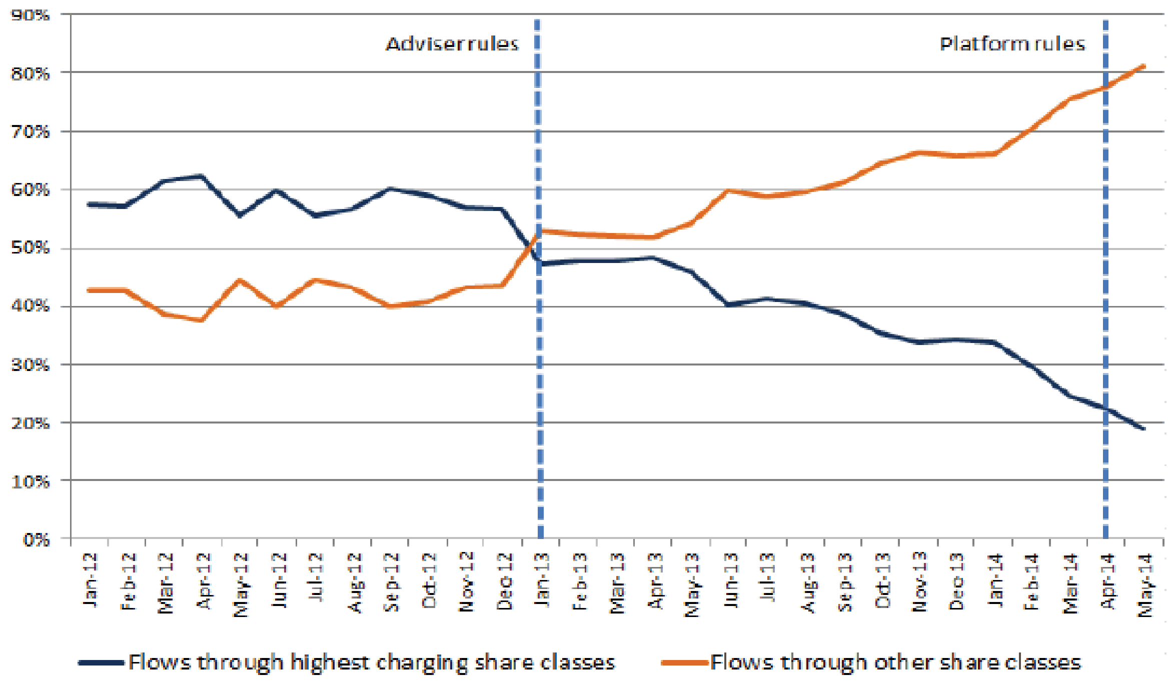
Question 21

Please describe how discontinuing embedded commissions will affect competition and market structure, and whether this will address the CSA's three main concerns (outlined above).

It is our view that the elimination of embedded commissions will lead to greater competition and a broader range of lower-cost investment providers offering greater access to a variety of different products.

Evidence in the U.K. for example, saw a shift toward the sale of lower-cost products when the playing field was levelled by the Retail Distribution Review ("RDR") as highlighted in the chart below.

- Gross retail flows through highest-charging class shares and other shares – page 74 Europe Economics Retail Distribution Review – Post Implementation Review – December 2014 https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf



Source: IMA (2014), "Asset management in the UK 2013 – 2014".

Question 27

How practicable are the mitigation measures discussed and how effective would these measures be at assuring; access to advice, choice of payment arrangements for all investor segments, and a level playing field among competing investment products?

We feel that the mitigation measures discussed are prudent and address the impact of this change to investors and the financial services industry. While there will likely be a transitionary period to ensure all industry participants have time to prepare for and implement the changes, we feel the overall positive impact on investors is worthwhile and significant.

It is worth noting that many similar regulatory changes related to compensation for representatives have often been accompanied by a consumer education and advocacy effort which seeks to inform investors about the change and its implications.

Recent regulatory reforms, such as CRM2 and POS, will aid in this overall effort to increase investor protection, fee transparency and enable a more level playing field amongst investment fund products. As the CSA consultation paper indicates, it is clear that there is a global trend toward reducing conflicts of interest, enhancing fund fee transparency and aligning financial service with the compensation paid by investors.

We appreciate the opportunity to comment on the CSA's paper and would be pleased to further discuss our comments with CSA staff at your convenience.

Sincerely,

(Signed) "*Atul Tiwari*"

Atul Tiwari
Managing Director
Vanguard Investments Canada Inc.

[1]CFA Institute Survey – From Trust to Loyalty – A Global Survey of What Investors Want
[2]Vanguard Global Advisor Trends Study 2016 - https://www.vanguardcanada.ca/advisors/articles/vanguard-news/news-from-vanguard/gat-press-release.htm

Consultation on the Option of Discontinuing Embedded Commissions – CSA Paper 81-408

June 9, 2017

To the members of:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

In the Care of

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, QC H4Z 1G3

My Background

- My office is in Vernon, BC and I'm licensed to sell insurance and mutual funds. I started in the business in 1987 / earned my Registered Financial Planner designation in 1995 and my Certified Financial Planner Designation in 1996. I also have the Elder Planning Counselor designation.
- I have approximately 250 households that I work with and they are a very diverse group of clients ranging from young savers to retired people...some professionals, small business people and regular individuals trying to save for their financial futures.

My Concerns

- I fully agree the client's interest has to be our number one priority.
- However, I do have several concerns with regards to your proposal, and in general with the direction the CSA policy has been going.

Embedded Compensation

- When I started in this business there were no embedded commissions. I can tell you it was difficult to convince clients to pay an upfront fee to purchase a mutual fund. At that time, it wasn't that clients didn't want to pay for my service as they had no issue for me being paid. The issue was they didn't want to pay an upfront fee or a fee out of their pocket. They had no choice.

- I believe the embedded commissions started in 1988 or 1989 and this was a huge revelation for the mutual fund industry…it gave clients a choice.
- Clients could either buy funds with a fee or could buy a fund where you didn't pay a fee, but there was an embedded commission paid to the advisor.
- At first there were only a few companies offering the embedded commission structure where the client didn't have to pay anything upfront and the advisor received an upfront and ongoing commission. Of course, the client was tied into a six or seven year schedule but could withdraw up to 10% each year without incurring any fees. It didn't take very long before all the fund companies offered the embedded commission model.
- It was interesting to note that the fund companies never took away the option to pay upfront. The clients were given a choice and it was fully disclosed at the time of purchase.
- I can tell you from personal experience when I offered the choice to clients, they had no issue with the embedded commissions….it was their "preferred choice". I also have to assume that since mostly all the companies came out with an embedded commission model it was the "preferred choice" of most clients to purchase their mutual funds that way.

The CSA wants to do away with embedded commissions, but why take the choice away from the client.

- Over the last year, I have been explaining in detail to remind clients how we get paid with the embedded commission model and I have also explained "the regulators are wanting to take away your choice of how you purchase your funds by banning embedded commissions".
- I have not had one client say that they agree with banning embedded commissions. In fact, they understand we are in business and need to be paid. The most common response I get is "why are they doing this?" and many are insulted that their option may be taken away.
- I would argue…if clients are given all the information, they are very capable of making their own decisions and don't need to be insulted by taking away their choice. The market place will evolve over time and ultimately determine how the funds will be purchased. I know in my own practice, I am moving more to fee based accounts, but that model does not work for everyone…especially smaller accounts.
- I would also argue that human behaviour is such that if the CSA mandates that clients have to pay a fee that there will be a number of clients who will simply do nothing…meaning they will procrastinate and put off their savings. Unfortunately, this will impact their financial futures and put more pressure on governments to subsidize them in their retirement years. We want to make it as easy as possible for consumers to save for their retirement…not put up roadblocks.

CRM2

- The fact that the amount of compensation an Advisor's firm is paid is now disclosed on statements has just come into play in the last six months and clients can now see exactly how much compensation they are paying. This is a good measure that allows Consumers the opportunity to weigh the value of what they get, for what they pay.
- Over the last six months, I have had numerous conversations with clients and pointing out exactly how much they are paying and I would say most are happy to know what that number is. So far, this is definitely educating the clients. It has brought up some interesting conversations but it is important so they can determine if they are getting value for what they are paying.
- It's only been six months and the CSA should let this new initiative take effect before new rules are rolled out.

CSA policies are already excluding smaller investors from quality advice.

- The only department in my dealer that is growing is the compliance department! This passes on more costs to the advisor and more costs to the client.
- The cost of compliance and disclosure has forced most Dealers and Advisors to focus on their larger clients. Smaller clients are "encouraged" to go elsewhere. The increasing compliance burden (more forms, more boxes to check) means I can't afford to take care of smaller clients. Ironically, these are the younger people starting out to save and they need our advice more than anyone. I can't say offering embedded commissions will get them started sooner, but I can say forcing them to pay an upfront or ongoing fee will deter them from saving.

Banning embedded commissions doesn't mean clients will get better advice.

- When I discuss the potential ban on embedded compensation with my clients, they don't see how this will help me give better advice to them.
- Why should their ability to choose how they deal with me be limited? Regardless of how many rules you make or change, clients will either trust an Advisor and work with them…or not.
- Shouldn't they be able to look at the numbers, discuss my services to them and agree on the best way to proceed?
- It seems closeminded to imply that all clients would want to do business the same way and your proposals are forcing consumers down a path where there will eventually only be one way.

It is very concerning…

- that a Regulator that regulates Advisors, does not have an Advisory Council for developing policies. The advisors are on the front lines with clients and would provide great feedback. You have policy makers who have no idea what goes on in a client meeting.

The consumer has no idea that banning embedded commissions are being contemplated.

- When I discussed banning embedded commissions is being contemplated with my clients, 100% of them were completely unaware.
- I find it very hard to believe…of all of the clients that I brought this up with, none of them had any real knowledge of the problem and were still not worried about it when I explained the issues.
- It is pretty hard for a consumer to comment on this process when they don't know it is happening.
- Canadian consumers will be shocked if the CSA chooses to go ahead with these proposals.

Advisors can't keep up to the pace of regulation and change.

- Other Advisors tell me that they cannot keep up with the pace of Regulatory change. You are wanting to change the rules and we haven't even seen the impact of the new CRM2 rule changes…and whether they are working.
- If you gave the industry some time to catch up and implement the changes you wanted, you might see that many new potential policies would not be needed.

My clients want to deal with a professional that will build a long-term trust relationship with them and look after their best interest. They want to learn about their finances and to trust the advice and suggestions that their Advisor gives them, but they do not want to become financial advisors themselves. If we meet their needs, they will choose how they deal with me and how I get paid. Regulators dictating that clients are incapable of being able to make a choice is an insult to their intelligence.

The only solution is to increase Advisor Professionalism
If you increased the professionalism of Advisors, it would solve many of your problems. I am member of the Financial Planning Standards Council, the Institute of Advanced Financial Planners and Advocis, I have to put my client's interest first and I'm bound by a code of ethics and have to adhere to many hours of ongoing education. With these principles as a guide, there could be a lot less rules.

These organizations already have a professional solution in place and they just need to be included in your policy development to make them even more relevant to Canadians. I would encourage you to work with them and make Financial Planning a Profession. This will benefit everyone…clients, advisors and the industry.

Please feel free to contact me if you have any questions,

Greg Mussenden, CFP, R.F.P., EPC

Summit Financial Planners | Manulife Securities Investment Services

Thomas B.K. Martin
[redacted]
June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autoite des marches financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

C/O The Secretary
Ontario Securities Commission
comment@OSC.gov.on.ca

Comments re CSA consultation paper 81-408

By way of background , I am a 35 year veteran of the industry who has been a partner in a discretionary investment management firm, an investment dealer and a mutual fund dealer. I have worked on the administrative side of the business and have had client responsibilities. My credentials are the CSC, the Partners and Officers exam, C.P.A., C.A., C.F.P. I have sat on a number of industry task forces at the request of regulators over the years.

My comments regarding banning embedded compensation are as follows:

1 Conflicts of interest are inherent in professions. The auditor is paid by the company he is auditing; the surgeon is paid to operate, not to not operate; the lawyer is paid to litigate, not to not litigate, etc. That there may be an apparent conflict with embedded commissions is not necessarily reason enough to ban them, particularly when there is now so much required disclosure around fees and performance.

2 Embedded commissions are a fact of life in financial products including but not restricted to:
mutual funds
segregated funds
G.I.C.'s

Certain types of bonds
Life insurance
Annuities
Property and casualty insurance

Canadians are used to paying embedded commissions and the issue of embedded commissions in financial products of any sort is not one of overbearing significance in day to day life to me, my family or clients. To ban them in this one financial product would seem an excessive regulatory intervention particularly in light of the next point.

3 Investors can choose to purchase their mutual funds in a variety of ways. They are not forced to pay embedded commissions. Channels currently exist to purchase mutual funds or to purchase a variety of other similar products without embedded commissions.

4 At one time one could purchase most mutual funds only by paying an embedded commission of 9%. Over time, the marketplace has evolved to now provide many different purchase options. Not only has the mandatory 9% commission structure disappeared, but the frequency of the deferred sales charge commission has significantly declined. These things took place without regulatory intervention. Undoubtedly, the marketplace will continue to evolve in response to the desires of consumers.

5 It seems ironic that some years ago the regulators forced the mutual fund manufacturers to pay trailer fees on all assets with no exception/discretion in certain circumstances and now they are considering banning them altogether! The attached trailer fee cheque copy for 1 cent was <u>mandated</u> by regulation all in the name of theoretical purity. Perhaps, it was regulation gone to absurd levels. Certainly, for me, absurd enough that I have kept the cheque for almost 20 years!

6 There are essentially two types of embedded commissions in mutual funds. A sales commission and a trailing fee or commission. Each has their own distinct issues.

7 It can be forcefully argued that the trailing commission is an extremely efficient way to compensate the industry for their services. To get rid of them , after 20 years of refinement, is akin to throwing the baby out with the bath water. To replace them with mandatory individual billing of clients would create a lot of extra work. One can't assume that all clients will want or that it will be possible to bill all clients automatically and electronically. There is going to be additional computer programming costs, hard costs for paper and postage for clients who want to be billed directly, the need to now keep receivable sub-ledgers for clients with each client having an account, as well as the need to register for HST for many individuals who will now have to collect fees as opposed to receive trailer commissions. As well, for the client, there could be more issues around paying fees manually.

There are bound to be both billing/payment/collection/banking issues which impact both client and service provider. A firm may receive trailer fees from 20 or 30 fund companies but have several thousand clients. The complexity of dealing with fee accounts for thousands of clients is obviously going to be more complex than dealing with trailer fees from 20 companies for which there is a mature and efficient system in place. It is impossible to estimate exactly what the extra costs will be. It is extremely easy to assume these issues away, but they will add substantial cost to the system, which will likely lead to higher fees with no substantive added benefit to the client, as well as a reluctance to take on smaller accounts. There will be accounting issues, regulatory capital issues, and auditing issues, both statutory and regulatory.

In summary, my experience is that my clients and the public are much more concerned about receiving practical investment advice which integrates with their overall financial planning needs than they are about the transparency and potential conflicts with the fees they pay. The much larger challenge for regulators than the method of fee payments is ensuring that those giving advice are doing so in the best long term interests of their clients. To this end, the regulators must take a much more sophisticated approach to the qualifications of those giving advice and their review of suitability of investments for investors.

respectfully,

T.B.K. Mt

Thomas B.K. Martin

NATIONAL BANK

BY ELECTRONIC MAIL

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-2318
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec H4Z 1G3
Fax: (514) 864-6381
consultation-en-cours@lautorite.qc.ca

Dear Secretaries:

RE: CSA Consultation Paper 81-408: *Consultation on the Option of discontinuing embedded commissions* Published on January 10, 2017 (the "Consultation Paper")

National Bank appreciates the opportunity to comment on the Consultation Paper. We acknowledge that the CSA is examining the potential investor protection and market efficiency issues arising from the prevailing practice of remunerating dealers and their representatives for mutual fund and other product sales through commissions. This includes sales and trailing commissions paid by investment fund managers or product manufacturers. National Bank supports the initiatives of the CSA as well as greater transparency with investors. We also support the intention to rationalize the fund series.

In recent years, the regulators and SROs have provided guidance and introduced many regulatory initiatives which have improved transparency on mutual fund fees and embedded commissions, such as Point of Sale Disclosure and the Client Relationship Model. These key regulatory initiatives benefit investors by enabling them to better understand the costs of investing in mutual funds and other products, and to consequently make more informed investment decisions. National Bank considers that investor protection and fairness must, above all, be the drivers for change.

National Bank is a diverse financial group which: (i) manufactures mutual funds, owns proprietary distribution channels, and supplies services to third party distributers; (ii) operates a discount brokerage firm; and (iii) operates an MFDA-regulated mutual fund dealer and an IIROC-regulated investment dealer throughout Canada. We therefore take great interest in the regulatory initiatives contained in the Consultation Paper and their potential impact on investors, the mutual fund industry, the investment industry, and financial intermediaries. Accordingly, our intention is to share our concerns regarding the regulatory initiatives contained in the Consultation Paper, as well as our experiences. We trust that our comments will be taken into account during the review process, and will also provide a positive and productive contribution to the outcome of the regulatory initiatives proposed in the Consultation Paper.

1. Proposed Regulatory Initiatives Contained in the Consultation Paper

Question 1: Do you agree with the issues described in this Part? Why or why not?

Issue 1: Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.
Issue 2: Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.
Issue 3: Embedded commissions paid generally do not align with the services provided to investors.

We agree that embedded commissions raise potential conflicts of interest and limit investors' awareness of dealer compensation costs. Certain of these issues have been resolved with the implementation of CRM2, which increases transparency. As per the 31-103 policy statement, the CSA expects registered firms to provide specific information as to the nature and amounts of actual charges that will apply to clients' purchases.

"…. the sales charge or deferred sales charge option available to the client and an explanation as to how such charges work. This means registered firms should advise clients that mutual funds sold on a deferred sales charge basis are subject to charges upon redemption that are applied on a declining rate scale over a specified period of years, until such time as the charges decrease to zero. Any other redemption fees or short-term trading fees that may apply should also be discussed."

"…Registrants should advise clients with managed accounts whether the registrant will receive compensation from third parties, such as trailing commissions, on any securities purchased for the client and, if so, whether the fee paid by the client to the registrant will be affected by this."

Together with these requirements, we have also put time and effort into training our employees so they clearly understand that transparency is embodied in the high quality advice we want to provide to our clients.

This year, clients either already have been or will be issued reports on fees and charges, which specifically indicate the amounts of trailing commissions received by dealers related to those securities owned by clients.

We believe we should first evaluate the results of these latest disclosures prior to implementing even more new ones and new rules. It is important not only to improve transparency and information for clients, but also to evaluate the quality and sufficiency of what is currently being provided. In addition, it is crucial to evaluate if the solution has not already begun to be put in place by the industry. Investors are offered low cost and fee-based solutions for their investment needs which can provide transparency and align the interests of all parties involved. The current significant movement toward fee-based accounts would be interesting to follow in order to determine whether that could fix the issue, or a part of it.

Question 3: Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

Obtaining advice is a significant benefit for all investors. Investments with embedded commissions offer an accessible way for investors, including modest investors, to obtain professional advice from registered representatives.

We do not believe that banning embedded commissions would result in clients massively moving to discount brokerage or robo-advisory firms, nor would it prevent clients from finding advisory services should they actively seek them. But, there are clients who will not be able to obtain advice either due to their inability to afford the costs of advice or their discomfort with technology. Often, these clients have limited investment and financial knowledge.

As well, banning embedded commissions may have greater impact on smaller firms whose lesser scale would render implementation of a fee-based platform or other required technological innovation difficult, if not impossible. Some small dealers may even simply decide not to continue to operate their dealer business, which would lead to fewer service offerings and, thus, decreased competition within the Canadian market.

Clients who seek alternatives to embedded commissions, and who have the financial capacity, can readily take advantage of fee-based platforms or other types of direct payment arrangements that are, and will continue to be, offered by Canadian dealers.

Question 4: For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**
- **structured note**

should the product be subject to the discontinuation of embedded commissions?

If discontinuing embedded commissions is going to take place, we think regulators should aim to have a level playing field such that all of these products should be encompassed by the ban. In order to avoid potential or perceived conflicts of interest, it should not be permitted for a registered representative to have the choice between the exempt market (with a commission) and the prospectus regime (without any commission). Regulatory arbitrage can be avoided by subjecting all similar products to comparable regulations. Segregated funds, or other similar products, as well as new issues should be part of a similar regulation to establish that level playing field.

We submit that the exception to the rule should be for so-called "no-load A Series" securities, for which clients pay no up-front commissions and **only** trailing commissions. Maintaining no-load A Series would allow modest investors to continue to have access to advice without having to additionally disburse for these services when provided by their registered representatives. This would benefit both clients and the industry.

Question 5: Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

As mentioned previously, we think no-load A Series securities should be excluded from discontinuation of embedded commissions. With CRM2, clients will be clearly informed of the compensation (trailing commissions) received by registered representatives related to these products. Transparency will be achieved, and all types of clients will be able to continue to receive professional advice from their registered representatives without having to disburse fees directly. We believe this will lead many modest clients to continue to seek advice, whereas the discontinuation of embedded commissions would very likely lead them to cease doing so.

Question 7: Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

As indicated above, we believe that discontinuing embedded commissions would very likely lead many clients, including in particular clients with modest means or smaller investments (<$100k in savings – which is approximately 30% of our clients), to discontinue seeking investment advice. These investors are likely to be more negatively impacted. We understand the CSA shares the view that such an outcome would not be beneficial to Canadians, as evidenced by the research cited by the CSA regarding the value of advice. We therefore submit that retaining a very limited scope of permitted embedded commissions (i.e. no-load A Series securities only) would help the CSA achieve the cited objectives while mitigating the anticipated negative impact on Canadian investors and the investment industry.

Question 8: Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105, b. referral fees, and c. underwriting commissions.

<u>Marketing and educational practices</u>: We are in favour of discontinuing payments related to sales communications, conferences, seminars, sponsored events, or other marketing and educational practices. If transparency requirements are the basis for discontinuing embedded commissions, we think they should also apply to all of these marketing practices, of which clients are generally not aware and from which conflicts of interest may arise or be perceived. We respectfully submit that educational practices and seminars are part of a dealer's know-your-product obligations, and products like mutual funds should be treated just like any other type of product.

<u>Referral fees</u>: Referral fees are subject to a mandatory disclosure process under NI 31-103. The rules require full transparency to clients when referral fees are involved. Referral fees are not related to a product but rather to the referral of a client to or from a registered representative – no matter what the product recommended is, or will be. As such, we do not believe discontinuing referral fees should be considered.

Question 9: If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

For the aforementioned reasons, based on transparency and avoidance of conflict of interest principles, we believe such types of payments and benefits should be discontinued.

Question 10: With respect to internal transfer payments:
a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?
b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers

directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

a) In our view, NI 81-105 addresses the potentially problematic issues arising out of payments within integrated financial service providers, while still recognizing that integrated structures are realities of the Canadian marketplace.
b) We believe existing rules (general conduct rules and those relating to conflicts of interest, referral fees, NI 81-105, etc.) already proscribe objectionable behaviours that could arise as the result of internal transfer payments. Furthermore, with full transparency resulting from CRM2 disclosures of costs and fees, we submit that clients now have access to all the information necessary about compensation received by their dealers. Within an integrated financial service provider, a registered representative's incentives are not necessarily tied directly or solely to invested assets under management (as is the case for embedded compensation) such that the individual interacting with clients is unduly incentivized to promote investment products.

Question 11: If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

It is important that clients be offered several payment options and are able to choose from amongst them. We agree that investment fund managers could be involved in order to facilitate the direct payment arrangement a dealer has with a client. Depending on the type of payment arrangement, it could be easier for the client to have the investment fund manager make deductions from purchase amounts or periodic redemptions from the client's account. However, it should be ascertained whether most investment fund managers have the capability to offer this service, and at what cost. We think that small investment fund managers/issuers may not be able to offer such services. This could have an impact on the attractiveness of their products.

Question 12: Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

> **1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;**
> **2. Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs; and**
> **3. Embedded commissions paid generally do not align with the services provided to investors.**

Transparency requiring full disclosure of fees, commissions, and conflicts of interest would address the three key investor protection and market efficiency issues discussed in Part 2. As mentioned in the response to Question 1, employee training and education are also key elements of investor protection.

Question 13: Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

Various rules and guidance have been introduced recently with respect to disclosure of fees and compensation as well as conflicts of interest, including CRM2 and POS3. All of these rules have similar objectives, i.e. transparency, disclosure, and the protection of clients. Emphasis should first be put on ascertaining the impact of these rules and guidelines and on enforcing them, in order to thereafter be able to evaluate whether additional regulations really are required.

Question 15: What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- **Will investors receive advice and financial services that are more aligned with the fees they pay?**

  Financial services provided by registered representatives have to be aligned with the needs of their clients. Registered representatives have obligations to know their clients and their products, and to observe high standards of ethics and conduct. We do not expect the removal of embedded commissions to lead to more aligned services, as such an obligation is already in place and supervised by dealers.

  It is unlikely that small investors will pay less for being serviced by a registered representative. Investors already pay 100% of the fee, currently in the form of embedded commissions. Switching to a direct service payment system would not change that situation. Investors will have the choice between different types of payment arrangements and will have the opportunity to choose which best aligns with their specific needs.

  Fee-based platforms will be one of these multiple choices. Fee-based platforms could have equivalent fees. However, in some instances, those fees may end up being even higher for relatively the same level of service. As such, we are not convinced this would inevitably lead to better investor outcomes.

  Also, as previously mentioned, we believe some investors will not be able to afford the cost of advice nor will they have the technological knowledge to use robo-advisors. If embedded fees are eliminated, institutions may charge "explicit" fees for services (e.g. $150 to meet your Personal Banker). Such explicit service fees may induce ill-informed investors to switch from mutual funds to GICs which could have long-term impact on the potential of wealth accumulation.

- **What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?**

  Robo-advisory services are currently limited in Canada. We do not expect that discontinuing embedded commissions will have as dramatic an impact on automated advice as is foreseen by the CSA. Clients who want and need personal advice will not necessarily move to discount brokerage firms or robo-advisory firms. If they can afford it, investors will likely accept direct payment arrangements with advisory firms. Advice is not just product related. It also includes advice on types of accounts, tax issues, financial strategy, etc. Those seeking advice for these elements, which are more and more popular in the wealth management approach, will not be satisfied by switching to a discount brokerage firm or a robo-advisory firm.

- **Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?**

  Fee-based and discretionary fee-based service offerings will increase, even without the proposed ban of embedded commissions. We expect the type of clients who will seek a new service offering are those who need advice but who also want to be involved in the decisions affecting their portfolios. For this reason, we anticipate that fee-based accounts will grow faster than fee-based discretionary accounts.

- **What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?**

  On a short-term basis, we do not expect any significant changes. However, business models and compensation grids may have to be adapted. Discount brokerage evolves rapidly, and its history demonstrates that changes in pricing can occur very quickly.

- **What effect will the proposal have on the cost and scope of advice provided to specific investor segments?**

  Dealers (most likely small dealers) may want to reconsider their global offerings, i.e. what type of clients they want to serve. The possibility of having fewer service providers should be carefully considered by regulators. As mentioned by the CSA in the Consultation Paper, "*Some dealers and their representatives may decide to refocus their business on high net worth fund investors and/or charge a fee for advisory services that some investors may not be able to afford, thus increasing the potential for certain investors to lose access to advisory services.*"

  Some clients who could use discount or online brokerage may also consider limiting their investments to products with no/low costs, or to products available to less knowledgeable investors. This would result in less diversified client portfolios and could impact their total returns. Also, such clients would be unable to take advantage of financial planning services.

Question 16: What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- **Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?**

  Our offering will include fee-based payment arrangements which will be available to all types of investors, including small investors. Depending of their assets under administration, some investors could pay more than others, and may see their annual fees become higher than what they currently pay with the embedded commissions. The switch from the current model to fee-based accounts may not be beneficial for investors, given current industry pricing (approximately 1.25% for accounts above $100k). It will probably be more costly for smaller accounts, hence no savings.

Question 17: Do you think this proposal will lead to an advice gap? In particular:

- **Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.**

  Mass-market households ($100,000 or less in investable assets) and mid-market households (between $100,000 and $500,000 in investable assets) could be the most impacted, since most of them will have to choose between different types of payment arrangements with their firms. Many affluent households are already in fee-based arrangements, or may be economically advantaged in doing so.

- **Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?**

  Clients are usually either in face-to-face relationships or in the discount brokerage channel. The differentiation is appropriate.

- **What types of advice or services currently provided today would be most affected by the proposal?**

  We do not anticipate an advice gap *per se*. Clients who currently receive advice will likely continue with a new type of direct payment arrangement. However, on the demand side, some investors will likely be disheartened with having to move to this type of arrangement, or will not be able to afford the costs and will cease to seek advice. This is the outcome we consider to be the most realistic and worrisome.

- **How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?**

  As discussed previously, we believe that allowing no-load A Series securities to maintain embedded compensation is a measured way to address many of the concerns raised in the Consultation Paper. This would maintain a payment option that remains advantageous for a considerable portion of Canadian investors.

- **Do you think that online advice could mitigate an advice gap? If so, how?**

  As discussed previously, we believe it is unlikely that investors wishing to have face-to-face advice will be satisfied with automated advice.

Question 18: Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

- **Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?**

  We believe so. The DSC option is less available, and continues to be distributed by fewer and fewer dealers all the time. F Series are more common and favoured, given the popularity of fee-based accounts. Some manufacturers are reducing management and administration fees, and others are also eliminating deferred sales charges. Transparency has improved with CRM2 and POS3, such that clients have become more aware of the fees and commissions they pay. They now receive an annual report on fees and charges to this effect. This awareness will lead the industry to greater transparency and to continually reduce fees.

Question 20: We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

We do not see any regulatory obstacles to this effect. The only obstacle we can see is related to the significant investments that implementation of fee-based platforms require, or their limited availability for firms. However, we do see strong growth for fee-based series.

Question 21: Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4?

- **Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?**

  We expect that smaller dealers may face more challenges with the discontinuance of embedded commissions. If smaller dealers have to modify their business plans and let go of their mass-market household clients, they would likely have to deal with losses in revenue. Some of them may decide to end their businesses entirely, or to merge with another firm. In such cases, the Canadian brokerage industry would experience diminished competition, which would lead to a reduced service offering to Canadian investors.

- **What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?**
  - **o Independent dealers?**
  - **o Independent fund manufacturers?**
  - **o Integrated financial service providers?**
  - **o Mutual fund dealers?**
  - **o IIROC dealers?**
  - **o Online/discount brokers?**

Some dealers may have to invest in technology in order to develop fee-based platforms. For those who believe there will be a movement toward robo-advisors, there will also be a need to develop, buy, or enter into service agreements with providers of such technology or capabilities. Merger opportunities may also result from this proposal.

We do not anticipate a massive flow toward discount brokerage firms, but these firms may have to re-evaluate their pricing grids if embedded commissions are no longer paid.

- **What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?**

  We strongly support regulations ensuring that all products with embedded commissions have similar constraints, in order to avoid regulatory arbitrage between products.

- **What would be the impact on dually-licensed mutual fund dealers and insurance agents?**

  To avoid conflicts of interest and product arbitrage, products such as segregated funds should be under the same obligations as mutual funds.

- **Will the proposal lead new, lower-cost entrants to the market? Why and how?**

  We do not expect new entrants.

- **What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?**

  For clients wanting face-to-face advice, robo-advisors are not an attractive alternative. This proposal will not be a source of competition between face-to-face advice providers and robo-advisors.

Question 22: What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- **Is there any specific operational or technological impact that we should take into consideration?**

  A fee-based platform requires additional staff for coding and maintaining the program rules, which many small firms might not be able to afford. For this reason, we support maintaining embedded commissions in no-load A Series securities, thereby eliminating a barrier to entry for dealers and maintaining accessibility to advice for investors.

Question 23: The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- **Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?**
- **To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?**

  Most of the compliance controls related to conflicts of interest will need to remain in place. Dealers have obligations to mitigate and to supervise material conflicts of interest. Also, different direct payment options may require additional supervision. All dealers will have to decide what option(s) they will offer and what supervision will be needed in order to comply with applicable regulations. Dealers will have to evaluate whether the type(s) of direct payment arrangement(s) chosen by clients is/are the best available in the dealer's offer. This is an ongoing obligation that will require continuous re-evaluation.

Question 24: Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

Direct payment arrangements will be based on the needs of the clients. Clients will pay for the services they need, or those for which they want to pay or can afford. Clients will have to directly support the costs of advice, the creation of any fee-based platforms, the cost of IT, compliance, etc.

Question 27: How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

- **access to advice for investors,**
- **choice of payment arrangements for all investor segments, and**
- **a level playing field amongst competing investment products?**

We do not think clients will be able to negotiate their direct payment arrangements. Clients will likely be offered a choice of direct payment arrangements, from which they will be able to choose the most appropriate based on their needs or their financial capacity. As mentioned earlier, we strongly encourage regulators to ensure that all products with embedded commissions be subjected to similar regulations in order to avoid regulatory arbitrage between products. Not all dealers will have the resources to modify their information technology systems. Some of them will have to make choices such as mergers, entering into a service agreement, or discontinuing their business.

Question 29: Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

a. Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.

Normally, "modest investors" are fully invested (no liquidity available). In order to pay the costs of the dealer compensation and services, they will have to sell units and investments. This might generate tax consequences. If the client holds some liquidity and does not fully invest his money, then the client is not taking advantage of 100% of the market variation.

c. What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

Merge of the fund series must be allowed without client consent. No repapering should be requested by the regulators, since clients do not generally want to have to sign new documentation when changes are more operational-related. Since dealers and their registered representatives have obligations to maintain adequate records, operational impacts could be resolved without clients' signatures.

Systems may not be ready for such changes. There will be a financial impact which will likely be passed on to clients. Fee-based platforms are expensive to establish.

Question 32: For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- **Are there unique costs or challenges to specific businesses?**

  Some firms might be more impacted by the technology developments needed and their related costs. All firms will be challenged by the transition period of 36 months. Within this delay, registered representatives will have to communicate with all of their clients to: explain the direct payment options available, obtain all the required consents, and adequately document any changes.

- **What transition period would be appropriate?**

  A transition of 36 months will prove challenging and, therefore, anything less would not be feasible.

- **Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?**

  Existing redemption schedules for DSC and LL should be maintained until the redemption schedule is completed.

Question 33: Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

Please see the answer to Question 32. We prefer existing redemption schedules for DSC and LL being maintained until the redemption schedule is complete.

Question 34: As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

We believe an interim measure of capping embedded commissions would not help the industry, and would only increase the level of complexity of this proposal. Embedded commissions have been in place for a very long time and we see no benefit to capping them on an interim basis. Clients could also be more confused by implementation of an interim step. The more changes there are, the greater the likelihood of confusion.

Conclusion

National Bank would like to thank you for providing us with an opportunity to comment on this important issue. We look forward to our continued participation in any further public consultation on this topic and would be pleased to discuss our input in greater detail with you. We have expressed our main concerns and our objective is to find solutions that are relevant for, and serve the needs of the Canadian market.

Yours truly,

Martin Gagnon
Executive Vice-President, Wealth Management,
Co-President and Co-Chief Executive Officer National Bank Financial

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumers Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Delivered By Email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

Dear Sirs and Mesdames:

Re: Canadian Securities Administrators Paper 81-408 - *Consultation on the Option of Discontinuing Embedded Commissions* (the "Consultation Paper")

Sentry Investments Inc. ("Sentry") is one of Canada's leading independent investment managers, with more than $18 billion in mutual fund assets under management. Since opening our doors in 1997, we have earned and kept the trust of more than half a million Canadian investors. Sentry offers a diverse range of investment products and solutions through financial advisors and investment dealers, as well as portfolio management services to a variety of institutional clients.

Sentry is pleased to have the opportunity to provide its comments on the Consultation Paper. We appreciate and thank the CSA for the significant effort that has been dedicated to developing and publishing the Consultation Paper and providing outreach as part of its process.

We, generally, support the CSA initiatives that seek to enhance investor protection and market efficiency in the Canadian marketplace. However, we believe that discontinuing embedded commissions and transitioning to direct pay arrangements will result in additional issues and unintended consequences for investors and the investment industry, as a whole. Accordingly, alternative solutions must be considered.

We are members of the Investment Funds Institute of Canada ("IFIC") and support the analysis set out in the submission made by IFIC on behalf of its members with respect to the Consultation Paper (the "IFIC Submission"). The IFIC Submission provides additional

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information to address the CSA concerns set out in the Consultation Paper and sets out an alternative to discontinuing embedded commissions, all supported by additional research.

We urge the CSA to carefully consider the IFIC Submission and any other feasible alternatives that would assist the CSA in addressing its concerns set out in the Consultation Paper before a decision is made to discontinue embedded commissions and transition the industry exclusively to direct pay arrangements.

Thank you for the opportunity to comment on the Consultation Paper.

Sincerely,

Edna A. Chu
Senior Vice-President and Chief Compliance Officer

Copy:
Philip Yuzpe, President and Chief Executive Officer

PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

The Portfolio Management Association of Canada ("**PMAC"**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the Canadian Securities Administrators' ("**CSA**") Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (the "**Consultation**"). Capitalized terms used in this letter but not defined here have the same meaning given to them in the Consultation.

About PMAC and our approach to this Consultation

PMAC represents investment management firms registered to do business in Canada as portfolio managers. PMAC members encompass both large and small firms managing total assets in excess of $1.5 trillion for institutional and private client portfolios[1]. Even though PMAC represents firms registered to do business under National Instrument 31-103 – *Registration Requirements and Exemptions* ("**NI 31-103**") as portfolio managers ("**PMs**"), as of 2016, over 65% of our members are also registered as investment fund managers ("**IFMs**").

PMAC is cognizant that the Consultation and impact of any decision by the CSA to discontinue embedded commissions will affect various registration categories and business models to different degrees. Through data collected by PMAC in a 2017 survey, we noted that member firms are compensated for different services based on a wide variety of fee models, but that the most

[1] For more information about PMAC and our mandate, please visit our website at: www.portfoliomanagement.org.

prevalent compensation model is fees charged based on a percentage of an investor's assets under management.
For the purposes of this letter, PMAC's response is primarily focused on the implications that the Consultation may have for PMs, their business ecosystem, the securities they invest in, and their clients. Where we have received more general feedback on the Consultation we believe could be useful to the CSA from a practical or operational perspective, we have also included such information here.

Overview

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. In fact, that is PMAC's mission statement: advancing standards. For this reason, we are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole.

PMAC would like to thank the CSA for their work in drafting the Consultation as well as for mandating an extended comment period to allow stakeholders to gather data and ideas around alternative measures and/or the potential effects of discontinuing embedded commissions. Should the CSA determine as a result of the Consultation that discontinuing embedded commissions is the only way to sufficiently manage or mitigate the identified investor protection and market efficiency issues they believe arise through the use of embedded commissions, PMAC believes that the comments solicited under Part 4 - *Regulatory Impact* and Part 5 – *Mitigation Measures* of the Consultation will be critical for the CSA to carefully consider to ensure that measures are adopted to minimize disruption and to mitigate any negative impacts to investors, industry and our markets.

PMAC continues to support and champion the ongoing efforts of the CSA to identify opportunities to improve the investor-adviser relationship. We believe that the integrity of the client-registrant relationship is of crucial importance to confidence in the markets, a healthy economy and access to investment advice for all Canadians. We also believe that ensuring broad access to a variety of investment products and investment advice that is provided with the highest levels of integrity and skill is in the best interest of Canadians as a whole. We express our concern with any measures – or the manner of implementation thereof - that could either harm or hamper access to investment choice and advice.

SUMMARY OF PMAC'S KEY RECOMMENDATIONS

1. Consider any new, alternative options to banning embedded commissions put forward to the CSA as a result of the Consultation that would address the CSA's investor protection and market efficiency concerns with a view to improving outcomes and minimizing the disruptive impact of any such change on investors and stakeholders.

2. Review the feedback received as part of this Consultation in conjunction with the proposed changes to be implemented as a result of CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* ("**CSA 33-404**") as one way to assist in addressing certain investor protection concerns and alleviating the investor expectations gap identified by the CSA.

3. Regardless of the determination made as a result of the Consultation, focus on bolstering investor education and outreach as a critical way to increase investor knowledge about the importance of investing, the benefits of advice, the nature of the various investor-registrant relationships, including the impact of dealer compensation on investment returns, and

products available to help Canadian households meet their savings and retirement goals. Change within the industry without corresponding outreach to investors in general runs the risk of disrupting business without achieving the CSA's goals of increased alignment between investors and dealers and of increased investor negotiating power and fee transparency.

4. Where possible, maintain as much investor choice as possible with respect to the ways in which investors can pay for advice. Where feasible, encourage the use of innovative regulatory initiatives and technologies for both online and traditional firms to address the risk of an advice gap. Streamline any regulatory action arising out of the Consultation, CSA 33-404 and any future "CRM3" amendments to minimize the impact of such changes on firms and to allow advisers to focus on servicing their clients.

5. Work strenuously to harmonize the regulation of compensation models across other applicable regulators to ensure that the possibility for regulatory arbitrage is minimized, especially if other products with embedded commissions continue to be available in other regulatory environments. We believe that a lack of harmonization will lead to regulatory arbitrage to the detriment of the CSA's goals in the Consultation.

6. If the CSA decides to discontinue embedded commissions, carefully consider feedback in respect of necessary technical, operational, client communication and other aspects required for stakeholders to effectively transition to the new requirements with minimal disruption. Aspects of such transitional planning include the need for FundServ's technology to operationalize the redemptions for investors' fees to avoid a very onerous manual process and to allow sufficient time for meaningful investor education by firms with respect to the nature of the redemptions for fees paid that will appear on their CRM2 reporting. Members anticipate that these redemptions, without proper education and messaging, may affect the performance reporting and confuse clients, resulting in an influx of investor calls.

Each of these recommendations and additional comments are discussed in turn below.

CONSULTATION QUESTIONS

Part 4: Regulatory Impact

Question 13 - Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

It is our understanding that other commenters may have compiled research and suggestions around alternative options for consideration by the CSA that would address the CSA's investor protection and market efficiency concerns. To the extent that the CSA view any of these, including "CRM 3" reporting of management expense ratios ("**MERs**"), as being acceptable alternatives to banning embedded commissions and that such measures are anticipated not to have a disruptive impact on industry and investors, PMAC would be supportive of further consultation on such alternatives. Being cognizant that uncertainty is not good for any stakeholders, we encourage the CSA to make a considered determination as to whether to ban embedded compensation and to announce and implement a transition plan as soon, and as clearly, as possible to allow for necessary changes to be made.

We view the consultation undertaken in CSA 33-404 as being closely connected with addressing the investor protection and market efficiency concerns of the CSA with respect to embedded compensation. We were pleased to see that the CSA also views these two initiatives to be interrelated, as noted in CSA Staff Notice 33-319 – *Status Report on CSA Consultation Paper 33-404*. Efforts by the CSA to address the investor expectations gap identified in CSA 33-404, through the implementation of certain targeted reforms relating to, among other issues, the management of conflicts of interest, may be helpful components in alleviating certain of the investor protection concerns outlined in this Consultation.

Canadians benefit from a world-renowned regulatory environment. We commend the CSA for their actions in creating and preserving this environment as well as for being committed to researching and implementing best practices in securities legislation from international organizations, such as IOSCO. PMAC believes that this Consultation provides an important opportunity for the CSA to continue this positive trend – regardless of the regulatory change that it determines is necessary to implement with respect to embedded fees – by leading the charge in encouraging collaboration between various industry stakeholders – be they CSA members, SROs, industry and thought-leaders in the field – to help to bolster investor confidence in our markets, advisers and the value of obtaining investment advice. Especially in a low interest rate environment and where many Canadians are not participating in the equity markets and do not have defined benefit pension plans upon which to rely, access to quality advice provided by highly qualified professionals is of increased importance in providing for reliable and adequate retirement savings. We see the investor protection and market efficiency issues raised by the CSA in the Consultation as being closely connected with the issues of investor trust, transparency and education.

PMAC has been a consistent advocate of greater transparency to assist investors with greater information about their options, including around costs, risks and features of various investment vehicles. We also continually support increased investor education and outreach as a critical way to increase investor knowledge about the importance of investing, the benefits of advice, the nature of the various investor-registrant relationships, including the impact of dealer compensation on investment returns, and products available to help Canadian households meet their savings and retirement goals. We believe that regulatory change is most impactful when accompanied by a corresponding public awareness campaign which can educate investors as to their options, negotiating power and the value of advice.

We commend various members of the CSA for their very accessible, clear and informative outreach on initiatives such as fees, CRM2 reporting and identifying fraud and are of the view that more such campaigns are of essence in increasing the number of Canadians who access investment advice and who invest for their future.

Upon implementation of the regulatory amendments the CSA determines are necessary as a result of the Consultation, we see investor education and awareness as being a useful tool in combatting the risk of an advice gap as well as in informing investors of the various options that may exist in terms of paying for advice – whether this be through up-front payment, redemptions (and the tax implications thereof), embedded commissions, direct fees or otherwise.

PMAC views practical measures that bridge the gap between the often complex world of compensation structures and the sometimes opaque distinctions between types of purchase options and types of investment advice as being an essential component in any compensation reform the CSA intends to adopt. Some members noted that "CRM3" client reporting with disclosure of MERs and non-cash incentives may present one option for helping to inform clients of the total fees they pay for both products and advice.

PMAC does caution that, despite the importance of the feedback the CSA will receive through this Consultation, a focus solely on compensation models may do a disservice to investors and the industry in general by obscuring other, equally or more important, investor objectives. These include having investment goals, retirement, financial and estate planning, as well as the importance of obtaining professional advice to help clients articulate and meet their goals. While the focus on fees is a timely one, we remind the CSA that a focus solely on this aspect of the registrant-investor relationship may not ultimately serve to encourage Canadians to seek professional investment advice for the benefit of their future savings. The regulatory focus on fees focus can also have the negative effect of commoditizing investment product and services and discouraging investor research and investigation to thoroughly understand investment services and products. In addition, embedded compensation is not the only conflict of interest situation that exists within the investor-registrant relationship, as we highlight in more detail below.

Change within the industry without corresponding outreach to investors in general runs the risk of disrupting business without achieving the CSA's goals of increased alignment between investors and dealers and of increased investor negotiating power and fee transparency.

We also see a role for regulators, governments and financial institutions in responsibly employing the tenets of behavioural economics to help Canadians understand the value of advice and the value of investing in our capital markets. We commend the CSA for its work to understand the impact this discipline can have on investor behavior and how Canadians go about seeking investment advice.

Members note that the advice they provide clients extends beyond helping clients invest for retirement and understanding different types of accounts. The value of advice also involves the very detailed and knowledgeable analysis undertaken by registrants in terms of knowing their clients and knowing their products in order to help clients meet their savings goals.

Question 14 – Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

Members did not identify any other conflicts of interest that would be created by a transition to direct pay arrangements that would not already be addressed by securities law. Some members noted that an advantage of direct fee arrangements is the promotion of additional alignment of firm, registrant and client interests. While, generally, members agree that the direct fee model may carry with it the fewest inherent conflicts, they did note that the CSA's assumption that all conflicts of interest would be addressed by such a move may not be entirely accurate since conflicts can theoretically exist in any form of fee arrangement. That having been said, the duty of care owed by registrants to their investors under NI 31-103 and, additionally, the common law[2] duty owed by portfolio managers – means that there is and will continue to be an obligation on the registrant to disclose and manage all such conflicts. We see an important interaction between the CSA's concerns over conflicts of interest in this Consultation and the proposed targeted reforms in CSA 33-404. These targeted reforms would enhance conflicts of interest disclosure, management and avoidance obligations on registrants in a way that could further alleviate concerns over the impacts of such conflicts on investors, regardless of compensation structure.

Question 17 – Do you think this proposal will lead to an advice gap? In particular … are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?

Members did not feel positioned to opine on whether the proposal in the Consultation would lead to an advice gap but did note the advantages to preserving as much choice for investors as possible. Members have noted that several members of the CSA are leading the charge in enabling the

[2] And, in certain provinces, statutory, fiduciary duty.

registration of emerging business models. These regulatory initiatives may yield innovative, efficient and useful solutions for both online and traditional firms to help address the advice gap for lower wealth investors and/or to service Canadians who are not yet participating in our capital markets. PMAC urges the CSA to extend these helpful initiatives beyond the online space so that traditional firms can, where applicable, also harness these innovations for the benefit of their investors.

Members also stressed that any regulatory action arising out of the Consultation, CSA 33-404 and any future "CRM3" amendments should be as streamlined and coordinated as possible to minimize the impact of such changes on firms and to allow advisers to focus on servicing their clients. We commend the goal stated by the Ontario Securities Commission ("**OSC**") in its Statement of Priorities for the fiscal year ended 2018 in which the OSC prioritized the assessment of ways in which to reduce the regulatory burden while maintaining appropriate investor protection. We ask the CSA to view all proposed regulatory changes through this lens. PMAC supports the work of the CSA to fortify the registrant-investor relationship while ensuring that such measures are undertaken in such a way that minimizes disruption to industry as much as possible, while maximizing benefits to investors, being aware of the often significant systems, compliance, and other costs that are involved in changing business practices and of the extensive regulatory changes the investment management industry has already recently navigated.

Question 21 – …What is the likelihood and magnitude or regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?

PMAC believes that harmonization of regulatory requirements and, in particular, compensation models, will be a critical aspect of ensuring that investors are aware of their options and the fees that they pay for certain types of investments and advice. Any non-harmonized outcome will exacerbate the confusion the CSA is concerned that investors face. Non-harmonization is also likely to also have adverse impacts on the operational and compliance departments of firms that provide advice. We urge the CSA to work closely with other regulators to ensure that the possibility for regulatory arbitrage is minimized, especially if other products with embedded commissions continue to be available in other regulatory environments - regardless of the route the CSA ultimately determines to take to address the concerns identified in the Consultation. Other jurisdictions have tried to address this prior to fee reform, most notably the UK. PMAC believes that failing to implement similar fee reforms across all regulated sectors could create a real risk of a significant number of investors being steered towards those products that carry embedded compensation.

Question 22 – What impact will the proposal have on back office service processes at the IFM or at the fund dealer? In particular, is there any specific operational or technological impact that we should take into consideration?

PMAC views this as a central question that the CSA should carefully consider in making its determination as to whether and/or how to discontinue embedded commissions. Members have identified the following operational and other considerations that would need to be appropriately addressed, updated and deployed in advance of any change in permissible compensation structures.

Technology / Systems

Members noted that, were IFMs to be required to process redemptions for investor fees, this would be an intensive, manual process to implement. We understand that FundServ is working on technology to operationalize this process and urge the CSA to consider the feasibility of coordinating the effective date of any regulatory change with the availability of appropriate technology to allow firms to seamlessly adopt such systems for the benefit of investors. Members believe that implementing manual processes and/or other systems changes needed prior to having such technology available to them would increase the regulatory burden and operational risk without a corresponding benefit to investors.

Members noted that investor education – both from firms and the regulators – may be required so that clients will understand the nature of the redemptions for fees paid that will appear on their CRM2 reporting. Members anticipate that these redemptions, without proper education and messaging, may affect the performance reporting and confuse clients, resulting in an influx of investor calls.

We therefore ask that the CSA allow sufficient time for such changes to be made in advance of any implementation of regulatory amendments in this regard in order to minimize disruption to investors and stakeholders.

Concluding Comments

We would like to thank the CSA for all of the work, thought and outreach that has gone into developing and publishing this Consultation.

We do urge the CSA to carefully consider any feasible alternatives proposed that would serve to manage the investor protection and market efficiency concerns outlined in the Consultation. PMAC is strongly in favour of the CSA selecting one course of action through which to remedy or mitigate the perceived harms caused by the use of embedded commissions instead of adopting any stop-gap or temporary measures which would necessitate a series of operational, technological, communication, reporting, investment and other changes to the ways in which firms help their clients save for their future. It is our view that the industry has been tasked with implementing a vast number of changes over the past few years – many of which are positive but which have nonetheless necessitated the dedication of a great deal of business resources. Should the CSA determine to phase out the use of embedded commissions, we ask that such a transition be implemented with sufficient time to allow for all of the changes, technologies and requirements outlined in our letter - and those of other commenters - to take place with minimal negative impact on all stakeholders.

We would be happy to speak with you further about any of the remarks in our letter.

Sincerely,

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9 June 2017

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RE: CSA Consultation Paper 81-408 – Option of Discontinuing Embedded Commissions

Dear Sirs and Mesdames:

ICI Global[1] appreciates the opportunity to comment on the Canadian Securities Administrators' ("CSA") Consultation Paper 81-408 regarding the option to discontinue embedded commissions ("Consultation"). The Investment Company Institute ("ICI") and its members have closely followed global regulatory developments in this area for several years. In the United States, we have been actively engaged in the fiduciary rulemaking of the Department of Labor ("DOL"), including during the 2015 rulemaking proposal period and most recently as a result of the President's February 2017 order directing DOL to re-examine whether the rule adversely affects the ability of investors to access retirement information and advice. As the CSA evaluates comments on this Consultation, we urge the CSA to carefully consider not only the

[1] ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US$25.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

benefits that the CSA seeks to bring to Canadian investors but also the potential for the proposed changes to negatively impact investors, including reducing their access to financial advice.

In the Consultation, the CSA argues that embedded commissions cause or lead to the following harms to investors:[2]

- conflicts of interest that misalign the interests of fund managers, dealers and representatives with those of investors;
- limit investor awareness, understanding and control of dealer compensation costs; and
- generally do not align with the services provided to investors.

In support, the CSA states that "The evidence we have gathered to date shows that embedded commissions encourage the suboptimal behavior of fund market participants, including that of investment fund managers, dealers, representatives and fund investors, which reduces market efficiency and impairs investor outcomes."[3] The Consultation's Appendix A, Evidence of Harm to Investor Protection and Market Efficiency from Embedded Commissions ("Appendix") sets forth the information and studies gathered to support the CSA's identified issues with embedded commissions.

Many of the academic studies cited in the Appendix include studies relied upon by DOL for its fiduciary rulemaking. We raised significant concerns with the research cited by the DOL. We described inaccurate characterizations of the academic research and described how the academic research did not capture the current state of the US market for mutual funds sold with front-end loads. We also raised specific concerns with certain of the studies and how they were used by the DOL to support its regulatory impact analysis.[4]

The following US-based academic studies are cited in the Appendix to support the CSA's arguments concerning harms from embedded commissions and also were relied upon by the DOL for its fiduciary rulemaking:

- Susan E.K. Christoffersen, Richard Evans and David K. Musto, "What Do Consumers' Fund Flows Maximize? Evidence from their Brokers' Incentives," *The Journal of Finance*, Vol. 68, Issue 1 (February 2013) ("CEM paper").

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[2] Consultation at 3.

[3] Id.

[4] *See, e.g.*, Letter to DOL on Proposed Fiduciary Rulemaking from Paul Schott Stevens, President and CEO, Investment Company Institute, dated 21 July 2015, available at https://www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf ("2015 Letter from Paul Schott Stevens"). *See also,* Letters on Proposed Fiduciary Rulemaking from Brian Reid and David W. Blass, Investment Company Institute, dated 21 July 2017, available at https://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf, https://www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf and https://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf; and Letter with Supplementary Information from Brian Reid and David W. Blass, Investment Company Information, dated 24 September 2015, available at https://www.ici.org/pdf/15_ici_dol_ria_comment.pdf . Additional ICI testimony and other statements on the DOL fiduciary rulemaking is available at https://www.ici.org/fiduciary_rule/statements.

- Jonathan Reuter, Boston College Department of Finance, National Bureau of Academic Research, "Revisiting the Performance of Broker-Sold Mutual Funds," November 2, 2015 ("Reuter 2015")
- Daniel Bergstresser, John Chalmers and Peter Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," *Review of Financial Studies*, Vol. 22, 2009 ("BCT paper")
- John Chalmers and Jonathan Reuter, "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?" National Bureau of Academic Research Working Series/Working Paper 18158, June 9, 2012 ("Chalmers and Reuter paper") (the foregoing papers, together, the "US-based studies")

The CSA also references in the Appendix a 2015 paper by the Executive Office of the President of the United States, "The Effects of Conflicted Advice on Retirement Savings," and a 2004 study by Lori Walsh, Office of Economic Analysis of the US Securities and Exchange Commission, *The Costs and Benefits to Fund Shareholders of 12b-1 Plans: An Examination of Fund Flows, Expenses and Returns*.

As more fully described in the Appendix to this letter, we identified serious flaws in the DOL's impact analysis, including the significant misapplication and mischaracterization of several studies, including the US-based studies. Consequently, the CSA should be cautious when using these US-based studies to support broad conclusions related to adverse investor outcomes as a result of commissions paid to intermediaries.

We also direct your attention to the current re-examination of the DOL's fiduciary rulemaking and experiences with the UK's Retail Distribution Review ("RDR"). While we agreed with the DOL that advice providers should act in the best interest of their clients, we raised serious concerns that their rule would negatively impact retirement savers' access to guidance, products and services that they need to meet their retirement goals.[5] As we and others predicted, there is evidence that the DOL's fiduciary rule, as it is being phased in, is harming US investor access to financial advice. For example, since adoption of the DOL's fiduciary rule, the shift from commission-based accounts to fee-based accounts has accelerated and smaller investor accounts are being "orphaned" by intermediaries. Other disruptions and dislocations in the US retirement services industry include changes to the availability of, and investments offered in, IRA brokerage accounts as well as reductions in web-based financial education tools. Robo-advice, although offering many attractive features, will not be a perfect substitute for human interaction.[6] Similarly, the UK Financial Conduct Authority has identified concerns with higher costs for advice after RDR as well as an unwillingness of some advisers to serve smaller account customers.[7]

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[5] 2015 Letter from Paul Schott Stevens, *supra* note 4.

[6] *See*, Letter to DOL on Re-examination of Fiduciary Rule from Brian Reid and David W. Blass, Investment Company Institute, dated 17 April 2017, available at https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf ("April 2017 DOL Letter"). *See* also, Robert Van Egghen, "Survey reveals consumers distrust robo-advisers," *Ignites Europe*, May 31, 2017.

[7] "FCA admits RDR contributed to advice gap," FT Adviser, July 19, 2016, available at https://www.ftadviser.com/2016/07/19/regulation/rdr/fca-admits-rdr-contributed-to-advice-gap-hujPxa8fmBkivLaaAxxfN/article.html. *See also,* April 2017 DOL Letter at 17-18, *supra* note 6.

While we appreciate that the Canadian market may be different, we still believe that the CSA can benefit from considering the US and UK experiences to gain insights into what regulatory approaches may be most helpful in achieving the CSA's desired outcomes while avoiding unintended negative consequences for investors. The risks to investors, as briefly described above, are evident from the experiences in both the United Kingdom and the United States.

Lastly, we encourage the CSA to take time to study the effects of regulatory changes in the Canadian market, such as the new annual intermediary disclosure on fees and performance. Based on experience in the US mutual fund market, changes can take several years to be both clear and visible in terms of market outcomes.[8] The new annual disclosure in Canada provides an investor with information on direct and indirect fees paid to an intermediary. We are unaware of comparable disclosure in any other fund market. We believe that it would be valuable for the CSA to have more time to understand and assess the response of investors and markets to this information.

While we respect the CSA's request to remain Canadian-focused, we do believe the experiences in the United Kingdom and the United States are relevant and should be helpful as the CSA considers not only the benefits of the options, but also the potential for those options to create risks for investors.

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If you have any questions or would like additional information, please contact me (dan.waters@iciglobal.org or +44-207-961-0831). More specifically, for questions on our Appendix, please contact Sean Collins, Senior Director, Industry and Financial Analysis at sean.collins@ici.org or +1-202-326-5882.

Sincerely,

/s/ Dan Waters

Dan Waters
Managing Director

[8] In the United States, for example, trailing commissions paid through funds (i.e., "12b-1 fees") have been diminishing in importance since the early 2000s as a way to compensate financial professionals for providing advice. This process, though evolving over a number of years, has occurred by virtue of market forces, rather than regulatory intervention. *See, e.g.*, Sean Collins and James Duvall, "Trends in the Expenses and Fees of Funds," *ICI Research Perspective*, 23, No. 3, May, 2017.

Annex

The CSA argues that embedded commissions cause or lead to the following harms to investors:[9]

- conflicts of interest that misalign the interests of fund managers, dealers and representatives with those of investors;
- limit investor awareness, understanding and control of dealer compensation costs; and
- generally do not align with the services provided to investors.

The Consultation's Appendix A ("Appendix") sets forth the CSA's support for these assertions, including citation of the following US-based studies:

- Susan E. K. Christoffersen, Richard Evans and David K. Musto, "What Do Consumers' Fund Flows Maximize? Evidence from their Brokers' Incentives," *The Journal of Finance*, Vol. 68, Issue 1 (February 2013) ("CEM paper").
- Jonathan Reuter, Boston College Department of Finance, National Bureau of Academic Research, "Revisiting the Performance of Broker-Sold Funds," November 2, 2015 ("Reuter 2015").
- Daniel Bergstresser, John Chalmers and Peter Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," *Review of Financial Studies*, Vol. 22, 2009 ("BCT paper").
- John Chalmers and Jonathan Reuter, "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?" National Bureau of Academic Research Working Series/Working Paper 18158, June 9, 2012 ("Chalmers and Reuter paper") (the forgoing studies, together, "US-based studies").

The Appendix also refers to a study by the Executive Office of the President of the United States ("White House study"),[10] and a study by Lori Walsh, Office of Economic Analysis of the US Securities and Exchange Commission ("SEC"), *The Costs and Benefits to Fund Shareholders of 12b-1 Plans: An Examination of Fund Flows, Expenses and Returns*, April 26, 2004 ("SEC paper").

We are cognizant of the CSA request that comments, wherever possible, be Canadian-focused. Nevertheless, given that the CSA cites US-based studies as evidence in favor of its views that embedded commissions are problematic, we believe the CSA will be aided by our perspective on the US-based studies that it used as support.

In our view, the US-based studies in fact provide very mixed evidence on the issues that seem of most concern to the CSA, such as whether the payment of embedded commissions for advice creates significant conflicts of interest, that funds paying commissions tend to

[9] Consultation at 3.

[10] Executive Office of the President of the United States, "The Effects of Conflicted Advice on Retirement Savings," 2015.

underperform, that embedded commissions encourage biased representative recommendations,[11] or that the costs of advice provided through embedded commissions may exceed its benefit to investors.[12]

US-Based Studies and Intermediary Compensation – Costs and Benefits to Investors

Perhaps the most relevant and essential consideration—as we noted in our comment letters to the US Department of Labor ("DOL") regarding its fiduciary rule[13]—is that none of these US-based studies compares the costs and benefits of advice under a commission-based system with the costs and benefits of advice under direct payment arrangements. For example, these US-based studies do not compare the investment experiences of investors who pay front-load commissions (or trailing commissions paid through a fund) with the investment experiences of those who pay asset-based fees directly out of pocket to financial advisers. This issue is as relevant to the CSA's Consultation as to the DOL's fiduciary rule.

Instead, what these studies typically assess is the performance of funds that are broker-sold (where investor pay a front- or back end load fee, as well as a higher or lower trailing commission depending on the amount of any front- or back end load fee paid) with those that are no-load. In the United States, no-load funds typically have lower expense ratios than broker-sold funds because there is no payment for advice. But many US investors purchase no-load funds with the assistance of a financial adviser and then pay the adviser directly (*i.e.*, outside of the fund) for advice and assistance. These studies do not account for the cost and payment of advice made outside of the fund. Consequently, they cannot be used to determine whether investor performance would improve or deteriorate if investors lose the ability to pay embedded commissions.

Second, as we also pointed out in our comment letters on the DOL's fiduciary rule, fee-based advice paid directly to an adviser can, under certain circumstances, be more costly than commission-based advice (notably front-end load payments with a small trailing commission) or equally as costly (*e.g.*, when an investor pays 1.00 percent through a trailing commission paid within the fund versus purchasing no-load funds with the help of an adviser who then charges the client 1.00 percent, which the client pays out of pocket). In particular, while both compensation models (fee-based paid directly and commission-based) have their advantages, the commission-based model can in certain circumstances be a more cost-effective means to receive advice, particularly for buy-and-hold investors, which is the case for many investors with modest-sized accounts.

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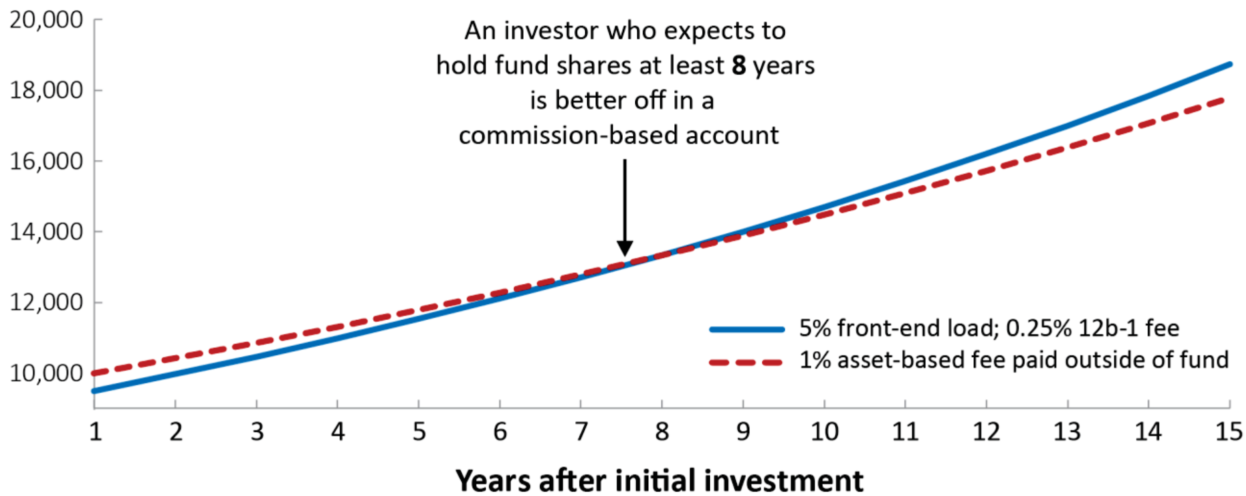
[11] Consultation at 99-106.

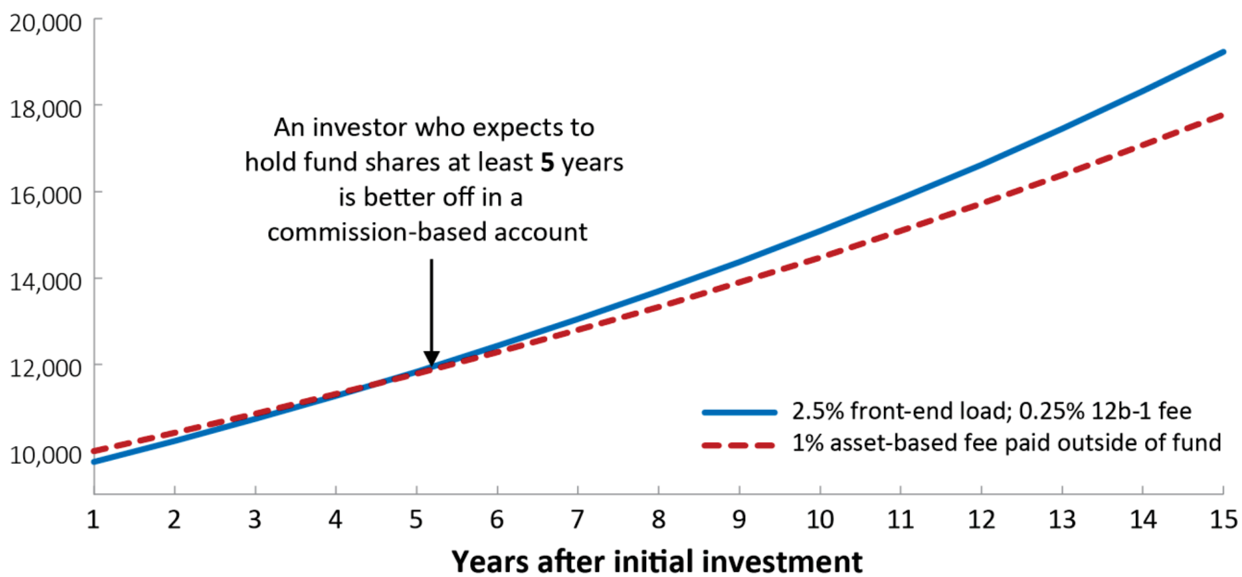
[12] Consultation at 125.

[13] Relevant submissions related to the DOL fiduciary rulemaking are cited in notes 4 and 6.

Figure 1
US Account Balances for $10,000 Initial Investment in Commission-Based Account versus Fee-Based Account*
*Account balance, dollars***



*Account balance, dollars***



* Commission-based account assumes the investor pays an upfront sales load of either 5% (top panel) or 2.5% (bottom-panel) and (in both panels) an ongoing 12b-1 fee of 0.25% per year. Fee-based account assumes the investor pays an ongoing asset-based fee of 1% per year.
** Scenario assumes a $10,000 initial investment, including (non 12b-1 fee) fund expenses of 0.75% per year, ignores income and capital gains taxes, and assumes a fund return of 6% per year, of which 5% is capital gains and 1% is income.
Source: Investment Company Institute

As an illustration, Figure 1 compares investor account balances for a $10,000 initial investment placed in a commission-based account as compared with a fee-based account. In the commission-based account, as in the front-load arrangements now common in the US fund industry, the investor pays a front-load fee (of 5 percent in the top panel versus 2.5 percent in the bottom panel) and an ongoing 12b-1 fee of 0.25 percent per year. A 5 percent front load is representative of the maximum front load an investor might pay, while a 2.5 percent load is representative of what an investor who qualifies for a discounted front load might pay. The investor in the fee-based account pays only an ongoing asset-based fee of 1.00 percent per year (which we assume the investor pays directly to the adviser), which is in line with a recent study by Cerulli Associates indicating that 96 percent of US fee-based advisers charge 75 basis points or more a year, and 85 percent charge 100 basis points or more a year.

Figure 1 shows that long-term investors may do better under a commission-based arrangement as compared with an asset-based fee arrangement paid directly to the adviser. For example, the top panel shows that an investor who has the choice between paying a financial professional an asset-based fee of 1 percent per year versus a 5 percent front-load fee (plus an ongoing 12b-1 fee) ends up with a higher account balance under the commission-based approach if he or she plans to hold fund shares longer than 8 years.

The bottom panel shows that this break-even point occurs sooner if the investor qualifies for a reduced front-load of 2.5 percent. In that case, if the investor plans to hold the fund shares for at least 5 years, he or she is better off (i.e., ends up with a higher account balance) by electing to pay for financial advice using a front-end commission-based approach.

If the comparison is intended to be between paying a trailing commission through the fund or investing in a "clean" fund (zero front- or back end-load and no trailing commission paid inside the fund) but paying a financial adviser directly for services, from the investor's point of view, either arrangement offers exactly the same net outcome (in either arrangement, the dashed red line depicts the investor's net account balance).

Understanding Specific US-Based Studies Cited As Support by CSA

Another significant concern—which we also pointed out to the DOL in connection with its Regulatory Impact Analyses ("RIA")[14]—is US-based studies have frequently been mischaracterized, misapplied, selectively interpreted, or simply misunderstood. We are concerned that by utilizing these same articles, the CSA risks treading the same path, in turn risking potentially adverse outcomes for investors.

Below, we summarize the concerns we advanced to the DOL regarding its interpretations of each of the US-based studies and which we believe also are relevant to the CSA as it considers certain US-based studies in its deliberations regarding the prohibition of embedded commissions in the Canadian market.

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[14] *See,* US Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice Regulatory Impact Analysis*, April 14, 2015, ("2015 RIA"). *See also*, Regulating Advice Markets, Definition of the Term "Fiduciary" Conflicts of Interest—Retirement Investment Advice Regulatory Impact Analysis for Final Rule and Exemptions (April 2016) ("2016 RIA").

1. <u>Jonathan Reuter, Boston College, Department of Finance, National Bureau of Academic Research, "Revisiting the Performance of Broker-Sold Funds," November 2, 2015 ("Reuter 2015")</u>

The CSA's Appendix cites the Reuter paper as evidence that funds that pay commissions tend to underperform those that do not. It interprets Reuter's paper as finding evidence that payment of dealer compensation impairs fund performs. Specifically, it states that Reuter's paper finds that actively managed non-specialized US equity mutual funds sold through brokers underperform similar actively managed funds sold directly to investors by an average of 0.65 percent on a risk-adjusted basis, or 0.42 percent after adjusting for trailing commissions (*i.e.*, 12b-1 fees).

The DOL's 2015 Regulatory Impact Analysis ("RIA") similarly claims, on the basis of academic studies, that the typical investment in a US commission-based ("broker-sold") fund underperforms direct-sold funds (i.e., no-load funds) by 100 basis points (Figure 2, Row 1). ICI, however, compared returns of front-load funds to those of retail no-load funds. We noted that to ensure commensurable return measures, it is necessary to asset-weight (to determine whether brokers' advice was causing investors to skew their purchases or holdings toward lower-return funds) and to adjust for 12b-1 fees (because investors who want advice services will have to pay for those services whether they pay an embedded commission or pay for advice directly via an asset-based fee outside the fund). On this commensurable basis, there were very modest differences (only 6 to 7 basis points) between the returns that investors earned on front-load funds and those earned on retail no-loads funds (Figure 2, Row 2).

Figure 2
Estimated Underperformance of US Broker-Sold Funds, as Reported by Selected Analyses

Row	Source	Under-performance (basis points)	Time period	Asset-weighted?	Adjusted for 12b-1 fee charges?	Risk-adjusted?	Analysis is based on assets in these types of funds:
1	2015 RIA	100	unclear	unclear	no	unclear	unclear
2	ICI 2015	6–7	2008–2014	yes	yes	yes	domestic and world equity,[1] bond, hybrid[2]
3	2016 RIA (a)	59	1980–2015	yes	unclear	yes	domestic equity
4	2016 RIA (b)	6	1980–2015	yes	unclear	yes	domestic and foreign equity
5	Reuter 2015 (a)	64	2003–2012	yes	no	yes	actively-managed domestic equity
6	Reuter 2015 (b)	18	2003–2012	yes	yes	yes	all actively-managed (excluding muni)
7	ICI 2017	11	2008–2016	yes	yes	yes	domestic and world equity, bond, hybrid

[1] World equity is an ICI category that includes funds that may invest primarily in foreign equities, or may invest primarily in a mix of both foreign and domestic equities.
[2] Hybrid is an ICI category that includes funds that invest in a (possibly changing) mix of domestic and/or foreign equities and bonds.

In part to address ICI comments in 2015, and to reflect a later, new study by Jonathan Reuter (*i.e.*, Reuter 2015), DOL's 2016 RIA, lowered its estimate of the underperformance of broker-sold funds from 100 basis points to 50-100 basis points. This is still far too high and reflects a selective reporting of DOL's own results and a selective reading of Reuter 2015.

DOL claims in its 2016 RIA that "Reuter finds that actively-managed broker-sold domestic-equity funds underperform index funds by 64 basis points per year." This result is smaller in magnitude, but consistent with previous literature showing underperformance in broker-sold domestic equity mutual funds."

In fact, when Reuter includes all types of funds (except for municipal bond funds), weights the funds by assets, and adjusts for 12b-1 fees, he finds that actively-managed broker-sold funds underperformed direct-sold funds by only 18 basis points (in Figure 2, compare Reuter 2015(a) in Row 5 and Reuter 2015(b) in Row 6). Further, when the DOL includes both domestic and foreign equity funds, it too finds very little underperformance of broker-sold funds (in Figure 2, compare 2016 RIA (a) in Row 3 with 2016 RIA (b) in Row 4) compared to direct-sold funds.

The striking difference between the performance measures in Rows 3 and 4 and Rows 5 and 6 reflects that over the periods analyzed, broker-sold domestic equity funds underperformed direct sold domestic equity funds *but* broker-sold international equity funds outperformed direct-sold international equity funds by a wide margin (about 160 basis points). Thus, commenters and policymakers that focus solely on the performance of domestic equity funds tend to adopt the view that broker-sold funds have underperformed in general, thereby evincing broker conflicts.[15]

The fact that broker-sold international equity funds outperformed direct-sold international equity funds by a wide margin suggests that the measured underperformance of domestic equity funds may arise from something altogether unrelated to broker conflicts of interest. Presumably, if conflicts of interest cause underperformance, broker-sold international equity funds should also underperform direct-sold international equity funds—not outperform by a significant margin.[16] The CSA should consider whether this same feature is present in the measured performance of Canadian mutual funds.

2. Susan Kerr Christoffersen, Richard B. Evans and David K. Musto, "What do Consumers' Fund Flows Maximize? Evidence from their Brokers' Incentives," *The Journal of Finance*, Vol. 68, Issue 1 (February 2013) ("CEM paper")

The CSA suggests that the CEM paper found that among "US mutual funds with loads or revenue-sharing that higher payments to fund brokers lead to higher inflows and that net returns are approximately 50 basis points lower for every 100 basis points of loads."[17]

This interpretation, however, is misleading. The CEM paper focuses on the relationship between fund net returns (relative to a benchmark) and "excess loads" paid to brokers. They define excess loads as the amounts paid to a broker over and above that that would normally be expected given the level of load a fund collects from an investor and given a range of other factors. Thus, taking their results as given, one would properly conclude that net returns are approximately 50 basis points lower for every 100 basis points of *excess loads* paid by funds to brokers.

[15] The CSA may invite readers to draw that conclusion when it states that Reuter 2015 indicates that "the average 10-year return for direct-sold funds held a 0.42% point advantage over broker-sold funds, using a value-weighted average." In fact, in Reuter's 2015 study that is true only if the focus is on actively-managed *domestic equity* funds. When Reuter includes *all* funds (excluding only muni funds), he finds underperformance of only 0.18% for broker-sold funds, slightly above the 11 basis points that ICI found for the period 2008 to 2016.

[16] The DOL's 2016 RIA was unable to explain this inconsistency in the US data. See 2016 RIA at 337, footnote 628.

[17] Consultation at 100.

An excess load of 100 basis points is extremely high, so high in fact as to be all but unobservable in the data. In fact, for 2013, averaged across all funds that made greater-than-expected payouts to brokers (i.e., had excess loads above zero), the average excess load is just 0.15 percent. On this basis, we calculate that the Christoffersen et al. model would predict underperformance of just 8 basis points.[18] Moreover, this would be true only for those funds that made greater-than-expected payouts to brokers. Those that made lower-than-expected payout to brokers (which amounts to half of the load fee funds in the sample) would be expected to *outperform* their benchmarks by some amount.

Moreover, the DOL's application of the CEM study embodies a mathematical error. This caused the DOL to overstate by 15 to 50 times any potential dollar benefit from its fiduciary rule (the effects of the DOL's fiduciary rule are in the main expected to have the effects of banning commissions at the fund level, whether front-load, back end-load or trailing commissions). After adjusting for this mathematical error, the net benefits of the DOL's fiduciary rule are about zero.[19]

In short, we urge the CSA to be cautious about interpreting the results in the CEM paper.

3. John Chalmers and Jonathan Reuter, "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?" National Bureau of Academic Research Working Series/Working Paper 18158, 9 June 2012 ("Chalmers and Reuter paper")

In support of the CSA's claim that conflicted advice may negatively affect investor outcomes, and also that investors may not derive offsetting benefits from the payment of trailing commissions, the Consultation cites the Chalmers and Reuter paper. The Chalmers and Reuter paper, updated in 2015, attempts to measure the impact of broker recommendations on US client portfolios. The authors find that plan participants in an Oregon University System who used brokers that were offered by one of their defined contribution plan providers between 1996 and 2009 were likely to need help with asset allocation and fund selection. Over the period 1996 to 2007, participants had access to a broker but no access to a target date fund. The authors found that plan participants who used a broker would have had better outcomes if they had been able to be defaulted into a target date fund. What this suggests is that well-designed target-date funds can be a valuable default option for participants in US employer-sponsored plans.

But, this must be interpreted carefully. The results in Chalmers and Reuter may be entirely consistent with plan participants doing better with advice than without. For example, during the period 1996 to 2007 when plan participants had the choice of using a broker or not (but in either case did not have access to a target date fund), a rather high proportion (roughly 30 percent) of the plan participants who chose not to use a broker were defaulted into a money fund option. For many US long-term retirement savers this is likely a sub-optimal choice. In contrast, plan participants who used a broker were defaulted into a somewhat similar option (a fixed annuity) very infrequently (only 2 percent of the time), instead apparently taking broker advice to invest in US equity mutual funds. Thus, although Chalmers and Reuter do not present evidence on this issue, it is possible that plan participants

[18] This is based on 2013 data, which is the most recent data ICI had available to it when these calculations were undertaken.

[19] *See*, April 2017 DOL Letter, *supra* note 6.

who used brokers over the period 1996 to 2007 experienced better performance than plan participants who over the same period did not use a broker.

In addition, Chalmers and Reuter show that over the period 1996 to 2007, plan participants who elected to use a broker had access to a much wider array of fund choices compared to plan participants who chose not to use a broker. For example, Chalmers and Reuter show that in 1996, plan participants who elected to use a broker could choose from among 40 different fund options, including 21 different US equity funds and 3 passively managed funds. At that time, plan participants who elected not to use a broker had a much narrower array of funds available to them, just 10 in total, of which only 2 were US equity funds, and only 1 fund was passively managed. Clearly, plan participants may have been willing to incur a distribution charge in order to have the benefit of investing in a much wider array of investment options.

In short, the CSA claims too much in suggesting that the Chalmers and Reuter paper provides evidence that "investors derive almost no offsetting benefits from the payment of distribution fees." In fact, as we discuss below with respect to the next paper—the BCT paper—there are very likely significant "intangible benefits" to using a broker.[20]

4. <u>Daniel Bergstresser, John Chalmers and Peter Tufano, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," *Review of Financial Studies*, Vol. 22, 2009 ("BCT paper")</u>

The CSA cites the BCT paper as evidence that "[c]onflicted advice may negatively affect investor outcomes."[21] In fact, the evidence in the BCT paper is highly mixed and the authors are very careful in their interpretation of their evidence. For example, they, like Reuter 2015, report that "broker-sold funds deliver lower risk-adjusted returns." But, as in Reuter 2015, BCT also report that broker-sold foreign equity funds outperform direct-sold funds by a wide margin. Again, if broker incentives were causing brokers to direct investors to underperforming funds, that should presumably be evident across the entire spectrum of funds. That that is not the case suggests something other than broker incentives may be driving the results on fund performance.

The CSA also cites the BCT paper as evidence that "[i]nvestors may not derive offsetting financial benefits from the payment of trailing commissions."[22] We also would caution against this interpretation. The authors themselves note that their results are consistent with two quite different hypotheses. One is that, as CSA seems to suggest, there are material conflicts of interest between brokers and their clients. The alternative the BCT paper offers is that "brokers deliver substantial intangible benefits that we [the authors] do not observe."[23] For example, as BCT state, "[b]rokers may help their clients save more than they would otherwise save, they may help clients more efficiently use their scarce time, they may help customize portfolios to investors' risk tolerances, and they may increase overall investor comfort with their investment decisions."[24]

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[20] The BCT paper uses the term "intangible benefits" to refer to benefits they are unable to measure using their data. This should not be construed, however, as implying that those benefits are "intangible" to the investors who receive financial advice and assistance from brokers or other financial professionals.

[21] Consultation at 106.

[22] Consultation at 125.

[23] *See* BCT paper at 4130.

[24] *See* BCT paper at 4131.

In our view, this latter interpretation is correct, but is in fact only a partial list of the benefits brokers or other financial advisers may provide to clients. Other benefits may include helping clients: plan for and manage their assets in retirement; manage tax-related issues; create estate plans; determine how best to react to market downturns; plan for, and choose investments suitable for, saving for home purchases or education.

These kinds of "intangible" benefits can be very significant. For example, a 2013 Morningstar study attempted to quantify the benefits to consumers of receiving financial advice. They focused on five financial planning decisions and techniques, finding that advice creates value in each of the five categories, for a total increased gain of 1.6 percent, compared to the baseline when no advice is received.[25] An additional Morningstar study showed that financial advice can help investors improve their optimal timing of taking Social Security benefits, adding gains of another 0.74 percent per year.[26] Combining both estimates, these studies suggest that better financial decision making achieved through professional financial advice, can add 2.34 percent annually to an investor's returns. By this standard, even if studies such as the BCT paper are correct that broker-sold funds underperform direct-sold funds by 50 to even 100 basis points,[27] investors who seek financial advice might on net still come out far ahead.

The Appendix describes Canadian studies that also discuss the value of advice for mutual fund investors. For example, the Appendix cites one study as indicating that clients who work with an adviser can theoretically add about 3 percent to their net returns.[28] Another Canadian study the CSA cites suggests that advice can help overcome biases such as "the tendency to prefer short-term gratification (consumption) over longer-term returns (saving), inertia and status quo bias and a propensity to push to a later date actions that require self-control."[29] Finally, the Consultation cites a study of Canadian investors by Foerster et al., which posits that funds investors may seek advice from fund dealers or representatives who provide benefits "in the form of financial planning, including advice on saving for college and retirement, tax planning and estate planning."[30]

5. Other US-Based Papers

The Annex also describes a White House study and a 2004 SEC paper. We briefly discuss each of these papers.

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[25] *See* David Blanchett and Paul Kaplan, "Alpha, Beta, and Now… Gamma," *The Journal of Retirement* (Fall 2013). An earlier version is available from Morningstar at https://corporate1.morningstar.com/uploadedFiles/US/AlphaBetaandNowGamma.pdf.

[26] *See* David Blanchett, "When to Claim Social Security Retirement Benefits," *Journal of Personal Finance*, 11(2), 2012. Also see Wade Pfau, "The Value of Sound Financial Decisions: From Alpha to Gamma," *Forbes*, online edition, available at https://www.forbes.com/sites/wadepfau/2016/05/05/the-value-of-sound-financial-decisions-from-alpha-to-gamma/#7127ba7255df.

[27] The BCT paper indicates that broad equity funds (i.e., excluding foreign equity funds), underperform direct sold funds by anywhere from as little as 23 basis points to as much as 88 basis points, depending on how they risk-adjust fund returns.

[28] *See*, Vanguard research, "Putting a value on your value: Quantifying Vanguard Advisor's Alpha", (September 2016), https://www.vanguard.com/pdf/ISGQVAA.pdf.

[29] *See* Consultation at 128, citing a paper by The School of Public Policy at the University of Calgary.

[30] *See* Consultation at 128, citing Stephen Foerster, Juhani Linnainmaa, Brian Melzer and Alessandro Previtero, "Retail Financial Advice: Does One Size Fit All?," NBER Working Paper 20712, (2014), available at http://www.nber.org/papers/w20712.

● *White House study.* The CSA cites the White House study in support of the view that conflicted advice may negatively affect US investor outcomes. The CSA states that the White House study found that "conflicted advice leads to lower investment returns. Savers receiving conflicted advice earn returns approximately 1 percent point lower each year." The White House study, however, undertakes no independent analysis. Instead, it simply seeks to summarize and synthesize results from a number of academic studies, including those discussed in this Appendix.

It should be apparent from the discussion around Figure 2 above, however, that the White House conclusion is not supported by recent studies comparing performance of US broker-sold to US direct-sold funds. Even a highly selective reading of those studies suggests that broker-sold funds underperform by at most 64 basis points. But the broadest, most comprehensive, and most pertinent measures of fund performance—including those provided by the DOL itself—offer little support for the contention that US broker-sold funds dramatically underperform (see Figure 2, lines 4, 6 and 7). At most, the evidence suggests broker-sold funds might underperform very modestly. Further, even if so, as the BCT paper suggests, investors might be willing to bear this modest cost in exchange for the valuable "intangible" financial advice that brokers provide.

● *SEC paper.* The CSA cites as evidence a 2004 study by the Office of Economic Analysis of the SEC as highlighting that trail commissions (*i.e.*, 12b-1 fees) might create conflicts of interest. Namely, the CSA summarizes the SEC paper as indicating that "investment fund managers use fund unitholder money to pay for asset growth from which the investment fund manager is the primary beneficiary through the collection of higher fees and the unitholders are not obtaining the benefits they should from the payments of 12b-1 fees."[31]

At root, the issue that the SEC's paper tries to tackle is whether investors who seek advice should pay for it through a disclosed front-end load rather than a trailing commission paid inside the fund. The SEC paper seems to conclude that advice-seeking investors will always be better off paying a front-load fee.[32] The SEC's paper, however, did not take into account an investor's holding period. A 2004 paper by ICI staff shows that shorter-term investors, when faced with the choice of paying for advice through a front-load fee or a trailing commission, will generally be better off paying a trailing commission.[33] Longer-term investors will generally be better off paying a front-load fee. Figure 1 illustrates the same message.

[31] The quote is drawn from the Consultation, not the SEC paper.

[32] The SEC paper argues that "If 12b-1 plans constitute a net benefit to investors, the amount of the annual fee should be recovered through higher net returns. Higher net returns could derive from either lower expense ratios due to economies of scale or higher gross returns due to the enhanced capacity of funds to either invest in assets with higher yields or reduce transactions costs. Overall, the results are inconsistent with this hypothesis. 12b-1 plans do seem to be successful in growing fund assets, but with no apparent benefits accruing to the shareholders of the fund." There is, however, another possibility. It could be that investors pay for the assistance of a broker or other financial adviser through a 12b-1 fee. Although this reduces the net return an investor may receive on any given fund, the investor's overall portfolio return may be higher because, for example, the broker provides advice on which group of funds to select in light of the investor's characteristics and market conditions, when to rebalance, when and how to drawn down balances for retirement in order to minimize taxes and so forth. The SEC study does not measures the increased returns investors may experience from the "intangible" benefits of better overall financial decision-making.

[33] *See* Sean Collins, "The Effect of 12b-1 Plans on Mutual Fund Investors, Revisited," working paper, Investment Company Institute, 2004, available at https://ssrn.com/abstract=522442.

In sum, the SEC paper is not about whether investors are better off paying for advice versus not paying for advice. It is about whether investors are better off paying for advice through front-load commissions or through ongoing asset-based fees. As the paper by ICI staff shows, there is no single “right” answer. It depends on the individual’s characteristics.

In addition, it is worth noting that the SEC paper was published in 2004 and the results are thus somewhat dated. The US advice market has changed significantly since then, with a shift away from the payment of commissions through front-load fees toward the payment for advice using asset-based fees outside of the fund. Because the paper is somewhat dated, and the issue the paper addresses is whether investors are better off paying front-load versus trailing commissions inside the fund, the CSA may wish to reconsider the relevance of this paper for the issues at hand.

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June 9, 2017

British Columbia Securities Commission
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Financial and Consumer Affairs Authority of Saskatchewan
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Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commissions, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
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Dear Sirs / Mesdames:

Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (CP 81-408) (the Proposal)

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on behalf of our members in response to the request for comment on the Proposal. The IIAC is the national association representing the position of 130 IIROC-regulated Dealer member firms on securities regulation, public policy and industry issues. We work to foster a vibrant investment industry driven by strong and efficient capital markets. The IIAC formed a Working Group of member firms to review the Proposal and assist in formulating a of our response.

The Proposal clearly outlines its rationale and objectives. It articulates the options considered and the reasons the CSA has chosen not to pursue certain options because they may not adequately address identified investor protection and market efficiency issues. We also applaud the CSA for the research undertaken in advance of the release of CP 81-408 to provide evidence for stakeholders to consider.

Overview

The IIAC agrees with some of the investor protection and market efficiency issues identified in the Proposal. In particular, we support the need to rationalize the fund series that currently exist, the desire to eliminate compensation-related conflicts and the objective to address transparency of dealer compensation costs. However, the IIAC does not agree with all the key investor protection and market efficiency issues identified by the CSA and that a discontinuation of embedded commissions will necessarily address and resolve these issues. The IIAC questions the CSA assumption that investors would pay less through direct pay arrangements than what is currently paid under embedded commissions arrangements. We believe that assumption is inaccurate especially for mass-market and mid-market investors.

Implementation of this Proposal will lead most IIAC members to consider how their businesses currently operate and the most effective and efficient means to ensure firms and advisors are compensated in the future under any revised regulatory model. The mitigation measures outlined in CP 81-408 fail to appreciate the shift of IIAC members to business models that charge a fee for advisory services. IIAC members have made it clear that this shift to fee-based accounts is the likely result should the CSA proceed with a ban on embedded commissions. This is a significant unintended consequence that the CSA has failed to consider.

Firms anticipate difficulties in adopting the other direct pay options the CSA has identified. Flat or hourly fee arrangements may introduce new potential conflicts of interest, more work and systems costs for dealers and significant adjustments in the client advisor relationship and the compliance oversight regime. It is not likely to reduce costs or fees paid by investors. Firms outlined that it will be challenging to create arrangements that would make flat or hourly fees economically viable, including how to calculate in advance how much advice and service a particular client may want. Different clients will want more or less of a relationship with their advisor. IIROC advisors are also able to provide clients with an array of products beyond mutual funds and as a result, it would be difficult to separate out the advice provided direct pay arrangements for mutual funds as opposed to securities. It is unclear how an advisor could charge an hourly rate if the meeting with the client involves multiple product types. Consequently, determining a flat or hourly fee in advance that reflects potentially different levels of services and product needs that may be offered is a significant hurdle for firms to address.

The option of allowing investment fund managers to facilitate investors' payment of dealer compensation by collecting it from a client's investment and remitting it to the dealer on the client's behalf is also less likely to be an option that will be utilized by IIAC members.[1] It is unclear how many investment fund managers have the capability to offer this service or be willing to adopt it. How would that compensation be calculated - a percentage? A flat fee? There may also be tax consequences if the investment is in a registered account and redemptions are required to pay the fee.

Most investment dealers do not have the compliance or technological capabilities to track and replicate the "trailer" on a product-by-product level (currently, the fund managers provide this service for trailers). Generally, trailing commissions are standardized by fund type; i.e. equity funds generally have a 1% trailer, fixed income funds a 0.5% trailer, and money market funds a .15% or .20% trailer. If a client has a variety of funds in their account with different fee schedules, the investment dealer is unable to systemically track different fees and cannot replicate those trailer amounts at the product level. Investment dealers would instead likely impose a flat or tiered fee at the account level which could be costlier for the client.

Fee-based compensation is seen to be the most logical solution for the majority of IIAC member firms. This was, in part, recognized by the CSA, which stated in CP 81-408 that "some dealers and their representatives may decide to refocus their business on high net worth fund investors and/or charge a fee for advisory services that some investors may not be able to afford, thus increasing the potential for certain investors to lose access to advisory services."[2] Furthermore, "moving to a fee-for-service model could have the consequence of discouraging some investors from seeking financial advice."[3] It is our view that the shift by investment dealers to a fee-based arrangement is likely to drive up the cost of advice and exacerbate the advice gap.

The Proposal suggests that robo-advice is a solution should there be a prohibition on embedded commissions. Robo-advice may be the only viable option for lower net worth clients with account sizes below fee-based account thresholds assuming the investment dealer firm offers technology based robo-advisory services. However, those investors would lose access to face-to-face KYC advice and personalized service.

As indicated above, investment dealers will likely adjust to a prohibition on embedded commissions by introducing more clients to fee-based accounts. Not only do firms see it as the most practical solution, but firms have indicated that they have increasingly shifted away from a transaction-based model to a fee-based model in general as a business decision. Most firms have said they have seen significant growth in fee-based accounts. Some have indicated that it is a "strategic imperative".

To illustrate this, one need only examine the data in the Investor Economics, Winter 2016 report. For example, fee-based brokerage accounts increased from 11% in 2011 to 22% in 2016, while transaction-based business saw a drop from 85% to 67%. This is partly due to the fact that mutual fund assets were not included in the earlier transition to fee-based programs, but have more recently caught up. Specifically, F-series in fee-based accounts have grown from $9.2 billion in 2004 to $83 billion in 2015.

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[1] One firm on the IIAC Working Group did indicate that they currently use this pay arrangement.

[2] See page 77 of CP 81-408.

[3] See page 66 of CP 81-408.

The data also shows that assets in fee-based accounts in general have increased from $202 billion in June 2011 to $448 billion in June 2016. Conversely, transaction-based accounts have been relatively stagnant over this same period of time. This will likely only accelerate in the future, as Investor Economics indicated that mutual funds have gained momentum and will continue to grow in fee-based brokerage programs, even without the implementation of a proposal to ban embedded commissions. By mid 2016, fee-based assets represented 43% of total assets in the full-service brokerage channel, up from 24% five years ago.

Also of note is that the adoption of fee-based accounts was even more rapid after the 2008 downturn. This point further illustrates that robo-advice may not necessarily be the method chosen by many investors, especially when a downturn in markets eventually occurs.

The CSA's assumption that investors will directly negotiate the fee they pay to dealers appears unfounded. Clients notionally have the ability to negotiate payment for certain services today, however it is rare and occurs almost exclusively with savvy, high net worth clients and certainly not "mass market" investors.

On page 72 of CP 81-408, the CSA outlines that rather than the clear disclosure of fees as required under CRM2, an upfront discussion and agreement regarding compensation will address the questions regarding what fees are being paid and what they are being paid for. While the CSA argues that the upfront negotiations will require advisors to better explain their value proposition, CRM2 has already increased the saliency of fees and prompted important discussions of value. All our members have indicated that in the last 18 months or so, they have been preparing their advisors to have these discussions with clients before the first performance reports were released in January 2017 under CRM2. Firms have spent countless hours with advisors to prepare them for these discussions that have been underway with clients for some time now. As a result of CRM2, clients, more than ever before, can see the true costs of trailer fees down to the last dollar and make a determination if they are receiving value for the fees paid and advice provided.

Related to this point is the IIAC's continued view that the CSA should delay any immediate regulatory changes until further analysis of the results of CSA survey on how firms are compensated for their services, how they compensate their representatives, and how they manage conflicts of interest is completed[4], as well as the multi-year research project by the CSA on the POS and CRM initiatives and their effectiveness in addressing the concerns outlined by the CSA. Throughout CP 81-408, the CSA has requested data and we encourage the CSA to adhere to their promotion of data driven policy-making by ensuring that not only the CSA survey data, but the IIROC's recent Compensation-related Conflicts Review as well as the just-released MFDA results, are fully considered as part of the policy decision making process for this Proposal. In particular, the MFDA results indicate broader use of investment funds among the mass-market Canadians and suggest a greater potential for an advice gap if there is a ban on embedded commissions than what is outlined in the Proposal.[5]

[4] CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*. (2016), 39 OSCB 10115.
[5] MFDA Bulletin #0721-C *MFDA Client Research Report: A Detailed Look Into Members. Advisors and Clients.*

While the CSA argues that investors will have the choice of payment arrangements they prefer and are most convenient to them, in actual fact, most IIROC firms will require investors to enter into fee-based arrangements. We acknowledge that fee-based arrangements may not be suitable for all investors but in practice, this will be the most efficient and effective method for firms to be compensated for the sale of mutual funds. Those clients who do not meet the minimum requirements set by firms will have to seek advice elsewhere, or not at all.

Another assumption made by the CSA is that while the IIAC agrees that the complexity of the mutual fund fee structure and options of fund types can be overwhelming to investors, the CSA has failed to address the complexity and confusion that may arise in the future when investors begin to see two different charges for their mutual fund purchases – one for the MER that is now stripped of an embedded commission and another fee charged for the fund by the dealer as a direct pay arrangement. The CSA has seemed to exclude a discussion of the MER from CP 81-408 and that clients will continue to pay it even with a discontinuation of embedded commissions.

We expand upon our high-level concerns in our responses to the Proposal's questions below.

Response to CSA Questions

Questions 4. For each of the following investment products, whether sold under a prospector in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**
- **structure note**

should the product to subject to the discontinuation of embedded commissions? If not:

a. **What would be the policy rationale for excluding it?**
b. **What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?**

The IIAC is of the view that for many reasons, if embedded commissions were discontinued, it should apply for products sold in the exempt market and under a prospectus. From a practical perspective, having two different infrastructures for both would be challenging for firms. In addition, as suggested by the CSA, this could lead to potential conflicts of interests for representatives who could chose to sell a product via the exempt market with a trailing commission when such a commission would not be received if the product was sold under a prospectus.

Question 5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

The IIAC has not identified certain types of funds or structured notes that should not be subject to the discontinuation of embedded commissions should the CSA proceed with this Proposal.

Question 6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

The IIAC supports a level playing field for the industry and supports the inclusion of products that could otherwise present arbitrage opportunities, such as segregated funds, among others.

Question 8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

a. **The payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;**
b. **Referral fees; and**
c. **Underwriting fees.**

a. Marketing and Educational Practices

NI 81-105 policies regarding marketing and educational practices are well understood, managed and enforced, and as such, we do not believe there is a policy rationale that would justify discontinuing these payments or benefits. Members acknowledge there may have been historical abuses (pre-introduction of NI 81-105) but since the implementation of NI 81-105, firms have implemented robust internal policies in addition to being tightly regulated by IIROC to prevent abuses. Other jurisdictions such as the U.K., which banned embedded commissions, continue to allow marketing and educational payments recognizing their benefits. NI 81-105 requires the dealer incur 50% of the costs of the educational event, removing conflicts and financial incentives for dealers to participate in these events. Members believe educational payments are vital to help fund education and training events that are essential for front line sales staff. Without these events, the cost burden for firms to provide for additional education would increase.

b. Referral Fees

The Proposal does not provide any policy rationale for a potential ban of referral fees. The CSA should not consider wholesale policy changes without articulating the investor concerns and potential consequences. Sections 13.7 to 13.11 of NI 31-103, in addition to provisions in the Companion Policy, clearly outline restrictions and disclosure requirements for referral fees. CRM2 further increases the transparency of referral fees for registerable services, and there are overarching conflict of interest provisions that apply. IIROC dealers have strict internal policies that track and manage referral arrangements and do not believe that referral fees will provide arbitrage opportunities or are misused in the IIROC channel. Furthermore, given the tight controls advisors are subject to if they engage in referral arrangements, members find that advisors do not enter into such arrangements frequently. As such, the current regulatory framework for referral fees is satisfactory.

c. Underwriting Fees

Similar to our comments above, there has been no policy rationale provided for a potential ban on underwriting fees for mutual funds or structured notes. The removal of underwriting fees could be a disincentive for sales through this channel and have negative capital market consequences. Clients value access to new issues as they can buy the securities at new issue price versus secondary market pricing. Firms note that the sale of closed-end mutual funds requires additional work of the advisor, which justifies the additional fee.

Question 9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

IIAC members believe that the rules regarding marketing and educational practices should be maintained. As previously noted, there are already restrictions regarding contribution levels and we do not believe it is necessary to change the scope of the permitted payments or benefits. However, as the IIAC commented in relation to CP 33-404, we suggest that the application of NI 81-105 be expanded to include pooled investment vehicles and structured products, especially when they are targeted towards retail investors.

Question 10. With respect to internal transfers payments:

Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

Integrated financial service providers of the IIAC Working Group indicated that they do not provide internal transfers payments to their affiliated dealers instead of trailers with respect to mutual fund products. The affiliated dealers and their representatives receive the same trailing commissions as an unaffiliated dealer or those selling third-party products would.

Question 11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

IIAC members support preserving choice for client payment options for advice and products. This payment option is currently permitted and we believe this option should continue if embedded commissions are discontinued. While the majority of IIAC members intend to move clients to fee-based accounts and are unlikely to use this payment option, this payment option could be very important for client-name accounts where the client cannot maintain a cash component inside their account and for firms that serve clients who may not meet fee-based account minimums.

Question 12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

The IIAC does not agree with all of the investor protection and market efficiency issues identified and we do not believe that the Proposal, if implemented, would satisfactorily address those concerns. Further, throughout this submission, we have outlined a number of potential negative consequences, including decreased choice in payment options, and an increase in the cost of advice.

In addition, the Proposal may not have the desired impact on the cost of products that the CSA envisions. The IIAC questions the CSA's view that the Proposal could reduce overall investing costs through product movement from higher cost mutual funds to lower cost passive investments. The preference by many advisors for actively managed funds is not because of compensation, but based on the benefits of active management. The CSA appears to be comparing product costs without considering the value proposition between the products. ETFs are still a "newer" product and they have not been part of many clients' portfolios during a market downturn and it is not clear how clients will react when there is a market correction. Further, there are regulatory and operational impediments for advisors in the MFDA channel to sell ETFs.

Change in investor experience and outcomes

Question 15: What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

Will investors receive advice and financial services that are more aligned with the fees they pay?

This question presupposes that clients are not currently receiving services aligned with the fees paid. IIAC members would disagree with that generalization for their clients and believe that initiatives such as CRM2 are helping clients understand the value they receive for their fees. Further, clients require different levels of service based on their unique needs, ability to pay for services and other factors. Service levels should not be judged against a checklist of "must-dos" to add value.

It is important to point out that for IIAC members, the embedded commissions that clients pay, regardless of the fund purchased, are generally consistent for each asset type; approximately 1% for equity funds and 50 bps for fixed income funds. There is little variability in the rates for each category of asset class that dealers receive. Trailer fees are more standardized today than they were in the past and thus, firms believe it is quite likely that clients will be paying more for the same funds in the future if these clients are required to purchase those funds within a fee-based account or other direct pay arrangement. This is especially true for clients with smaller investable asset amounts. For most fee-based accounts, the percentage of the fee is reduced for clients with higher investable assets. A client may now be charged a fee in excess of 1% for all account assets not just the specific fund. As a result, fees may be higher for many clients and the client needs will not necessarily have changed. While the fees and services may be aligned within fee-based accounts, some clients might be better served in a different sort of account arrangement, with reduced services and fees – although those options will also limit the ability for a high degree of face-to-face advice.

In addition, while the CSA believes that a discontinuation of embedded fees would result in a better and clearer advisor-client relationship, an hourly or flat fee will not necessary provide the client with the level of service envisioned by the CSA.

What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?

Currently, the products available and the level of personalized advice for clients using robo-advice is relatively limited. It is unknown at this time if robo-advice will expand to include a broader range of products and services, including actively managed products and offer increased levels of personalized advice. Further, it is undetermined what the pricing of robo-advice would be for those potential services.

While firms acknowledge the role that robo-advice has in today's market, it is still a small portion of the market and does not meet all investors' needs, especially those who are seeking face-to-face advice. Among Canadians who identified their primary investment relationship as full-service (i.e. with a dedicated human financial advisor), only 3% indicated they have tried using a robo-advisor.[6] As the CSA considered, it is also possible that these online entrants will not grow or stagnate at current levels.

A point made by the CSA in CP 33-404, and a point with which the IIAC agrees, is that there should be more emphasis on the need for increased professionalism of the industry and the provision of advice. However, by relying on robo-advisors to help certain clients, the focus becomes more on product advice rather than what the objectives of CRM 1 and 2 set out to achieve – that of enhanced communication and improvement of the advisor-client relationship in order to better inform the client of the nature of the account relationship and the services offered to clients.

This is evident from a recent article in Advisor.ca.[7] It demonstrated that while robo-advisors offer lower fees which can save investors a great deal of money, it fails to provide the advice that a human advisor can recommend – such as whether it is better to contribute to a TFSA or RRSP, how to pay off their credit card debt faster, how to create a budget, how to use tax savings from RRSP contributions to make lump-sum payments on a mortgage, etc. Therefore, while fees matter, it is clear that advice also matters.

As we outlined previously, many firms plan to only offer fee-based accounts if the Proposal is implemented. As a consequence, some clients will not have sufficient levels of investable assets to meet the minimums for fee-based accounts and may be forced to use robo-advice whether they wish to or not. Other clients may be seeking new advice models as a result of their investment dealer consolidating or leaving the advice space, and still others may choose robo-advice based on costs or other preferences. While these changes may certainly lead to additional growth in automated advice, based upon the present

[6] *2016 J.D. Power Canadian Full-Service Investor Satisfaction Study*
[7] See http://www.advisor.ca/news/industry-news/do-human-advisor-fees-offer-more-value-than-robo-advisor-fees-225908

robo-advice product and advice landscape, not all clients will be best served by shifting into the robo-advice channel.

Further, the IIAC is particularly concerned with how seniors may be negatively impacted if they are encouraged to shift to a robo-advisor. Additionally, as baby boomers near retirement and enter the de-accumulation phase, direct advice from an advisor will become increasingly important.

The IIAC and IIROC have both issued guidance and best practices for members on how to address seniors' issues. There are concerns regarding diminished capacity, use of powers of attorney and financial exploitation. One of IIROC's best practices relates to effective communication with senior clients and we wonder how robo-advisors will be able to manage communications with senior clients to assess if there are issues of diminished capacity or if someone is pressuring the client to change the asset allocation within their account. Emails, or phone conversations may not be able to pick up the same risk factors that an advisor could identify in face-to-face meetings. This is a regulatory area that must be considered if the CSA continues to promote robo-advisors as a solution to address the potential personalized advice gap that could result from CP 81-408 implementation.

Is discretionary advice likely to increase in Canada as we have seen in other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?

Discretionary managed accounts require certain minimum asset thresholds (some firms have stated they are sometimes set at $250,000, however many PMs will have their own minimums which tend to be higher and closer to $500,000) and their growth will be limited to clients that satisfy those requirements. There are increased regulatory requirements, including proficiency and supervision requirement for discretionary accounts. In order to mitigate risk associated with managed accounts, they are generally limited to certain types of clients (often knowledgeable and sophisticated), and restrictions are placed on the types of products that may be purchased within such accounts. Most often, managed accounts have a much more limited shelf of permissible products, including the purchase of options or the use of margin. New issuances and structured products are also relatively rare. The most important difference is the full discretion the advisor has over the products selected. Further, given the specific investment strategies and value proposition for clients who have managed accounts, they would not expect the portfolio manager to be purchasing mutual funds within such accounts. Consequently, it is unlikely that there will be substantial growth of discretionary advice in the mass-market segment. Furthermore, as the CSA correctly pointed out, if an increase in discretionary advice were to occur, it would "be likely to drive up the cost of advice."[8]

Despite the inability of many investors to afford discretionary advice, other regulatory proposals such as a best interest standard with its accompanying legal implications and inherent risk, may result in many firms simply offering managed accounts to their clients, further encouraging the growth of discretionary managed advice.

[8] See page 61 of CP 81-408.

What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?

There may be some growth in this channel for reasons similar to robo-advice as some clients will not satisfy the account minimums for fee-based accounts and may not have alternative account type options at a particular dealer, other clients may be disenfranchised as a result of their dealer consolidating or leaving the advice space, and other clients may choose online based on costs or other preferences. However, many clients do not have the financial knowledge, time or the desire to manage their financial investments themselves and want access to financial advice. It would not be beneficial for investors to be shifted into the discount brokerage channel if their preference would be to have access to personalized financial advice.

The Proposal would also likely have an impact on the fee structure for discount brokerage accounts. Embedded fees subsidize other costs associated with managing and operating the account. Some firms have said that without embedded fees, their platform would no longer be profitable or sustainable. Firms must determine how to adapt their trading fee structures – currently many platforms allow clients to buy or sell mutual funds without a trading fee and to make switch or redemptions without fees. Going forward, there may be fees for each of those transactions. As mutual fund trades are among the most expensive to process, firms may be required to increase or introduce new fees to recapture their costs, such as ongoing administration fees to ensure the model remains economically viable. Firms also indicated a possible reduction of offered products and the availability of tools and resources would have to be considered to potentially reduce expenses.

Question 16: What types of payment arrangements are likely to result if this proposal is adopted? In particular:

Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?

As previously discussed, most firms would move to fee-based payment arrangement and are generally not considering flat fees, hourly fees or front-end fees as payment arrangements.

Question 17. Do you think this proposal will lead to an advice gap?

On the topic of the advice gap generally, the IIAC notes that the CSA stated the following in CP 81-408:

Based on the experience in other jurisdictions, we note that an advice gap is not a phenomenon that occurs only because of a ban on embedded commissions, but rather it is a function of a number of factors (changes to existing business models, changes to consumer preference, technological changes, etc.) that occur normally in any competitive market for financial services.[9]

While the above comment may be true to some extent, the IIAC and our members firmly believe that the advice gap will necessarily widen with a discontinuation of embedded commissions. As we state

[9] See footnote 117 on page 63 of CP 81-408.

throughout this submission, IIAC members will largely move clients to fee-based accounts if embedded commissions are removed. This will automatically result in many clients either not meeting the minimum thresholds required to open fee-based accounts and/or potentially pay more in fees than they currently pay in trailing commissions.

We do not believe that the CSA sufficiently considered this result, based on its emphasis throughout CP 81-408 that clients would have a variety of options to choose from with respect to how fees might be paid in the future.

This result also occurred in the U.K. where it is noted that almost half (48%) of firms used a fee-based system post-RDR[10] even when previously existing ongoing commissions payments were permitted to continue until April 5, 2016.

The CSA also seems to believe that "market innovations" would help ensure that mass-market households still have access to advice. We find this sweeping statement somewhat troubling as there is little data provided to support it.

While the Financial Conduct Authority (FCA) report in December 2014 found limited evidence of an advice gap, HM Treasury and FCA launched the Financial Advice Market Review, published in March 2016[11], aimed to specifically address concerns regarding an advice gap. It outlined several key findings including that advice is expensive and not always cost-effective for consumers as well as the fact that there are many consumers who would be willing to pay for advice but who are discouraged by the cost.

Recent research from the Schroders Adviser Survey[12] in the U.K. show that account minimums have increased. In 2014, £25,000 was generally an account minimum but by 2016, that amount had increased to a £100,000 minimum. Even more concerning is that two out of ten advisors surveyed admitted to formally asking smaller clients to leave their practice post-RDR.

Which segments are likely to be affected?

The mass-market segment and mid-market segment are likely to be the most impacted by firms' movement to fee-based accounts and the potential increase in the cost of advice. Seniors in particular may be disenfranchised if they are not comfortable using robo-advice or online brokerages. We previously mentioned particular concerns for seniors' use of robo-advice relating to diminished capacity, abuse, use of power of attorneys, and the lack of access to personalized advice regarding the de-accumulation phase.

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[10] See footnote 98 on page 57 of CP 81-408.
[11] See page 15 of CP 81-408.
[12] See http://www.thisismoney.co.uk/money/investing/article-4024484/Financial-advisers-hike-investment-fees-50.html

Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?

The differentiation between face-to-face advice and other advice is appropriate. Personalized advice cannot be replaced by robo-advice or online advice and it is important for the CSA to monitor if clients lose access to personalized advice as a result of the Proposal.

Do you think online advice could mitigate an advice gap? If so, how?

At this time, the level of personalization and the product selection in the online advice channel are not comparable to face-to-face advice and should not be considered a mitigation measure to address the loss of access to face-to-face advice.

Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in the fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

There is a concern that the Proposal could result in a reduction of the products and services available at deposit-taker owned dealers as it may become uneconomical to provide mutual funds. It is the IIAC's understanding that bank branches may have similar concerns to those of IIROC members regarding the implementation of other payment models such as hourly or flat fees and that it may be prohibitively expensive and administratively burdensome to have investment managers redeem fees. A potential narrowing of products or services available is a concern even if the clients have continued access to advice through a deposit-taker or insurer-owned dealer.

Question 18: Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options, etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

While a wholesale shift away from embedded commissions is unlikely, the industry has made significant changes to the mutual fund fee structure in recent years without regulatory intervention. For example, the industry has been moving away from the DSC option, with many IIROC firms no longer even offering DSCs. Furthermore, as we have indicated elsewhere in this submission, trailing commissions have become quite standardized and consistent throughout the industry with very few equity funds pay trailing commissions over 1%. These examples demonstrate how a market response occurred to address the misalignment of interests between fund managers and dealers with those of investors.

Question 19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type?

The IIAC has some concerns with Figure 8 on page 50 of CP 81-408. While we understand that the chart was based in part on data from Investor Economics, Morningstar and Ipsos, members had issues with the information presented under the IIROC channel. Specifically, it indicates that independent dealers have account minimum of $250,000 and that deposit-taker firms have account minimums of $500,000. While there are certainly some minimums for fee-based and managed accounts in that realm, most firms indicate that either they have no minimums (especially in non-fee based accounts, i.e. commission-based accounts) or the minimums are significantly lower than those represented (for example, a common minimum referred to is $100,0000). As a result, we are the view that this chart requires amendment.

We believe this correction in account minimums for IIROC dealers is important as Figure 8 currently would underestimate the impact of the Proposal on mass and mid-market clients who currently have access to advice with IIROC dealers.

Question 20: We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

IIAC members did not identify any regulatory or structural reasons for the limited use of fee-based series in Canada. Discretionary managed accounts are a sub-set of fee-based accounts and these advisors have access to a broader range of financial products beyond simply mutual funds and correspondingly, the use of funds in these accounts is more limited. Further, for clients with $100,000 to $150,000 in investable assets, it is generally less expensive to buy advisor series when factoring in the MER than to purchase F class funds.

Potential Impact on competition and market structure

Question 21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis in Part 4? In particular:

Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?

The investment industry is already undergoing a period of consolidation and the Proposal may only further accelerate the rate at which firms determine whether or not to merge or exit the industry. Smaller dealers may not be able to absorb a reduction in revenue while clients are being converted into a direct payment model. Since 2012, Canada has lost 60 boutique IIROC firms through either mergers or closures. There are another 50 IIROC firms that are currently losing money and their ability to remain operational is unknown. In this environment of tighter margins, and increased regulatory costs, the loss of a revenue source could have a significant impact on whether or not some of the boutique and independent firms are able to survive.

What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?

The IIAC believes that the loss of independent firms would have a negative impact on investors. Independent and smaller firms may offer different services and products and will often have lower account minimums. Reduced choice or access is not an optimal outcome from the Proposal.

What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?

IIROC Dealers

The Proposal presents numerous challenges for IIROC firms which are outlined throughout the response.

With respect to potential opportunities the Proposal may present, some firms may benefit from industry consolidation through mergers. The merged firm may be able to leverage technology to improve their scalability and increase asset levels. Other IIROC firms that have developed robo-advice channels may benefit if there is an increase in the number of investors that use robo-advice as a result of displacement. However, the challenge in a movement towards robo-advice is that this channel may not be able to appropriately address asset allocation. In addition, robo-advice may not be the best model for mutual funds in a registered account, which are usually held as part of a long-term strategy.

Online/discount brokers

As with other IIROC firms, discount brokerage firms similarly face numerous challenges on how to re-price their models if embedded commissions are banned. As previously discussed, firms may introduce new trading fees, custody fees or administration fees to compensate for the lost revenue. IIAC members did not identify any potential opportunities for online brokerage firms as a result of the Proposal.

Finally, online/discount brokers and other channels may wish to seek reasonable compensation from fund manufacturers for the substantial infrastructure costs of operating dealer firms, such as the costs of initial and ongoing education and registration of employees, technology to support sales and regulatory processes, market research to meet evolving client needs and client support services, including phone, online and digital channels. If this compensation were not directly tied to investors' purchases or continued ownership of investment fund securities or structured notes, this would not result in investors indirectly incurring embedded commissions.

What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products? What would be the impact on dually-licensed mutual fund dealers and insurance agents?

The potential differences in the rules for securities and insurance products provide an opportunity for arbitrage. IIROC advisors have suitability obligations that mandate what products should be recommended to clients. Further, many IIROC firms are including products like segregated funds and GICS in their CRM2 reporting.

However, firms stated that dually-licensed advisors can sell insurance products through an insurance carrier and those products would not be held within the IIROC dealer and would not be subject to the same suitability and reporting requirements. The IIAC has advocated for consistency of regulatory requirements across financial products.

Will the proposal lead new, lower-cost entrants to market? Why and how?

IIAC members believe that the Proposal will not necessarily result in "new" entrants but that current market participants could expand their distribution channels or develop new products. There are significant regulatory and monetary barriers to entry. The Proposal suggests that embedded commissions make it more difficult for new entrants to have their products distributed, however firms disagreed and stated that dealers have significant KYP requirements and new products must demonstrate their ability to perform. The CSA's CP 33-404 targeted reforms may further restrict product shelves and limit the ability of new entrants to have their products distributed.

Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?

The IIAC believes that the proposals set out in CSA CP 33-404 contradict, in some instances, the assumptions set out by the CSA in CP 81-408.

<u>One-Size-Fits All</u>

For example, while the CSA has criticized the "one-size-fits-all" nature of trailing commissions which it believes misaligns the provision of services and advice customized to the investor's specific needs, expectations and preferences[13], many of the targeted reforms in CP 33-404 we believe, in fact contemplate the very opposite result.

The CSA has argued a discontinuation of embedded commissions will be replaced by an upfront discussion regarding compensation and what fees are being paid for and for what. The result, states the CSA, is more likely a "compensation arrangement that is most appropriate for the client's situation."

While we agree that compensation should be based upon the customized services received that specifically contemplate the client's situation, as we argued in the IIAC's CP 33-404 submission, the targeted reforms will result in all advisors being expected to offer services and have proficiency levels more akin to a financial planner or CFA rather than an investment advisor. We outlined in our submission that the CSA is creating a one-size-fits-all type of client ignoring that not all client's wish to receive certain services, nor pay for them.

As the CSA acknowledges in CP 81-408, "financial services and advice can, but need not always encompass a broad range of services such as investment recommendations, asset allocation, the setup of systematic savings plans and/or registered plans, the preparation of a written financial plan, tax planning, estate planning, debt management, budgeting cash flows, etc."[14]

The IIAC fully supports this statement; however, the proposed targeted reforms appear to create one, inflexible standard meant to work for each and every client. Specifically, the detailed KYC information (such as basic tax information, total net worth and outstanding debts) is more appropriate for an

[13] See page 15 of CP 81-408.
[14] See footnote 118 on page 63 of CP 81-408

individual opening a portfolio managed account but not an individual purchasing RRSP securities at a bank branch. This is also evident in the targeted reforms around suitability, requiring the consideration of "other basic financial strategies", including non-securities product strategies (such as suggesting the client not invest but pay down debt or directing cash into a savings account).

As we stated previously, and outlined by the FCA in their Financial Advice Market Review, clients do not want or need personal recommendations in respect of every decision, nor do they always need a comprehensive assessment of all their financial circumstances and requirements. [15]

While CP 81-408 appears to support this approach, the outcomes of many of the targeted reforms will lead to the opposite result.

Robo-Advisors and CP 33-404

CP 81-408 anticipates that robo-advice will be disruptive to the status quo and have the potential to increase access to advice over time and become an "important distribution model in Canada."[16]

However, as the IIAC set out in the submission to CP 33-404, that consultation paper fails to address the diversity of business models offered by our members. Specifically, CP 33-404 does not discuss how the targeted reforms and a best interest standard would be applied to members with discount brokerage operations. Most importantly, CP 33-404 is silent on how robo-advisors would satisfy a best interest standard.

Furthermore, how would a robo-advisor satisfy the proposed targeted reforms – for example, under the proposed suitability targeted reforms, whether a client should not invest, but pay down their mortgage instead.

Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?

Fund companies can close series or merge series and that would force clients into reduced series options. For the fund companies, there would be administrative issues depending on whether or not they close or merge series. At the dealer level, it can be difficult for firms to switch their clients to other fund series as firms require client consent. Firms have stated that they do not expect that all clients will provide the necessary consent to switch series. This is a regular struggle for firms when they are attempting to reach clients and obtain necessary consent. Often clients simply fail to respond.

As such, firms may need regulatory assistance to address situations where there are "orphaned" client accounts. It is already a problem which was highlighted by CRM2, and firms expect to see more occurrences of orphaned accounts with this Proposal when client consent is required in order to switch clients into fee-based fund series or other direct pay arrangements. Firms should have the ability to end the client relationship when the client does not respond to communications by the dealer. Otherwise,

[15] https://www.fca.org.uk/publication/corporate/famr-final-report.pdf at pages 6 and 33.
[16] See page 58 of CP 81-408.

firms would no longer be collecting any revenue from the client but would still be required to provide tax reporting, CRM2 reporting and other various regulatory reporting at a loss. In such situations, we suggest the introduction of a default mechanism such as negative consent for those clients who fail to respond to repeated attempts by the firm to engage.

Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?

Integrated financial service providers are already utilizing cross-selling and cross-subsidization and member firms do not believe the Proposal will result in an increase in these business practices.

What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

IIROC dealers do not believe that robo-advice will directly compete with traditional face-to-face advice in terms of their pricing and value proposition. However, if there are more participants in the robo-advice channel, the competition among robo-advisors could influence pricing, product offerings and the level of services provided.

Question 23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight? To what extent, if any, does the use of direct pay arrangements by representatives today alleviate the need for some of these controls and oversight?

IIROC currently requires firms to have controls and oversight for their fee-based accounts so in that respect, members do not believe the Proposal would alleviate the need for most of those controls and oversight. In addition, members believe that other direct pay arrangements, such as hourly fees, would require more controls and oversight as firms would need to review invoices and monitor the time each advisor spent on each of their accounts and ensure that the charges are appropriate. Furthermore, at the front entrance point, the set-up time of such accounts would be quite significant. In addition, under direct pay arrangements, rather than charging at the product level, new arrangements will be required for charges at the distribution/account level. The challenge of this shift from product level pricing (where a fixed income fund is charged at 0.50%, an equity fund at 1.0% and a money market fund at 0.15-0.20% and are all standardized), is that once the charges are moved to an account level, it becomes much more challenging to determine the appropriate pricing and as a result, it is likely that firms will move to just one global account price (which may be a higher total cost).

With respect to the option for investment fund managers to facilitate payment, unless there is industry or regulatory consistency in the arrangements, there could be a number of control and oversight concerns. For investment dealers, it is very difficult to maintain oversight over these arrangements as some investment fund manufacturers will take instructions directly from clients or advisors, even in nominee account scenarios, meaning the dealer will not be aware of the fee arrangement, the appropriateness of the fee rate charged etc. until after the fee is applied and even at that point, the transaction code may not make this very obvious as systems such as Dataphile were built before these types of arrangement were put in place. In the current environment, it would be a very labour intensive process to manage.

Question 24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

As previously discussed, the loss of trailing revenue for some firms will be sufficiently disruptive and result in mergers or some firms exiting the industry entirely. For those firms that are able to transition to other revenue sources, they will ensure that their new models compensate for the loss of trailing revenue. Members believe that not all direct payment models will be able to compensate for the loss of trailers and that is one reason why certain models will not be utilized by most firms.

Question 25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

In general, members do not believe that representative compensation models will change. Members did note that there may be increased dealer costs with the introduction of the Proposal and CP 33-404 and correspondingly, the commission grids or advisor salaries may be modified to reflect that, or the costs may be passed on the investors.

Question 27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

a. **access to advice for investors,**
b. **choice of payment arrangements for all investor segments, and**
c. **a level playing field amongst competing investment products?**

a. Access to Advice

As discussed previously, it is too uncertain at this time to assess whether innovations in technology, including various forms of online advice, will make the provision of advisory services to smaller accounts more viable. Robo-advice is still in its infancy and it is unclear to what extent investors will shift to robo-advisors in the future. An affiliate-dealer in the U.K. has observed that the use of robo-advice has not increased to a large extent since the banning of embedded commissions. The general experience in the U.K. appears to be a slower acceptance of this form of advice, partially due to the high infrastructure spending that is necessary, in addition to the lack of clear evidence regarding profitability for dealers. It is still a question as to whether robo-advice will assist smaller investors.

The mitigation measure referring to the fact that investment managers could facilitate investors' payment of dealer compensation by collecting payments from the investor's fund investment and remitting them to the dealer on the investor's behalf, presents some significant challenges. Members indicate that this type of arrangement would be extremely problematic to manage as compared to a fee-based arrangement. Specifically, it would be challenging to implement based on the wide variety of funds that would be held in each account. Dealing with this variety fund by fund, advisor by advisor and account by account could make such an arrangement unworkable. In addition, as the CSA recognized, not all investment fund managers have the capability to offer such a service to dealers, or to do so, would require a significant outlay of costs that have to be passed on. IIAC members also pointed out that currently just three fund companies provide such a service in a consistent and reliable manner today.

Furthermore, members indicated that there would be challenges in ensuring the integrity of the fee system. The CSA proposal would expect the client to negotiate the quantum of the payment with the dealer but then the investment fund manager is tasked with collecting the payment at the correct rate that the client negotiated with the firm. There would be issues regarding reconciliation – ensuring that the fee the client agreed to is in fact the fee that the dealer is receiving. Furthermore, if some fund companies offer this method of collection and some do not, it will cause additional complications for dealers potentially reducing the choice of investments available. Members also indicated that to have such systems in place for clients with smaller investable assets will not be cost effective for the client or the dealer.

Finally, while the CSA discussed their view that research suggests that embedded commissions encourage high fund costs and inhibit competition by creating a barrier to entry, the Proposal to have investment fund managers facilitate investors' payment of dealer compensation, would in fact create a significant barrier to increased competition by new entrants into the market. The costs of implementing such a system for new entrants would be prohibitive.

As we outline below in Question 30, such an arrangement also leads to issues regarding GST/HST where deductions are made from the purchase amount or from periodic withdrawals, as well as capital gain taxes where redemptions are made, in addition to more significant charges where such redemptions are made with respect to a registered account.

b. Choice for Investors

The CSA has provided no evidence that investors would in fact, be willing or able to negotiate the fees they pay nor even welcome such a system. Furthermore, as the IIAC has stated elsewhere in this submission, members have indicated that they will move almost all clients into fee-based arrangements should the CSA proceed with a prohibition on embedded commissions. As a result, investors will have little choice and in many instances, pay more for their mutual funds than they do today. This would be especially true for households with less investable assets who would pay more for a fee-based account than high net worth clients.

c. A level playing field amongst competing investment products?

As mentioned previously, the IIAC supports a level playing field for the industry regarding possible gaps in the regulatory framework for segregated funds and possible risks relating to regulatory arbitrage by dually-licensed insurance agents. We encourage the CSA to work cooperatively with the CCIR to ensure that both investor protection and market efficiency issues are addressed.

Question 28. What other measures should the CSA consider to mitigate the above unintended consequences?

The IIAC is unable to provide any further measures.

Question 29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

Would there be a negative tax impact to investors associated with their payments of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences?

Each type of direct pay arrangement presents its own tax challenges. With respect to flat or hourly rates, HST/GST would be added to the fees, thereby increasing the cost of any fee charged. Further, it could be very difficult for the client to determine how to allocate the fee in terms of what is an allowable tax deduction for investment advice in a non-registered account. For example, if the client and advisor meet for two hours and discussed financial planning and various mutual funds for the client's portfolio, how would that conversation be tracked and divided into what advice would be considered deductible and what would not.

Redemption pay arrangements could trigger capital gains or losses when securities are redeemed as compensation. These losses/gains could be triggered monthly as the fees are paid out and result in complicated tax reporting for the client and potential tax liability if there are gains, increasing the overall cost of this option. From a dealer perspective, this arrangement requires additional compliance and supervision policies as firms would need to create unique codes to track the redemptions to provide to the CRA. This option also has a risk of timing misalignments between redemptions and the payment of fees, which would put the account into a debit. Of concern is the situation where the account is a registered account, and any redemption that results in a debit balance may cause the firm to be liable to CRA for the amount of the advantage.

Another tax concern occurs when a client is invested in funds in a registered account and the client wishes to pay their fees from another account, the CRA is now considering whether paying the fees from another account is an advantage and this may no longer be permitted without penalties. In addition, firms will face complications when the client is invested in illiquid funds that may be problematic to redeem and therefore may need to pay the fees from outside the account.

Other potential impacts

In addition to the operational and tax impacts discussed above, the reduction of fund series or the switching of clients into different accounts could negatively impact CRM2 reporting. For many firms when a client is transferred to a new account, even internally, the performance reporting data is reset. Many firms rely on service providers, and one of the industry's largest providers for CRM2 data management and reporting resets performance for new accounts. As we have previously discussed, many clients will be moved to fee-based accounts, other clients may have to transfer firms as a result of industry consolidation or move to robo-advisors, so this could impact a large number of clients. We do note that some firms have the capability to retain performance history for internal transfers.

To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?

The CRA currently views switches between series as a non-taxable event and therefore there should not be negative tax consequences to the client. However, the switches can impact tax reporting and make it more difficult to track historical information on the security. A switch is considered a purchase and data may be tracked from the "purchase" when the switch occurs making it more difficult to track the historical information.

What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

In order to reduce the number of fund series, fund companies would either have to close funds or merge series. Each option would require convening a special meeting of shareholders. Administratively, this would be a significant burden for dealers to manage the proxy process. These meetings would be on top of the normal AGM proxy season. In order to mitigate this impact, the CSA should provide exemptions to the fund companies for these special meetings. If the series are being merged or closed for regulatory reasons, shareholders cannot prevent the mergers or closures and therefore the meetings would be an unnecessary expense and a misuse of firms' resources.

Question 30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

a. **To what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;**

b. **Does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and**

c. **What measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?**

It is likely that the loss of this cross-subsidy would have some impact on the cost of providing advice and services to lower-wealth fund investors. As we have previously stated, this would also be the case where lower-wealth fund investors are moved to fee-based accounts. In such situations, in order to cost-effectively service these accounts, dealers would have to charge higher percentages for these smaller households, as well as charge upfront fees for services such as financial planning.

With respect to high net worth clients that are often in fee-based accounts, the higher amount of investable assets, the lower the percentage that is charged for these accounts. Furthermore, the higher the assets, the lower the MER that is often charged, so these clients generally pay fees that are aligned with the services they are receiving.

Question 32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change on restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimate costs.

- **Are there unique costs or challenges to specific businesses?**
- **What transition period would be appropriate?**
- **Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?**

And

Question 33. Which transition option would you prefer? Why? Are there alterative transition options that we should consider?

IIAC members do not believe that Option 2 is a workable or practicable option. The logistical challenges of transitioning a certain percentage of accounts by a certain date would only increase complexity and costs for both dealers and fund managers.

We believe that Option 1 is more appropriate. The proposed transition period of 36 months may prove to be challenging, especially in circumstance where flat or hourly fees are introduced, thus requiring clients to meet with their advisors and negotiate a new fee and payment method. Meeting with each and every client in a 36-month time frame would be extremely difficult. This time frame would also be challenging for dealers who plan to move clients into fee-based accounts and the accompanying discussions that would be necessary with these clients. Further, firms may be unable to obtain the required client consent to transition clients and this will impact timelines. It is an unfortunate reality that not all clients actively engage with their advisor or dealer and a certain number of consents will not be signed back. It could be as a result of the client not having an incentive to sign the form and the envelope may never be opened, it could be a forgotten account, or there was a change of address. Property law requirements related to unclaimed property would only become effective after several years and would not address situations where the client refuses to change to a fee-based account for example. Firms should be provided with the ability from regulators to impose a default fee schedule or to be able to move clients to fee-based accounts if, for example, that firm is no longer offering commission based accounts.

In addition, as IIAC members are dependent on third parties such as FundServ, it would be up to such companies to articulate the time frames necessary for the technology builds that would be required from their end. Similarly, dealers would need time to make the necessary changes to their technology as well as the systems, compliance and procedural changes, including receiving client instructions and building those into the client documentation. This includes the necessary documentation that would result with the collapse of series options.

With respect to DSC and low-load purchase options, the IIAC would leave this question to the fund managers to respond to regarding whether these options be maintained until the redemption schedule is completed or discontinued at the Transition Date. However, we imagine that fund managers would likely indicate that options be maintained until the schedule expires. This is due to the fact that the managers have already paid an up front commission to the dealer, so in order to recoup their costs, they must be permitted to continue to charge the ongoing management fees as well as any redemption fees until the completion of the redemption schedule. Furthermore, many fund managers would be unable to simply unwind and discontinue a schedule as they often have financing arrangements in place to pay the upfront commissions.

Question 34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

The IIAC does not believe the CSA should consider using a fee cap as a transition measure. To begin with, many of the conflicts of interest identified by the CSA in respect to embedded commissions would continue. In addition, we do not believe that the CSA should interfere with the fees charged in the investment industry and the challenges this would present in respect of setting the appropriate rate either in the present or future.

Furthermore, such a measure, especially as a transition or interim solution, would simply cause increased costs and complexity for investment dealers and additional confusion for clients.

Conclusion

While the IIAC does not, in principle, oppose a discontinuation of embedded commissions and the possible investor protection concerns it may address, it is important to highlight the business realities that would result in the investment industry from the Proposal - specifically a wholesale shift to offering only fee-based accounts for most clients, irrespective of the CSA permitting other direct pay arrangements.

As a result of this likely unintended consequence, we believe the CSA may need to consider possible alternatives to a ban of embedded commissions that may provide remedies to the issues the CSA has highlighted including conflicts of interest, transparency and investor awareness of fees paid, and the alignment of services to fees paid.

For example, as mentioned previously in this submission, the industry has recognized some of the issues surrounding DSCs, and the IIAC would support the removal of this fee option as it can result in the inhibition of movement to other products.

Although conflicts of interest management was specifically addressed by IIROC in its existing Guidance Note 12-0108 released on March 26, 2012, the IIAC acknowledges that the management of compensation-related conflicts of interest is certainly an area where improvements can be made, and believes this can be achieved if the industry and regulators work cooperatively on this issue.

IIROC has promoted this objective first in IIROC Guidance Note 16-0068 issued on April 6, 2016; then again in its Guidance Note 16-0297 issued on December 15, 2016 where it highlighted some preliminary results of its review to gather more detailed information on how firms identify, monitor and manage compensation-related conflicts; and finally in the recently released Guidance Note 17-0093 issued on April 27, 2017.

The IIAC and our members generally support the additional guidance provided in the recent Notice which helps to supplement and clarify IIROC Guidance Notice 12-0108. We recognized that additional guidance is needed to assist firms to not only reasonably identify, manage and supervise compensation-related conflicts of interest, but how to take steps to avoid them where possible. We fully support IIROC's statement that disclosure alone may not be sufficient. Further, we agree that IIROC's Business Conduct Compliance team should take additional steps to strengthen its oversight of compensation-related conflicts through enhancements to its exam process.

We concur with the findings from IIROC's review, specifically that firms can do more related to their compensation programs to ensure that they do not contain certain features that could result in a misalignment between the interests of advisors and those of their clients; that firms can ensure that disclosure is complete and in plain language, and that supervisor compensation should consider other factors to offset undue bias towards branch profitability at the expense of the client's best interest. However, we maintain our position that regulators should not interfere with the amount of fees or compensation charged by firms; market competition and demonstrating value to their clients should govern how fees and compensation are determined.

In addition, members have some concerns with the factors that IIROC may be focusing on in future examinations of a firm's fee-based account programs. While IIROC generally acknowledges that cost alone is not the only factor when determining to put a client in a commission-based or fee-based account, it is important to stress the value proposition of fee-based accounts beyond simply the fee charged. This includes the consistency and transparency of a predictable fee, the clarity provided to clients with these accounts, including understanding the value of the services they pay for, and more closely aligning the interests of the client, advisor and firm when the advisor compensation is not tied to trading. Fee-based programs are particularly appropriate for investors who prefer consistent and explicit monthly or annual charges. As such, it is inappropriate and misleading to determine the client benefits of a fee-based account solely based on costs related to transaction fees charged under a commission-based account.

It is also important to recognize that fee-based accounts can take on a number of forms and methods to determine the amount of the fee. Some firms offer a specified number of trades within a fee-based account and above that number the client pays per trade. Other firms may offer fee-based accounts with a commission per trade on top of the fee. There may also be a number of services that are offered in conjunction with a fee-based account based on the firm's offerings and expertise and the needs of the client. Thus, it is important to recognize that firms have differing business models and rationales for their fee-based offerings.

The IIAC would be pleased to work with both IIROC and the CSA in its determination and potential development of any additional amendments to and/or revised guidance on the Conflicts of Interest Rules. The IIAC believes that this approach may best address many of the concerns raised by the CSA under the Proposal.

We would welcome an opportunity to discuss our submission and address any further questions the CSA might have.

Sincerely,

M. Alexander

Michelle Alexander
Vice President and Corporate Secretary
Investment Industry Association of Canada

APCSF Association Professionnelle des Conseillers en Services Financiers
Professional Association of Financial Services Advisors

Réponse de l'APCSF au document de consultation 81-408 sur l'option d'abandonner Les commissions intégrées

Présenté à l'Autorité des marchés financiers

Par

APCSF

L'Association Professionnelle des Conseillers en Services Financiers

9 juin 2017

"L'Association Professionnelle des Conseillers en Services Financiers (APCSF) représente les conseillers en services financiers de toutes disciplines. Elle a pour mission de préserver la pérennité du conseil financier indépendant, par la promotion et la défense des intérêts professionnels communs aux membres. L'APCSF regroupe les conseillers en services financiers sous sa bannière, afin de les représenter auprès des divers organismes d'encadrement, les médias et le grand public. L'APCSF vise à promouvoir la profession auprès du public et favoriser la relève pour les générations futures."

Introduction

Les fonds d'investissement ont été créés à l'origine pour donner aux petits investisseurs un accès aux actions ordinaires: « Cependant, par le biais d'un fonds commun de placement, l'individu jouit d'un intérêt direct dans les actions sous-jacentes du capital social, ce qui est proportionnel à son investissement dans le fonds. Ainsi, le fonds commun de placement est le véhicule qui permet au petit investisseur une « participation active au capitalisme ».[1]

Si les promesses de rendements des fonds d'investissement stimulent la propension à l'épargne pour le public, leur histoire témoigne d'une exigence constante en matière de conseils et d'accompagnement pour la plupart des gens : « Les thèmes de la finance de masse et de la démocratisation des marchés ont émergé et pris sens dans un contexte boursier haussier attirant de nombreux petits épargnants. Des signes d'un important ralentissement économique, et non plus seulement financier, sont perceptibles alors que nous rédigeons la conclusion de ce mémoire. Ils se répercutent directement sur l'actif sous gestion des fonds qui connaît un important recul dû à la baisse de leur valeur boursière et au rachat d'un nombre considérable de parts en ce temps d'incertitude. »[2]

D'abord propulsée par l'émergence de nombreuses sociétés indépendantes de 1980 à 1995, tant dans la gestion que dans la distribution, l'industrie des fonds d'investissement est aujourd'hui concentrée et dominée par les grandes banques canadiennes. Ainsi, l'investisseur se retrouve-t-il le plus souvent devant une offre de produits et de services financiers suivant le modèle « gestionnaire-courtier-employé » au sein d'une même société intégrée. Mais il existe aussi une autre réalité qui est celle d'une demande de produits et services financiers constituée par « l'investisseur et son représentant indépendant », entre lesquels la relation « employeur-employé » se transforme avec les années en une relation de confiance mue par un intérêt commun de « grandir ensemble ». Ce deuxième modèle du « petit entrepreneur et son client » fait concurrence au premier, mais avec des moyens qui sont inégaux. Malheureusement, ces différences dans les modes de distribution semblent ignorées ou négligées dans les statistiques et les études présentées dans le document de consultation 81-408.

Les commissions intégrées ont été introduites il y a plus de 25 ans par des sociétés de gestion de fonds indépendantes, pour rémunérer la distribution de leurs produits auprès des courtiers indépendants. Ces sociétés ne profitaient pas des avantages des sociétés intégrées dont les clients sont acquis depuis leur plus jeune âge. Résultat des acquisitions qui ont accentué la concentration de l'industrie au Canada, le nombre de ces sociétés indépendantes, dans la gestion de fonds comme dans la distribution, a beaucoup diminué ces 20 dernières années. Aussi, l'APCSF invite les ACVM à la prudence afin que les mesures réglementaires entreprises ne favorisent pas davantage la concentration, mais plutôt qu'elles soutiennent et favorisent la

[1] Solomon Spiro, « Some Aspects of the Mutual Fund and Investor Protection », Osgoode Hall Law journal, York University, Volume 9, numéro 3, Décembre 1971, p.601, traduction de: « However, through the medium of a mutual fund, the individual enjoys a direct interest in the underlying equity shares of corporate stock, which is proportionate to his investment in the fund. Thus, the mutual fund is the vehicle which may bring 'participatory capitalism' to the small investor."

[2] Maxime Lefrançois, « La financiarisation et la massification de l'épargne, le cas des fonds mutuels canadiens, Mémoire de maîtrise, Université du Québec à Montréal, janvier 2009, p.138.

concurrence en renforçant les intervenants les plus vulnérables du secteur financier, alors que l'efficacité des conseils personnalisés pour l'accumulation d'actifs a été démontrée rigoureusement par les chercheurs.[3]

Dans notre mémoire sur la consultation 81-408, nous démontrerons que le projet d'abandon des commissions intégrées pénaliserait les investisseurs qui disposent de moins de 100 000$ à investir de 2 façons; 1ère) en détruisant l'offre de conseils personnalisés pour leur réussite financière et 2e) en les privant des connaissances et de l'expérience d'un représentant compétent, qui les aide à choisir les produits et services financiers qui répondent à leurs besoins. À long terme, le nombre des ménages aisés et du marché intermédiaire (plus de 100 000$ à investir) diminuera progressivement, ce qui accentuera davantage les inégalités sociales.

Questions de la consultation 81-408

Partie 2 du document 81-408

1. Convenez-vous des enjeux exposés dans cette partie? Pourquoi?

Réponse : Non.

Premier enjeu. Selon notre expérience, les commissions intégrées ne sont pas à la source des conflits d'intérêt soupçonnés. D'ailleurs, le sondage publié dans l'avis 33-318 confirme notre opinion puisqu'il ne mentionne aucunement les commissions intégrées comme une source des conflits d'intérêt, mais il relève plutôt les pratiques de rémunération qui ont cours dans les sociétés intégrées comme responsables. Ces observations ont d'ailleurs été rapportées au mois de mars dernier dans un reportage de la CBC à l'émission « Go Public » sur des allégations de conflits d'intérêt à la banque TD, reliées aux pratiques de gestion et de rémunération tel que décrit dans l'avis 33-318. Quant aux doutes soulevés dans le document de consultation 81-408[4], selon lesquels le choix des fonds serait orienté davantage vers les fonds avec des commissions plus élevées et des rendements plus faibles, au détriment de l'investisseur, ils ne correspondent pas à la réalité du comportement de l'immense majorité des représentants indépendants. On observe plutôt le développement d'une relation mutuellement avantageuse à long terme entre le représentant autonome « type » et son client, qui lui reste fidèle tout au long de sa carrière. Dans son étude, Pierre Lortie observe également que la structure de rémunération actuelle favorise des intérêts convergents entre l'investisseur et son représentant.[5]

En ce qui concerne le 2e enjeu, les commissions intégrées ont largement contribué au développement de l'industrie des fonds d'investissement au cours des 25 dernières années, favorisant le financement efficace des conseils et l'éducation du public dans la gestion financière, et en permettant surtout d'élargir l'accès à l'investissement et aux conseils

[3] Claude Montmarquette de CIRANO et Université de Montréal, et Nathalie Viennot-Briot de CIRANO, The Gamma factor and the value of financial advice, 7 novembre 2016.

[4] Document de consultation 81-408, pp.10-12.

[5] Pierre Lortie, A major setback for retirement savings: changing how financial advisors are compensated could hurt less-than-wealthy investors most », University of Calgary, avril 2016, pp.i-ii.

personnalisés pour le grand public. Les commissions intégrées permettent d'établir une norme raisonnable dans les coûts et la rémunération pour le public non-initié, qui ne saurait autrement négocier la rémunération de son représentant. Ces arguments ont été développés par Pierre Lortie dans une étude en 2016[6]. Les nouvelles règles de divulgation introduites dans le MRCC2 répondent aux préoccupations de transparence quant aux coûts reliés à la distribution des fonds. **Il faut cependant noter que ce sont les résultats nets de tous les coûts qui constituent le véritable étalon de mesure pour l'investisseur.** Comme les mesures de rendement sont disponibles pour l'investisseur, il peut par conséquent comparer les résultats de ses placements et la valeur des conseils qu'il reçoit. Enfin, les investisseurs sont familiers avec les frais intégrés, qui sont une pratique courante pour tous les produits financiers sur le marché qui intègrent les coûts de distribution dans les prix des produits comme les CPG, les hypothèques, les obligations d'épargne, les assurances, les billets structurés, etc.

Enfin le 3^{e} enjeu, une évaluation des coûts des conseils qui accompagnent la distribution des fonds d'investissement n'a pas été présentée dans le document de consultation 81-408. Si la relation entre le travail exécuté et les services rendus « n'est pas claire »[7], c'est qu'elle n'a pas été suffisamment étudiée. Une omission grave quand on mesure l'importance de l'abandon des commissions intégrées pour le marché de masse et les représentants autonomes à commission. Par ailleurs, la confusion dans les titres professionnels et le travail exécuté par chacune des catégories professionnelles de l'industrie (représentants en épargne collective à commission, représentants de plein exercice et employés en succursales d'institutions de dépôts), ne permet pas de tirer de conclusions quant à leur apport respectif en valeur ajoutée pour l'investisseur.

Les employés des institutions de dépôt n'ont pas à démarcher les clients qu'ils desservent, contrairement aux travailleurs autonomes à commission. Le démarchage est particulièrement important et coûteux durant la période de démarrage de la pratique des conseillers qui sont travailleurs autonomes. Une pratique en services financiers comporte des coûts que ne rencontrent pas les employés salariés d'une institution de dépôt. Les représentants « travailleurs autonomes » ne sont pas rémunérés pour les rencontres avec des prospects qui ne se concluent pas par une vente. Quelles sont les différences dans l'étendue des qualifications, le temps consacré aux conseils et le service à la clientèle entre les travailleurs autonomes et les conseillers salariés?

Les conseils en placements et les conseils en matière de planification financière ne sont pas de même nature. L'offre de services et les conseils des représentants en épargne collective doivent être distingués de ceux des représentants de plein exercice. Quelle est la nature des conseils et du travail des conseillers généralistes, planificateurs financiers et ceux des courtiers de plein exercice?

Enfin, les services associés à la gestion des risques suivant les événements de la vie comme le chômage, la maladie ou le divorce sont ignorés; les besoins de l'investisseur au détail n'ont rien de comparable avec ceux de l'investisseur institutionnel. Pourtant, on continue d'utiliser la statistique « alpha » pour mesurer la valeur des conseils, alors que le facteur « gamma », qui inclut tous les bénéfices des conseils, s'avère beaucoup plus approprié.

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[6] Pierre Lortie, pp. 20-21.

[7] Document de consultation 81-408, p.15.

Les conséquences des risques associés aux événements des marchés ne sont pas évaluées, ni considérés à l'annexe A, alors que des études démontrent que la plupart des investisseurs subissent des pertes importantes en raison de leurs comportements, qu'ils ne connaissent pas ou qu'ils n'appliquent pas les principes reconnus de la gestion de portefeuille.[8]

2. Existe-t-il d'autres enjeux ou problèmes importants liés aux commissions intégrées? Veuillez, si possible, présenter des données qui illustrent votre argument.

Réponse :

Les frais et autres coûts de distribution intégrés au prix des produits sont une pratique courante dans le commerce et dans le monde financier. La prohibition des frais et commission intégrés aux frais de gestion des fonds représenterait un précédent hors norme. Il est important de souligner que l'intégration des coûts de distribution constitue la norme dans le monde financier, au même titre que les certificats de placements garantis, les obligations d'Épargne Placements Québec, des prêts hypothécaires et autres prêts à la consommation, des produits structurés, des obligations et débentures négociées sur le marché, les introductions en bourse (IPO). Pourquoi alors les fonds d'investissements devraient-ils faire exception et en être exclus?

Le document 81-408 n'a pas analysé suffisamment les caractéristiques des commissions intégrées chez certains gestionnaires pour lesquels les problèmes d'inter-financement soulevés aux pages 14 et 15 du document sont absents. Par exemple, des gestionnaires de fonds comme Fidelity et EdgePoint réservent l'option de souscription initiale dans une série de fonds séparée de celle utilisée pour le mode des frais de rachat sur 3 ou 6 ans. Ainsi, l'argument d'interfinancement ne s'applique donc pas pour ces sociétés indépendantes qui affichent des ratios de frais de gestion (RFG) plus bas (15 à 25pb) pour le mode de souscription avec frais à l'acquisition, par rapport à la structure avec frais de rachat offerte. **Les ACVM pourraient s'inspirer de cette évolution naturelle observée depuis environ 10 ans chez ces gestionnaires de fonds indépendants et réglementer toutes les sociétés de fonds, afin d'exiger qu'une structure de coût distincte soit offerte pour le mode de souscription avec frais à l'acquisition, de celle de la souscription avec frais de rachat, tout en préservant les avantages que présentent les commissions intégrées.**

Les commissions intégrées ont été créées il y a plus de 25 ans par des sociétés de gestion indépendantes qui distribuaient leurs fonds par des réseaux de distribution indépendants non-affiliés. **Si des conflits d'intérêt ont été observés dans les sociétés intégrées dans la distribution de produits exclusifs (avis 33-318), l'utilisation des commissions intégrées ne devrait-elle pas être réservée pour la distribution de fonds uniquement dans les réseaux non-affiliés?**

Les commissions intégrées sont essentielles pour le financement des conseils des ménages du marché de masse et du marché intermédiaire. Leur coût dans le ratio de frais de gestion annuel correspond au coût de la rémunération observé dans les comptes de gestion à honoraires de plus de 1 million $. Sur cette base, il n'y a donc pas d'inconvénient à intégrer ces coûts dans le ratio

[8] John Rice, CFA, CFP, KeatsConnely (602-955-5007) pour Dalbar, « Quantitative analysis of investor behavior », 2015 advisor edition; Warren Bailey, Alok kumar, David Ng, Behavioral biases of mutual funds investors, Journal of Economics, Elsevier 2011.

de frais de gestion. **Toutefois, l'investisseur du marché intermédiaire dont le portefeuille progresse de 100 000$ à 500 000$ devrait pouvoir profiter de la flexibilité des options de retrait plus courtes entre 2 et 4 ans. Quant aux investisseurs du groupe de ménages aisés, des limites dans les sommes investies avec des commissions intégrées pourraient être imposées, afin qu'ils profitent des économies d'échelle pour les sommes gérées qui sont importantes**.

3. Les commissions intégrées comportent-elles des avantages importants — accès aux conseils, efficience et rentabilité des modèles d'affaires, concurrence accrue — qui l'emporteraient parfois ou toujours sur les enjeux ou les problèmes qui y sont liés? Veuillez, si possible, présenter des données qui illustrent votre argument.

Réponse : Oui.

Les frais et commissions intégrées procurent simplicité et commodité par l'intégration de tous les coûts associés à la distribution, aux conseils, à l'administration et à la gestion des fonds. Dans une étude, Pierre Lortie explique pourquoi les commissions intégrées sont efficaces et largement répandues pour la distribution des produits financiers : *« The bundling of goods or services is a common practice in retail and industrial markets. A large body of marketing research shows that the complementarity of services offered in a bundle enhances its value for consumers, which far exceeds the strict additivity of individual component prices, particularly when the bundle reduces the real cost in time and efforts needed to select and purchase the items individually».*[9]

Tableau 1.1

Comparaison pour 10 000 $ des commissions intégrées sur 3 ans et 6 ans avec un compte à honoraire										
Frais de vente reportés		Commission de Service	1ère année	Rendement de 4% ajouté après la 2e année					Total	Pourcentage
Période	commission à la vente			2e année	3e année	4e année	5e année	6e année	Rémunération	1ère année
sur 6 ans	5,0%	0,5%	550 $	52 $	54 $	56 $	58 $	61 $	832 $	66%
sur 3 ans	2,5%	0,5%	300 $	52 $	54 $	112 $	117 $	122 $	757 $	40%
Honoraires	0,0%	1,0%	100 $	104 $	108 $	112 $	117 $	122 $	663 $	15%

Les commissions intégrées sont essentielles pour financer les conseils associés au développement d'un portefeuille pour 67,2 % des ménages canadiens qui sont identifiés par le marché de masse.[10] **La somme de travail pour l'éducation de cette frange de la population habituée aux produits d'épargne classiques est beaucoup plus importante que celle des ménages aisés qui représentent la frange de la population la plus sollicitée et par conséquent la mieux informée.** Malheureusement, les ménages du marché de masse ne disposent pas des moyens financiers pour le financement des conseils et l'éducation financière dont ils ont besoin. Grâce au financement de la commission à la vente, par les commissions intégrées sur une période de 6 ans, un investissement de 10 000$ permet une avance de commission qui atteint généralement 5% de la somme investie, sans que l'investisseur ait à débourser de frais au moment de l'acquisition. Le gestionnaire de fonds finance la commission de vente à même les frais de gestion, prélevés durant les 6 premières années au cours desquelles l'investisseur s'est engagé à conserver son investissement auprès du gestionnaire. Durant la période, une commission de service réduite sera versée mensuellement selon une formule

[9] Pierre Lortie, p. 19.

[10] Tableau 1, p. 29 du document de consultation 81-408.

semblable aux honoraires de service mais de manière intégrée. Un exemple est illustré au tableau 1 ci-dessus, présentant une comparaison avec une option réduite sur 3 ans et avec l'option des honoraires habituellement offerte pour les comptes plus importants.

Après une période de 6 ans, les commissions de vente et de service totalisent 550$ (=500$ + 50$), soit 66% des commissions versées après une période de 6 ans. L'expérience indique qu'il faut compter au moins 12 heures de travail pour le démarchage, les rencontres, l'analyse et les recommandations, en plus de la mise en place, pour un nouveau client. À un taux de commission de 65%, un représentant à commission peut estimer sa rémunération à un peu plus de 25$/heure dans cet exemple. **Par ailleurs, l'investisseur est stimulé dans ses efforts d'épargne par l'accompagnement et les conseils de son représentant qui investit son temps dans la croissance de l'épargne et du portefeuille de son client, tel qu'il a été démontré dans l'étude du CIRANO (voir note 3)**.

Tableau 1.2

Comparaison pour 50 000 $ des commissions intégrées sur 3 ans et 6 ans avec un compte à honoraire

Frais de vente reportés		Commission de Service	1ère année	Rendement de 4% ajouté après la 2e année					Total	Pourcentage
Période	commission à la vente			2e année	3e année	4e année	5e année	6e année	Rémunération	1ère année
sur 6 ans	5,0%	0,5%	2 750 $	260 $	270 $	281 $	292 $	304 $	4 158 $	66%
sur 3 ans	2,5%	0,5%	1 500 $	260 $	270 $	562 $	585 $	608 $	3 786 $	40%
Honoraires	0,0%	1,0%	500 $	520 $	541 $	562 $	585 $	608 $	3 316 $	15%

Un autre exemple avec un investissement de 50 000 $ est présenté au tableau 2. Même avec une somme investie 5 fois plus importante, la commission de vente atteint 135$ de l'heure, en supposant 12 heures de travail initial et un taux de commission du courtier à 65%. Quant à l'option des frais différés sur 3 ans, les commissions reçues la 1ère année ne représentent que 40% de la rémunération totale après 6 ans. En conclusion, les commissions intégrées s'avèrent la meilleure formule qui permette aux ménages du marché de masse de profiter des conseils personnalisés et des connaissances d'un professionnel de la finance pour progresser dans leur situation financière personnelle.

À la page 29 du document de consultation, le tableau 1 indique que **62,9% de tous les ménages canadiens ne détenaient pas de fonds mutuels en 2012**. Une part importante (83,6%) de ces ménages ont moins de 100 000$ à investir, représentant plus de 52% de tous les ménages au Canada. **Il est dommage que le document de consultation ne fasse pas la distinction entre les conseillers à salaire et les conseillers autonomes à commission, qui desservent la catégorie la plus importante des ménages (52%).** L'analyse de ces données permettrait d'observer quel groupe de professionnels favorise la pénétration des fonds d'investissement au sein du marché de masse. Les statistiques invoquées dans le document semblent indiquer que les ménages du marché de masse, qui connaîtraient une carence en matière de conseils en placements et d'éducation financière, est précisément dominé par les banques et les caisses populaires.[11]

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[11] Document de consultation 81-408, figures 2 et 3, pages 35 et 37. Environics Research, B2B banque, Perspectives du marché pour les conseillers, septembre 2016, p.29.

Par conséquent, nous sommes en désaccord avec l'interprétation du document 81-408 à la page 30 qui affirme que « Les ménages du marché de masse préfèrent investir dans les produits d'épargne classiques plutôt que dans les fonds d'investissement ». **Nous croyons plutôt que l'énoncé est la conséquence du manque d'intérêt de la part des institutions de dépôt pour les ménages du marché de masse, qui ont moins de 100 000$ à investir et de la carence en matière d'éducation financière et de conseils qui en résulte.** La statistique démontre également qu'il est illusoire de penser que ces gens vont devenir des adeptes des robots-conseils ou qu'ils seraient contraints d'investir à cause de frais élevés. Les faibles rendements des produits d'épargne classiques découragent l'épargne et éloignent davantage les gens de la réussite financière. **Il aurait été très précieux de connaître la répartition du marché de masse par groupe d'âge afin d'estimer son potentiel de développement.** Les conseillers indépendants et entrepreneurs, qui bénéficient des commissions intégrées selon l'option de 6 ans, peuvent investir leur temps et leurs connaissances afin d'aider les ménages de masse à développer l'épargne pour des objectifs à long terme. Les coûts importants du démarchage pour l'entrepreneur en services financiers, sont une motivation à travailler pour la satisfaction de son client et mériter sa fidélité pour de nombreuses années. Cependant, il est indispensable qu'il puisse offrir l'option des frais de rachat à son client afin d'être compensé pour le service personnalisé, les conseils et l'éducation qu'il prodigue. Le conseiller à commission, de type entrepreneur, doit démarcher ses clients, contrairement aux banques et aux caisses populaires qui en héritent depuis leur naissance dans certains cas. **Les coûts élevés pour gagner un client constituent un frein au conseil indépendant, sans une rémunération adéquate qui permet d'assumer non seulement le coût des conseils et des services offerts, mais également ceux du développement de la clientèle.**

Dans un sondage Environics pour la banque Laurentienne, il est démontré que 22% des conseillers sont en début de croissance ou en démarrage et que leur clientèle se compose d'investisseurs ayant moins de 100 000$ à investir dans une proportion de 53%. Dans la province de Québec, le marché de masse (100 000$ et moins) représenterait 46% des clients des conseillers, contre 39% pour la moyenne canadienne.[12]

Les fonds d'investissement ne sont pas des produits garantis et ils ne sont pas appropriés pour des horizons à court terme; leur rendement peut être négatif en raison des risques qu'ils comportent. Les petits investisseurs doivent faire des sacrifices plus importants que les ménages aisés pour épargner, leur sensibilité au risque en est par conséquent accrue. À ce titre, le document de consultation 81-408 est silencieux sur la question des risques et il traite des fonds d'investissement comme des produits de commodité, au même titre que des certificats de placement garanti. Le document néglige l'importance que les conseils personnalisés ont joué historiquement, dans le développement de l'industrie des fonds mutuels. Des études prouvent pourtant que les conseils sont essentiels à la réalisation des rendements espérés par les investisseurs.[13]

Si les avantages des commissions intégrées pour la vaste majorité de la population (94%) qui dispose de moins de 500 000$ à investir sont éloquents, ils ne permettent cependant pas la réalisation d'économies d'échelle pour les portefeuilles plus importants (500 000$ et plus), qui

[12] Environics Research, B2B banque, Perspectives du marché pour les conseillers, septembre 2016, pp.7 et 9.
[13] Brad M. Barber, Terrance Odean, « The behavior of individual investors", sept.2011. Dalbar, « Quantitative analysis of investor behavior », édition 2015.

représentent 6% des ménages canadiens (tableau 1, p.29). **Par ailleurs, le jeu de la concurrence et une offre abondante d'alternatives s'avère de nature à faciliter la transition de cette frange de la population la plus sollicitée (donc la mieux informée des alternatives disponibles) et la plus rentable pour les institutions financières**. Plutôt que de croire que les ménages de masse « préfèrent investir dans les produits d'épargne classiques », nous croyons qu'ils ne sont pas suffisamment sollicités pour des produits « évolués » par les institutions financières, et que par conséquent ils sont moins bien informés et éduqués que les ménages aisés, sur les possibilités d'améliorer leur situation financière.

Partie 3 du document 81-408

4. Dans le cas de chacun des produits d'investissement suivants, placés au moyen d'un prospectus ou sur le marché dispensé sous le régime d'une dispense de prospectus :

- **OPC**
- **fonds d'investissement à capital fixe**
- **billet structuré**

Devrait-on abandonner les commissions intégrées? Dans la négative :
a. Sur quel fondement devrait-il être exclu?
b. Quel serait le risque que des arbitrages réglementaires soient faits sur le marché dispensé si les commissions intégrées n'étaient abandonnées que pour les produits placés au moyen d'un prospectus?

Réponse : Non.

a) Sauf exception, pour les fonds d'investissement à capital fixe qui sont sujets à l'offre et à la demande, qui ont des attributs de titres de participation. Par conséquent, les fonds à capital fixe devraient être traités comme les actions. L'argumentaire pour la préservation des commissions intégrées dans les OPC a déjà été développé dans la partie 2. Quant aux billets structurés, ils s'apparentent à des certificats garantis qui intègrent aussi des commissions. À cet égard, comme il n'y a pas de gestion ou de suivi à faire dans le cas des billets structurés, et que le risque de rendement revient à l'investisseur, le commissionnement des billets structurés ne devrait pas excéder de beaucoup celui des certificats de placement garantis.

b) Le risque d'arbitrages réglementaires serait évidemment très élevé, les seules limites résidant dans les certifications requises pour les sociétés et les représentants.

5. Y a-t-il des types particuliers d'OPC, de fonds d'investissement à capital fixe ou de billets structurés pour lesquels les commissions intégrées ne devraient pas être abandonnées? Pourquoi?

Réponse :

Harmoniser la rémunération comporte la maxime à travail égal, rémunération égale.
Dans la vente des produits des OPC, l'obligation du représentant est fondée sur la tolérance au risque et l'horizon de placement. Le rendement des fonds n'est pas une obligation du

représentant. Pour la vente des produits de fonds distincts en particulier, le représentant a aussi l'obligation d'analyser l'horizon de placement et la tolérance au risque du client, mais il doit en plus connaître les avenants au contrat d'assurance qui peuvent être ajoutés au produit et en informer le client à la remise du contrat. Le fonds distinct est un contrat de rente, non pas une valeur mobilière, la responsabilité du représentant va au-delà de la simple vente des produits d'épargne et l'évaluation de la tolérance au risque. Le représentant a la responsabilité de conseiller et administrer tout changement dans la succession du détenteur du contrat de rente. Pour tous les contrats d'assurance la commission est intégrée au produit; nous sommes d'avis que cela est de loin le meilleur véhicule pour assurer les services aux clients.

Pour les produits catalogués comme billets à capital structuré ce produit se vend comme une obligation. La commission du courtier est intégrée au billet. Abolir les commissions intégrées pour ces produits signifie que le client doit débourser une commission à l'achat du produit, représentant un frein à la vente de ce produit. Comme les billets structurés ne sont pas des placements liquides, leur détention dans un compte autogéré en vue de prélever des honoraires, signifie qu'il devra obligatoirement détenir des effets liquides pour en acquitter les frais.

Nous sommes d'avis que les changements suggérés par les ACVM d'abandonner les commissions intégrées pour les billets structurés et les fonds distincts, finiront par coûter plus chers à l'investisseur et favorisera la procrastination de l'épargne. En outre, nous croyons que l'offre de services, pour la vente de produits financiers, et la rémunération concernant certaines catégories de produits financiers apparentés (fonds distincts versus tous les produits d'assurances sur les personnes, billets à capital structuré versus toutes les émissions d'obligations, CPG, obligations d'épargne Québec, etc.), ne fera que stimuler la controverse et les recours concernant le traitement de la rémunération des représentants.

La réglementation devrait être simplifiée pour les produits structurés et à capital fixe, rassemblant les informations importantes sur une fiche du produit qui indique clairement la proportion du portefeuille qui bénéficie de l'effet de levier et en spécifiant les risques encourus pour l'investisseur par les choix du gestionnaire.

6. Y a-t-il d'autres types de produits d'investissement pour lesquels les commissions intégrées devraient être abandonnées? Pourquoi?

Réponse : Oui.

Pourquoi les produits exclusifs des sociétés affiliées des sociétés intégrées profiteraient-elles des commissions intégrées? **Il faut se rappeler que les commissions intégrées ont été créées par des gestionnaires de fonds indépendants pour des courtiers et des représentants indépendants en vue de les rémunérer.** On peut se demander si les sociétés intégrées devraient profiter des mêmes attributs que les sociétés indépendantes non-affiliées, puisqu'elles profitent d'un réseau de distribution affilié.

7. Adhérez-vous à la proposition d'abandonner tous les paiements faits par d'autres personnes que l'investisseur pour la souscription ou la détention de titres de fonds d'investissement ou de billets structurés? Pourquoi?

Réponse : Non.

Les gestionnaires de fonds indépendants seraient défavorisés par une telle mesure, leur nombre a beaucoup diminué depuis 20 ans sous l'impulsion des acquisitions par les institutions de dépôt, comme pour les courtiers en valeurs mobilières indépendants dans les années 80'. Comme l'indiquent les statistiques, la distribution est dominée par les institutions de dépôt et les assureurs. **La concentration de la distribution et de la gestion de fonds ne sont pas dans l'intérêt public.** Pourquoi devrait-il en être autrement pour les fonds mutuels que pour tous les autres produits financiers qui incluent les coûts de la distribution et de rémunération dans le coût du produit? Les études ont démontré l'efficacité du regroupement des coûts.[14] Enfin, l'abandon des paiements faits par des gestionnaires de fonds pourrait signifier la mort des réseaux indépendants encore en activité; les plus importants lanceraient leurs propres produits et les plus faibles seraient tout simplement acquis par des sociétés intégrées. **Au final, la distribution des fonds d'investissement ne serait plus assurée que par des sociétés intégrées et des distributeurs directs, réduisant le choix des consommateurs pour des services et des conseils objectifs indépendants du gestionnaire de fonds.**

Les commissions intégrées permettent une harmonisation de la rémunération pour tous les intervenants. Par ailleurs, les ACVM pourraient encadrer les commissions intégrées pour les billets structurés et les produits des OPC, en établissant des balises et des plafonds.

L'interdiction des commissions intégrées aux produits des OPC et aux billets structurés, avantagera toutes les sociétés de distribution intégrées, constituées surtout des banques et caisses populaires. Ces sociétés peuvent réduire les frais de distribution qu'elles financent par la vente des produits exclusifs, dont les marges de profits élevées compensent les faibles marges dans la distribution.

Le danger, la vente des produits maison réduira l'offre d'autres produits financiers sans altérer les frais de gestion totaux des produits OPC ou des Billets. **Les sociétés intégrées qui disposent d'un réseau de succursales peuvent supporter des pertes temporaires de revenu sur la distribution des produits des OPC et billets structurés, grâce aux ventes croisées d'autres produits de crédit, d'assurances crédit et d'autres produits d'épargne manufacturés qu'elles distribuent.** Les réseaux de distribution indépendants sont désavantagés, notamment parce que leurs représentants doivent détenir des certifications multiples pour les ventes croisées qui sont coûteuses. Finalement, les représentants indépendants sont tributaires de l'offre et du choix des produits qui leur sont offerts par les manufacturiers.

8. Devrions-nous envisager d'abandonner d'autres frais ou paiements relativement à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés, notamment :
a. le versement de sommes d'argent et la fourniture d'avantages non pécuniaires par les gestionnaires de fonds d'investissement aux courtiers et aux représentants en vertu de la partie 5 du Règlement 81-105;
b. les commissions d'indication de clients;
c. les commissions de placement?

Pourquoi? Ces types de frais et de commissions présentent-ils un risque d'arbitrage réglementaire et, dans l'affirmative, de quelle ampleur?

[14] Voir références de Pierre Lortie à cet égard aux pages 19 à 21.

Réponse :

a) Non
b) Oui, pour les sociétés affiliées, elles n'ont pas leur raison d'être.
c) N.D

9. Si le versement de sommes d'argent et la fourniture d'avantages non pécuniaires aux courtiers et aux représentants pour le soutien d'activités de commercialisation et de formation en vertu de la partie 5 du Règlement 81-105 sont maintenus après l'abandon des commissions intégrées, devrions-nous envisager de modifier la portée de ces versements et avantages? Dans l'affirmative, pourquoi?

Réponse : Oui.

Seuls les gestionnaires de fonds indépendants ne disposant pas de réseaux de distribution devraient être autorisés au versement de sommes d'argent et d'avantages non pécuniaires. Les sociétés intégrées devraient être exclues car des conflits d'intérêt dans la distribution de produits de sociétés liées sont inévitables.[15]

10. En ce qui a trait aux paiements de transfert internes :

a. Le Règlement 81-105, qui régit les paiements au sein de fournisseurs de services financiers intégrés, assure-t-il un traitement égal entre les fonds en propres et les fonds de tiers?

Réponse :

Les paiements devraient se limiter uniquement à la formation pour ce qui est des fonds en propres des fournisseurs de services intégrés.

b. Devrait-on abandonner les paiements de transfert internes à des courtiers membres de fournisseurs de services financiers intégrés qui sont liés à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés? Pourquoi? Dans quelle mesure les fournisseurs de services financiers intégrés font-ils directement ou indirectement des paiements de transfert internes à leurs courtiers membres et à leurs représentants afin de les inciter à distribuer leurs produits?

Réponse :

L'Analyse des pratiques de rémunération présentée dans l'avis 33-318 ont soulevé un certain nombre de pratiques généralisées qui pouvaient entraîner des conflits d'intérêt.

c. Devrait-on abandonner certains types de paiements de transfert internes qui ne sont pas liés à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés par un investisseur?

[15] En effet, les études indiquent qu'ils sont légion dans tous les pays, quelques soient les mesures réglementaires en place.

Réponse :

L'Analyse des pratiques de rémunération présentée dans l'avis 33-318 ont soulevé un certain nombre de pratiques généralisées qui pouvaient entraîner des conflits d'intérêt.

11. Si nous décidions d'abandonner les commissions intégrées, devrions–nous autoriser les gestionnaires de fonds d'investissement ou les émetteurs de billets structurés à faciliter le paiement de la rémunération du courtier par l'investisseur en la prélevant sur l'investissement de celui-ci et en la remettant en son nom au courtier?

Réponse :

Nous sommes contre le projet d'abandon des commissions intégrées qui incluent la commission de vente et la commission de suivi (ou de service). Par ailleurs, les gestionnaires de fonds devraient réserver des séries de fonds indépendantes pour les frais prélevés à l'acquisition, de ceux prélevés selon des frais de rachat pour plus d'équité (voir réponse à la question #2).

Partie 4 du document 81-408

Recherche de solutions

12. Compte tenu des données et des éléments probants fournis dans la présente partie, la proposition d'abandonner les commissions intégrées répondrait-elle aux trois principaux enjeux de protection des investisseurs et d'efficience du marché traités dans la partie 2?

Réponse : Non.

L'avis 33-318 a démontré que les conflits d'intérêt résultaient des pratiques de rémunération dans les sociétés intégrées et non des commissions intégrées dans les produits des sociétés de gestion. L'intégration des coûts de distribution et la rémunération des courtiers ne fait pas exception dans l'industrie des produits financiers et dans l'ensemble de l'économie.

Quel que soit la sphère d'activité, l'évaluation de la rémunération demeure toujours une question délicate. Les études ont cependant démontré que la pratique d'intégration des coûts s'avère la plus efficace.[16] L'abandon des commissions intégrées favorisera davantage les sociétés intégrées au dépend des sociétés de gestion et des courtiers indépendants, augmentant la concentration déjà très importante de l'industrie. Dans cet environnement, il sera plus difficile pour les représentants autonomes de concurrencer.

Le groupe CIRANO a démontré la valeur des conseils. Le document de consultation n'a pas démontré que les coûts excédaient la valeur des conseils. Le coût total que représentent les commissions intégrées dans les ratios de frais de gestion (RFG) des fonds s'élèvent à environ 125pb. Or, les honoraires de gestion observés dans les grandes maisons de courtage pour des

[16] Voir références de Pierre Lortie sur le sujet dans son document. Barreau du Québec, « La tarification horaire à l'heure de la réflexion ». SRC, Rémunération des médecins à l'acte.

portefeuilles de plus de 500 000$ jusqu'à 2 millions $ sont généralement de 100 à 175 pb. Il est donc très clair que le coût des commissions intégrées dans les RFG demeure très compétitif pour les portefeuilles de moins de 500 000$.

L'emphase des données et les éléments fournis ont été placés sur les coûts, en minimisant les effets bénéfiques, tel que ceux mesurés selon le facteur « gamma ». Les résultats et les bénéfices ne sont pas nécessairement plus grands lorsque les coûts sont plus faibles; les études de régression manipulent des statistiques qui ne distinguent pas les catégories de professionnels, surtout lorsqu'on fait référence aux données américaines.

Le document 81-408 ne distingue pas les différentes catégories professionnelles tel que « employé salarié en succursale », « travailleur autonome (conseiller indépendant ou membre d'une société intégrée)», « représentant de plein exercice (employé à commission ou autonome à commission) ». Le démarchage n'est pas pris en compte alors qu'il varie beaucoup entre les catégories de professionnels. Les amalgames reflètent davantage les types de professionnels à salaire et employés à commission des institutions de dépôt qui dominent le marché, en négligeant leurs concurrents directs représentés par les travailleurs autonomes.

13. Pour répondre à ces préoccupations, les ACVM pourraient-elles prendre d'autres mesures que l'abandon des commissions intégrées, conjointement ou séparément?

Réponse :

Pour protéger les intérêts des investisseurs, les ACVM doivent cibler les pratiques de rémunération et autres incitatifs des sociétés intégrées. **Il faut assurer une concurrence en protégeant et en favorisant les sociétés indépendantes dans la gestion de fonds et dans la distribution. Une révision des titres professionnels devrait reconnaître les différences fondamentales des conseillers travailleurs autonomes à commission de ceux qui sont à salaire et des représentants de plein exercice (employés ou autonomes).** Les exigences et les responsabilités diffèrent entre ces groupes professionnels. Les conseillers à commission indépendants devraient jouir d'un statut particulier et d'un encadrement qui protège et valorise leur pratique pour des services personnalisés qui sont appréciés de leur clientèle.

Les courtiers et leurs directeurs, qui ont la responsabilité de la supervision des représentants, devraient être imputables au même titre que les représentants, en particulier pour les représentants débutants avec une période probatoire de 6 mois, comme pour les assurances et pour les recommandations de prêts leviers.

14. Le passage à des mécanismes de rémunération directe risque-t-il d'entraîner d'autres conflits d'intérêts qui ne seraient pas encadrés par la réglementation actuelle des valeurs mobilières?

Réponse : Oui.

L'appât du gain chez certains conduira toujours à une rémunération créative. La rémunération à honoraires peut même permettre une augmentation des coûts qui autrement seraient plus faibles avec les frais intégrés aux produits. Des inégalités surviendront entre les investisseurs suivant des clivages variés comme « informé-novice », « négociateur- complaisant ». **Par**

exemple, les commissions intégrées actuelles tiennent compte des catégories d'actifs moins coûteuses dans l'évaluation des coûts globaux, alors que laissée à la discrétion du représentant, les honoraires pourraient s'avérer plus élevés qu'avec les commissions intégrées. Il est facile de comparer les RFG entre des produits similaires, mais il est impossible pour un investisseur de connaître le traitement d'un autre investisseur qui lui est comparable.

Changements dans l'expérience des investisseurs et les résultats qu'ils obtiennent

15. Selon vous, quel effet l'abandon des commissions intégrées aurait-il sur l'expérience des investisseurs et les résultats qu'ils obtiennent? Plus particulièrement :

« Si ces produits de plus en plus sophistiqués et jusque-là réservés aux initiés sont offerts à l'épargnant de masse, ce dernier doit être éduqué pour prendre adéquatement part à la révolution de l'investissement de masse. C'est ainsi que *The Economist* titrait récemment *Getting it right on the money: A global crusade is under way to teach personal finance to the masses*. »[17]

• Les investisseurs recevront-ils des conseils et des services financiers qui concordent davantage avec les honoraires qu'ils paient?

Réponse : Non.

Les investisseurs ne sont pas toujours conscients des risques qu'ils encourent et des bénéfices dont ils pourraient profiter pour des conseils. Ils pourraient alors refuser des consultations pour des conseils en vue d'économiser des honoraires et se priver des bénéfices des conseils, ou subir des pertes importantes dans la valeur de leur patrimoine en raison de leurs décisions émotives, de leur manque d'expérience ou de connaissances. L'idée que les investisseurs seront disposés à consommer les conseils de façon rationnelle et efficace pour leur plus grand bénéfice ne se confirme pas dans la réalité.[18] La nature des conseils n'a pas été établie par catégorie de professionnels et les différences dans les services offerts n'ont pas été prises en compte dans le document 81-408. **Par définition, le juste prix des services s'obtient dans un marché libre et en concurrence, alors qu'un marché réglementé comme en Angleterre est susceptible d'entraîner une carence des conseils du type *« advice gap »*.**

• Quel effet la proposition aura-t-elle sur le développement des conseils automatisés? Cet effet est-il susceptible d'être avantageux pour les investisseurs?

Réponse :

Les conseils automatisés ne peuvent être bénéfiques qu'aux personnes ayant la propension à gérer eux-mêmes leurs affaires et à acquérir des connaissances par eux-mêmes. Pour la très grande majorité, ils devront d'abord passer par une période d'apprentissage coûteuse. Les investisseurs, pour qui internet permet un accès facile et efficace à ces services, l'abandon des commissions intégrées ne changera rien puisqu'ils peuvent déjà profiter de ces services. Pour les autres qui n'ont pas l'intérêt, les connaissances, ni l'expérience de la gestion des placements et

[17] Maxime Lefrançois, p.85.

[18] Brad M. Barber, Terrance Odean, « The behavior of individual investors", pp.36-37.

des questions financières, ils perdront un accès à des services personnalisés et ils n'auront pas davantage recours à des services automatisés simplement parce qu'ils sont moins onéreux. **Le marché des conseils automatisés rejoint les gens motivés et intéressés à gérer leurs affaires, mais il n'est pas certain que la valeur des conseils et des services qu'ils y trouveront répondent à leurs besoins. À preuve, les investisseurs fortunés n'y ont pas recours, mais plutôt ils préfèrent un service personnalisé à haute valeur ajoutée.**[19] Les gens les moins fortunés, les moins expérimentés et les moins connaisseurs, ceux qui ont le plus besoin des conseils et d'assistance, seront laissés à eux-mêmes. Il a été démontré dans une étude que les petits et moyens investisseurs qui gèrent leurs placements sans intermédiaires obtenaient de moins bons résultats qu'avec les fonds mutuels.[20] Il est révélateur que la compagnie Vanguard offre d'une part ses fonds à très bas coûts sans conseils, et que d'autre part, la même société vante les mérites et la valeur ajoutée des conseils qu'elle vend séparément. Ainsi, elle peut récupérer les investisseurs qui connaîtraient des déboires avec ses fonds qu'ils gèrent eux-mêmes sans conseils, et d'autre part, séduire les investisseurs plus aguerris qui ne souhaitent pas profiter des conseils professionnels.

Voici les conclusions de Dalbar dans une récente étude sur le comportement des investisseurs: *« One thing that all the negative behaviors have in common is that they can lead investors to deviate from a sound investment strategy that was previously established based on their goals, risk tolerance and time horizon. … The data also shows that when investors react, they generally make the wrong decision."*[21]

• Y a-t-il des chances que les conseils discrétionnaires gagnent en popularité au Canada comme cela a été le cas dans les autres marchés qui ont délaissé les commissions intégrées et, le cas échéant, ce changement serait-il positif ou négatif pour les investisseurs?

Réponse :

Les renseignements présentés ne semblent pas concluants, la plupart étant préliminaires et plutôt optimistes quant à la résolution des problèmes observés, en particulier au R-U. Cependant, des données (figure 1) obtenues de la Chambre de sécurité financière (CSF) au Québec révèlent que **seulement 13,5% des planificateurs financiers au Québec ne possèdent aucun autre permis que celui de la prestation de conseils en planification financière**. Par ailleurs, 75% des planificateurs financiers détiennent aussi un permis en épargne collective, indiquant que la prestation de conseils de ces planificateurs dépend de la vente de fonds d'investissement. Fait à noter, le tiers des planificateurs financiers avec permis de fonds mutuels possède aussi des permis pour la vente d'autres produits. **Par conséquent, on peut raisonnablement conclure qu'un nombre important de ces conseillers vivent de la vente de produits plutôt que d'honoraires pour leurs conseils.**

Deuxièmement, on observe que 70% (22 662) de tous les membres inscrits (32 022) à la Chambre de sécurité financière détiennent un permis pour la vente de fonds

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[19] Michael S. Finke, Sandra J. Huston, and Danielle D. Winchester, "Financial advice: who pays", Association for financial Counseling and Planning education, 2011, p.24.

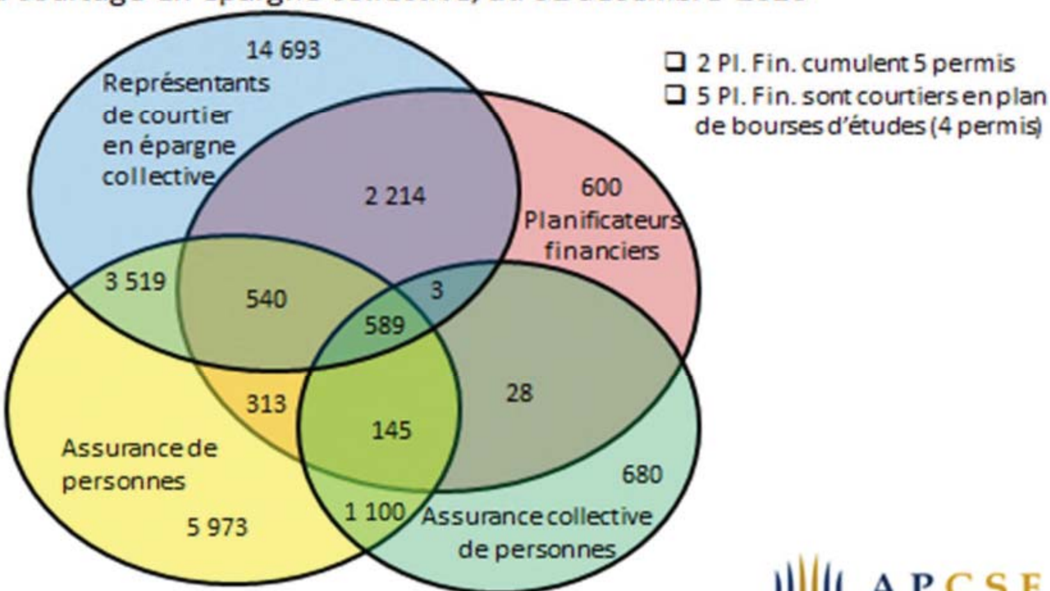
[20] P. Joakim Westerholm and Mikael Kuuskoski, University of Sydney, « Do Direct Stock Market Investments Outperform Mutual Funds? A Study of Finnish Retail Investors and Mutual Funds », 17 janvier 2014.

[21] John Rice, CFA, CFP, KeatsConnely (602-955-5007) pour Dalbar, « Quantitative analysis of investor behavior », p. 9.

d’investissement au Québec. Par conséquent, si l’abandon des commissions intégrées aura peu d’effets sur les employés salariés des institutions de dépôts, pour la prestation de conseils au Québec, on peut certainement conclure qu’elle se traduira par une diminution importante du nombre de conseillers autonomes au Québec et de leurs conseils à la population des marchés de masse et intermédiaire. **Ce qui se traduira par davantage de concentration de la prestation des conseils entre les mains des institutions de dépôt.**

Figure 1

Répartition des 4 439 planificateurs financiers dans les 3 principales disciplines des assurances de personnes, des assurances collectives, et du courtage en épargne collective, au 31 décembre 2016



Source: Chambre de la sécurité Financière, 24 mars 2017

APCSF

• Quel effet la proposition aura-t-elle sur la croissance du réseau des courtiers en ligne et des courtiers exécutants et le coût des fonds offerts dans ce réseau? Cet effet est-il susceptible d’être avantageux pour les investisseurs?

<u>Réponse :</u>

L'élimination ou la réduction du marché des conseils pour une classe importante de la population, entraînant une carence en matière de conseils, pourrait créer des opportunités d'affaires à court terme pour les réseaux sans conseils, récupérant une partie du marché délaissé. Mais ces gains de marché s'amenuiseront à long terme, un grand nombre d’investisseurs s’avèreront déçus de leurs résultats, après qu'ils auront connu des déboires avec leurs placements. Après avoir réalisé que leur situation financière se soit détériorée, ces épargnants se retourneront à nouveau vers les produits classiques offerts par les banques et les caisses populaires, favorisant davantage la concentration des services financiers.[22] **Nous avons déjà souligné que l'aspect des risques d'investissement, qui sont inhérents au potentiel de rendement élevé, n'avait pas été suffisamment considéré dans le document de consultation. Pourtant, les risques d'investissement constituent une dimension essentielle dans la décision des investisseurs de masse et intermédiaire, qui choisissent d'investir dans les fonds mutuels parce qu'ils se sentent en confiance avec leur conseiller.**

• Quel effet la proposition aura-t-elle sur le coût et l'étendue des conseils fournis à des segments particuliers d'investisseurs?

Réponse :

La segmentation naturelle dans les pratiques indépendantes sera généralisée et les clients non-rentables seront délaissés par les conseillers. Les pratiques de représentants à commission réduiront le nombre de leurs clients et chercheront à augmenter le nombre de clients plus rentables. Le nombre de pratiques d'affaires diminuera. Les représentants indépendants concentreront leurs efforts et offriront leurs services aux investisseurs du marché intermédiaire.[23] Les épargnants et investisseurs du marché de masse ne profiteront plus de l'éducation sur les placements et la gestion financière qu'ils recevaient d'un représentant autonome et leurs connaissances s'appauvriront pour la plus grande partie d'entre eux. Les conseils indépendants et les services personnalisés disparaîtront pour le marché de masse. La relève des conseillers indépendants se raréfiera et les conseillers salariés au sein des sociétés de dépôt deviendront la norme. **La concentration du marché entre les mains des sociétés de dépôts augmentera et la concurrence diminuera.**

16. Quels sont les types de mécanismes de paiement susceptibles de découler de cette proposition, si elle est adoptée? Plus particulièrement :

• Les mécanismes de paiement proposés par les courtiers différeraient-ils selon le segment d'investisseurs? Dans l'affirmative, expliquez en quoi et pour quelles raisons.

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[22] Voir étude de Pierre Lortie, pp.21-22 : « From an economic and social point of view, the horizontal industry structure where several manufacturers distribute their financial products through unrelated financial intermediaries is far superior to a vertically integrated structure where the great majority of financial advisers are limited to "selling" the financial products "*manufactured*" by their employer, in that it promotes market transparency, competition at both the product and distribution levels and focus on investment performance."

[23] Cette tendance est déjà observable chez plusieurs représentants autonomes qui recommandent des comptes à honoraires à leurs clients intermédiaires et aisés, notamment pour les comptes non-enregistrés. Les augmentations observées pour l'option de souscription à honoraires dans le document de consultation 81-408, pages 50 à 55, en sont la conséquence. **Par ailleurs, il faut remarquer que l'option de souscription avec frais à l'acquisition offre une commission de suivi égale ou inférieure aux comptes à honoraires, les deux modes s'avérant des substituts la plupart du temps, après l'échéance du terme pour les fonds acquis selon la méthode des frais de souscription reportés.**

Réponse :

Dans l'éventualité de l'abandon du financement des conseils sur plusieurs années avec des frais différés, les représentants qui offrent des conseils à valeur ajoutée n'auront plus les moyens de conseiller et d'éduquer les ménages du marché de masse sur les investissements, pour les faire progresser financièrement. **Le lien de causalité des observations en page 30 est inversé; c'est parce qu'ils ont été éduqués à utiliser les fonds d'investissement qu'on retrouve les ménages intermédiaires et aisés plus concentrés dans les fonds d'investissement (démocratisation de l'investissement).** Ces ménages, représentant 88% des détenteurs de fonds d'investissement, témoignent d'un travail d'éducation fait par des représentants à commission qui investissent plus de temps avec les gens moins fortunés grâce au financement sur 6 ans que leur permettent les commissions intégrées.

17. Pensez-vous que la proposition entraînerait une carence en matière de conseils?

Réponse : Oui.

Comme il a été expliqué précédemment, les ménages du marché de masse ne recevront plus l'éducation et les conseils des représentants autonomes. Les institutions de dépôt pourraient également procéder à une rationalisation de leur personnel et proposer des solutions Fintech à leur clientèle, appliquant le modèle d'affaires des guichets automatiques en remplacement du personnel. Pourtant, les fonds mutuels demeurent des produits évolués qui comportent des risques. **Enfin, d'où proviendront les conseils en planification financière pour les ménages du marché de masse à l'avenir?**

• Quels segments du marché risquent d'être touchés? Prière de considérer la segmentation en fonction du patrimoine, de facteurs géographiques (taille et emplacement de l'agglomération, par exemple, éloignée, petite, moyenne ou grande), de l'âge, des connaissances technologiques, du nombre de titres de fonds que détiennent les ménages, etc.

Réponse :

Les segments les plus touchés de la population seront les moins éduqués et les moins expérimentés. Il est dommage que le document de consultation n'ait pas présenté de statistiques selon les niveaux d'éducation, d'âge et d'expérience des investisseurs. Les épargnants des régions, par opposition aux villes centres, devraient être davantage affectés, en particulier ceux du marché de masse, par la baisse du nombre de représentants autonomes. Les ménages intermédiaires et aisés devraient s'attirer les services de représentants des grands centres poussés par la concurrence à élargir leur territoire de desserte. Il a été démontré que les personnes bénéficiant d'un niveau d'éducation plus élevé ou d'une situation financière aisée avait davantage recours aux conseils.[24] **Par ailleurs l'étude de Finke, Huston et Winchester met en évidence le fait que les gens ayant un faible niveau d'éducation, ou des moyens financiers modestes, ne réalisent pas suffisamment les bénéfices qu'ils peuvent retirer des conseils,**

[24] Michael S. Finke, Sandra J. Huston, and Danielle D. Winchester, "Financial advice: who pays", Association for financial Counseling and Planning education, 2011.

alors qu'ils sont ceux qui en ont le plus besoin. Comment alors seraient-ils disposés à payer directement pour des conseils?

• Souscrivez-vous à notre définition de « carence en matière de conseils »?

Réponse : Non.

Les conseils ne se réduisent pas à l'acquisition des fonds d'investissement comme on l'indique aux pages 63 et 66 du document de consultation 81-408, où on les compare avec des conseils en ligne. Contrairement à ce qui est affirmé dans le document de consultation à la page 30, les ménages du marché de masse n'ont pas une préférence pour les « produits d'épargne classiques ». Plutôt, ils ont besoin de conseils personnalisés et plus étendus qui favorisent leur éducation financière, tel qu'il est décrit dans l'étude de l'IFIC sur le Paiement des conseils: « *Près de neuf investisseurs de fonds communs de placement sur dix ont recours à un représentant pour investir et ils profitent grandement d'une discipline d'épargne qu'ils ont acquise grâce à ces relations. Il y a de bonnes raisons pour cela. Grâce au processus de collecte de renseignements auquel le client est soumis au début de la relation de conseil, à l'élaboration d'un plan d'épargne et au suivi et à la mise à jour du plan au fil du temps, le client acquiert une meilleure compréhension de ses objectifs de placement, de sa tolérance au risque et de la meilleure stratégie pour atteindre ses objectifs de placement. Le client comprend beaucoup mieux la finance et est moins enclin à prendre des décisions de placement subjectives.* » [25]

Nous croyons qu'il existe présentement une carence en matière des conseils auprès des ménages du marché de masse, puisque 78% d'entre eux ne détiennent pas de fonds d'investissement, alors que seulement 33% des ménages du marché intermédiaire et 24% des ménages aisés n'en détiennent pas.[26] On ne connaît pas la répartition par groupe d'âge, mais on peut estimer qu'elle est semblable avec un biais plus jeune pour le marché de masse. **Il est révélateur, au tableau 4 de la page 31, que la proportion des ménages ayant recours à un conseiller augmente selon les actifs à investir des ménages, témoignant de l'impact positif des conseils sur l'accumulation des actifs des ménages avec les années, tel que mesuré par CIRANO.** (Des statistiques des actifs par groupe d'âge permettraient de renforcer l'observation). En revanche, on observe la tendance inverse chez les ménages qui n'ont pas recours aux services d'un conseiller, leur proportion augmente avec la diminution de leurs actifs (encore une fois il est normal que les actifs augmentent avec l'âge, mais il est révélateur qu'il y ait 3 fois plus de ménages avec des actifs de plus de 500 000$ qui ont recours à des conseils, que ceux qui n'ont pas recours à des conseils). Par conséquent, on peut conclure que la richesse des ménages augmente pour les ménages ayant recours aux services d'un conseiller et aux fonds d'investissements. **En réduisant la carence des conseils pour les ménages du marché de masse, le recours aux fonds d'investissement augmenterait, stimulant l'épargne et augmentant davantage la proportion des ménages intermédiaires dont les 2/3 utilisent à la fois les services d'un conseiller et les fonds d'investissement comme véhicule de placement.**[27] Nous sommes d'avis que l'interprétation à la page 30 du document, selon laquelle il y aurait un « manque d'intérêt relatif » des ménages du marché de masse, est erronée.

[25] IFIC, « Paiement des conseils, l'importance des options proposées », août 2014; Montmarquette, C. et N. Viennot-Briot, *Econometric Models on the Value of Advice of a Financial Advisor*, CIRANO, juillet 2012.
[26] Document 81-408, tableau 3, p.30.
[27] Document de consultation 81-408, tableau 4, p.31.

En effet, les données présentées aux tableaux 5 à 8 ne permettent pas d'identifier clairement les représentants autonomes dans l'amalgame « institution de dépôt ou assureur ». **Notre expérience nous amène à croire qu'il existe une carence en matière de conseils dans les succursales des sociétés de dépôt pour le marché de masse et qu'il faudrait distinguer les conseillers « employés des institutions de dépôt » des conseillers « autonomes à commission et travailleurs autonomes affiliés à des assureurs ».** Les tableaux 6 à 8 des pages 33 et 34 démontrent que les « institutions de dépôt ou assureurs » dominent les 3 marchés identifiés pour ce qui est de la détention de fonds d'investissements ». Pourquoi ne présente-t-on pas la répartition des ménages qui ne détiennent pas de fonds d'investissement, qui représentent pourtant 62,9% des ménages canadiens (tableau1)? Leur répartition serait-elle différente? Si oui de quelle manière? Nous soupçonnons que la catégorie « institutions de dépôt ou assureurs » domine outrageusement la distribution des produits d'épargne classiques. **Ainsi, la conclusion selon laquelle les institutions de dépôt dominent la distribution de fonds d'investissement ne reposerait pas sur l'observation implicite d'une préférence des investisseurs pour ces institutions, mais s'expliquerait plutôt par le fait que le marché canadien est démesurément concentré dans toutes les catégories de produits financiers.** Voici dans quels termes le Ministère des Finances du Canada décrivait le marché canadien dans un rapport récent : « Comme il a été susmentionné, les six plus grandes banques possèdent maintenant 93 % des actifs du sous-secteur bancaire ». « La consolidation des institutions financières réglementées a des répercussions sur le contexte concurrentiel. Il se pourrait que les concurrents qui quittent le marché ne soient pas remplacés rapidement par de nouveaux arrivants. Les petites institutions financières et celles de taille moyenne ont soutenu qu'elles font face à des difficultés en ce qui concerne l'établissement de nouvelles entreprises au Canada, ainsi que la compétitivité et la croissance en raison du fardeau de réglementation proportionnellement plus élevé et des exigences prudentielles plus strictes par rapport aux grandes banques. » [28]

L'abandon des commissions intégrées, ou toute autre réduction du financement des conseils pour les ménages du marché de masse, réduirait inévitablement l'offre de conseils pour cette clientèle. **Par ailleurs, une amélioration du financement des conseils pour les représentants à commission, en réintroduisant par exemple les plans d'épargne contractuels abandonnés dans les années 90', permettrait de réduire la carence des conseils pour les ménages du marché de masse, grâce à un meilleur financement des conseils aux petits épargnants.**

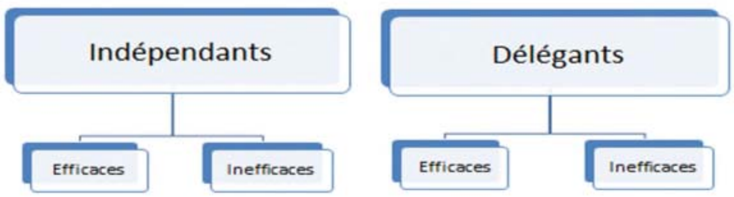
• Devrions-nous faire une différence entre la carence en matière de conseils « en personne » et la carence en matière de conseils en général?

Réponse : Oui et davantage.

La description des investisseurs par catégorie d'actifs aux pages 68 à 74 n'est pas suffisante. Plutôt, on devrait distinguer les types d'investisseurs selon qu'ils sont « indépendants » (page 74) et ceux qui sont « délégants ». Ces 2 types d'investisseurs devraient également être subdivisés en 2 catégories, selon qu'ils sont « efficaces » ou « inefficaces », voir figure 2.

[28] Ministère des finances du Canada, « Soutenir une économie forte et en croissance : préparer le secteur financier du Canada pour l'avenir », 26 août 2016, p. 25.

Figure 2
Types d'investisseurs qui définissent les besoins en conseils



L'IFIC cite une étude de Pollara Research qui établit à 87% la part des investisseurs « délégants » qui acquièrent leurs fonds d'investissements par l'intermédiaire d'un représentant, et CIRANO estime à 6% les investisseurs canadiens (Indépendants-efficaces) qui disposeraient des critères requis pour assumer eux-mêmes la gestion de leurs finances.[29] Des études démontrent que très peu d'investisseurs possèdent les caractéristiques et les habiletés pour gérer eux-mêmes leurs investissements.[30] Par conséquent, le marché des conseils en ligne demeurerait très limité. Les besoins pour des conseils plus étendus, comme il a été mentionné plus haut, demeurent la norme. (Voir la note 19). Il serait inquiétant que davantage d'investisseurs se voient résigner aux services de conseils en ligne, et qu'ils viendraient grandir la proportion d'investisseurs inefficaces, parce qu'ils auraient de la difficulté à obtenir les services d'un conseiller financier expérimenté. **En particulier, les épargnants du marché de masse qui ont un besoin d'éducation financière en seraient les premières victimes.** Enfin, des déplacements peuvent être observés dans le modèle des types d'investisseurs présenté à la figure 2, certains investisseurs « indépendants-inefficaces » devenant des investisseurs « délégants », alors que certains investisseurs « délégants-efficaces » pourraient devenir des investisseurs « indépendants ».

En conclusion, la « carence en matière de conseils » devrait être évaluée selon les besoins diversifiés des 4 catégories d'investisseurs décrits plus haut. Les besoins de conseils des investisseurs « délégants » peuvent être comblés suivant un vaste choix présentement offerts sur le marché. Nous recommandons que davantage de données soient recueillies sur les ménages du marché de masse, ceux-là qui connaissent la plus importante carence en matière de conseils à notre avis; en particulier, la répartition des ménages qui ne détiennent pas de fonds mutuels selon les réseaux de distribution, les types de professionnels (salariés, travailleurs autonomes, …) et par groupes d'âge. **Nous croyons que l'abandon des plans d'épargne contractuels dans les années 90' a réduit l'offre de conseils par les représentants indépendants (travailleurs autonomes) pour les ménages du marché de masse.** Pourtant, un segment important de la population bénéficiait auparavant de ces programmes d'épargne qui présentaient un premier pas dans le monde de l'investissement.[31]

[29] IFIC, « Paiement des conseils, l'importance des options proposées », août 2014, p.2.
[30] Brad M. Barber, Terrance Odean, « The behavior of individual investors", sept.2011. Dalbar, « Quantitative analysis of investor behavior », édition 2015.
[31] Le tableau 1 à la page 29 du document de consultation 81-408 indique que 52,6% des ménages canadiens qui ne détiennent pas de fonds d'investissement ont moins de 100 000$ à investir.

• Quels types de conseils ou de services actuellement offerts seraient le plus touchés par la proposition?

<u>Réponse :</u>

Les conseils personnalisés pour l'éducation et l'accompagnement du public épargnant de masse qui n'a pas une culture et une éducation financière, qu'ils détiennent ou non des fonds d'investissement. Les investisseurs « délégants » disposant de sommes moins importantes, 250 000$ et moins, subiraient une « carence en matière de conseils » qu'ils désirent recevoir. Les investisseurs « inefficaces » pourraient également subir des pertes financières s'ils ne reçoivent pas les conseils et l'enseignement des principes de gestion financière d'un conseiller.

• Y a-t-il des interactions potentielles entre la présente proposition, les réformes en cours telles que la deuxième phase du MRCC et d'autres réformes éventuelles comme celles énoncées dans le Document de consultation 33-404 des ACVM qui pourraient avoir un effet sur l'importance d'une possible carence en matière de conseils?

<u>Réponse :</u>

La préoccupation des ACVM quant à la connaissance, la compréhension et le contrôle des coûts ne devrait plus en être une, suivant l'application du MRCC2. Surtout, le niveau de concurrence entre les différents distributeurs et les différents professionnels devrait être plus vigoureux, permettant au public d'obtenir les services et la valeur ajoutée pour les coûts qu'il paye.

• Comment pourrions-nous atténuer une éventuelle carence en matière de conseils, de conseils en personne ou de services financiers?

<u>Réponse :</u>

Maintenir les commissions intégrées pour les ménages de masse avec des épargnes de moins de 250 000$. Favoriser la relève et le développement de conseillers indépendants et travailleurs autonomes qui œuvrent à l'éducation et qui accompagnent leurs clients dans leurs décisions financières. Rétablir les plans d'épargne contractuels pour l'acquisition des fonds d'investissements sur des périodes maximums de 5 ans (60 mois) et pour des montants maximums de 500$ par mois.

• Pensez-vous que les conseils en ligne pourraient atténuer une carence en matière de conseils? Dans l'affirmative, expliquer de quelle manière.

<u>Réponse :</u> Non, absolument pas.

Les conseils en ligne se limitent à des informations pour l'exécution de transactions pour des gens informés et motivés (investisseurs indépendants efficaces). Ils ne sont pas conçus pour découvrir les objectifs et les besoins de la plupart des gens (investisseurs délégants efficaces ou inefficaces). Les conseils en ligne sont réactifs et non proactifs, l'investisseur doit faire lui-même le suivi de sa situation financière et de son portefeuille. Les conseils se limitent à l'objet de la transaction pour laquelle paie l'investisseur. L'investisseur ne peut être objectif dans l'analyse de sa propre situation. Comment les ménages du marché de masse qui sont les moins informés et les moins éduqués financièrement pourront-ils combler l'absence d'un conseiller qui l'encourage à épargner?

• Pensez-vous que le fait que les courtiers appartenant à une institution de dépôt ou à un assureur détiennent une part importante du marché de la distribution des titres de fonds au Canada influera sur la probabilité qu'apparaisse une carence en matière de conseils ou sur l'importance de celle-ci?

Réponse : Oui.

Ils détiennent une part importante des actifs (mesure du marché), mais ils détiennent moins de 20% des ménages canadiens. **La carence en matière des conseils est un enjeu pour le marché de masse et le marché intermédiaire, pas pour les personnes les mieux nanties.** Les professionnels qui desservent le marché des ménages aisés poursuivront dans la même voie. **L'abandon des commissions intégrées est de nature à favoriser davantage la concentration de l'industrie et favoriser le modèle d'affaires des sociétés intégrées.**

Évolution du secteur indépendamment de la décision des autorités de réglementation d'abandonner les commissions intégrées

18. Étant donné les changements que nous avons constatés dans le secteur ces dernières années (réduction des frais, introduction de séries de fonds pour les investisseurs indépendants, simplification des séries de fonds, réductions automatiques des frais, facilitation de l'accès aux options de souscription à honoraires, etc.), quelle est la probabilité que le secteur des fonds d'investissement délaisse les commissions intégrées en l'absence de mesures réglementaires? Plus particulièrement :

• Le secteur continuera-t-il à délaisser les commissions intégrées si les ACVM ne donnent pas suite à la proposition? Plus particulièrement :

Réponse :

Le projet d'abandon des commissions intégrées est de nature à favoriser la concentration dans la quête des actifs de 1 350 milliards $. **Dans ce genre d'environnement d'affaires, y-a-t-il création de richesse?** Les coûts plus élevés des plus petits portefeuilles détenus par les ménages du marché de masse pourraient conduire les sociétés à les délaisser, alors qu'ils sont déjà négligés.

a) Les démarches entreprises par les autorités peuvent avoir influencé les gestionnaires de fonds dans leurs décisions d'affaires afin de se préparer à un nouvel environnement de concurrence. S'il est vrai aujourd'hui que l'épargne des canadiens suscite moins d'attrait de la part des grandes sociétés, il reste que plus des 2/3 de la population dispose de moins de 100 000$ à investir.[32] Les fonds d'investissement représentent le meilleur moyen pour les petits investisseurs d'améliorer leur situation financière à long terme. **Devant certaines décisions observées ces derniers mois (IG, Fonds Dynamique) de la part de gestionnaires qui ont choisi d'abandonner les commissions intégrées sur 6 ans**

[32] Document 81-408, tableau 1, p.29.

ou moins, les autorités ont maintenant la responsabilité de protéger l'accès à des conseils personnalisés pour le public épargnant et de contraindre ces sociétés à rétablir les conseils rémunérés par des commissions intégrées, selon des options qui permettent le financement de conseils sur de petites sommes (rachat sur 6 ans).

b) **Les autorités devraient encourager le développement de représentants "conseillers-éducateurs" dans la réglementation**, en vue d'intéresser davantage les firmes aux ménages du marché de masse.

c) **Les autorités devraient imposer à toutes les sociétés de gestion disposant d'un actif sous gestion déterminé (exemple : 10 milliards $), d'offrir une série de fonds avec frais de rachat sur 5 ou 6 ans**, afin de permettre aux petits investisseurs d'être sollicités par des représentants indépendants, en particulier les jeunes représentants de la relève. **Les autorités devraient forcer certaines sociétés de gestion et courtiers à plus de responsabilités sociales dans leur offre de produits. Les conseils devraient être reconnus, comme par le passé, comme une condition nécessaire pour la plupart des gens à l'acquisition d'un fonds d'investissement.** Aussi, tout investisseur canadien devrait pouvoir accéder à des services personnalisés s'il le désire et les sociétés de gestion devraient avoir l'obligation d'offrir des options de rémunération pour les petits investisseurs dans un certain nombre de leurs produits.

d) Les autorités devraient réglementer les gestionnaires de fonds afin qu'ils aient l'obligation d'offrir des plans d'épargne contractuels dans leur offre de produits, pour des montants maximums de 500 $ par mois qui s'échelonnent sur une période de 5 ans.

19. La figure 8 illustre-t-elle fidèlement les options de souscription offertes aux investisseurs selon le réseau, la taille du compte ou le type de société?

<u>Réponse :</u>

Il faudrait distinguer les titres professionnels et le statut des représentants (salariés et employés à commissions, travailleurs autonomes, représentants de plein exercice et représentants en épargne collective).

• Selon vous, les options de paiement et les modèles d'entreprise évoluent-ils en ce moment?

<u>Réponse :</u>

Il semble y avoir une tendance à implanter des services automatisés et de courtage en ligne pour les ménages des marchés de masse et intermédiaire. Les conseils personnalisés semblent de plus en plus réservés aux ménages aisés. Il est de plus en plus difficile de trouver des gestionnaires indépendants pour des recommandations de placements. La mobilité des représentants est réduite par les contraintes réglementaires et le nombre de courtiers indépendants de plus en plus restreint.

• De quelle manière évolueraient-ils au fil du temps si les ACVM décidaient de ne pas mettre en œuvre la proposition?

Réponse :

Il serait plus difficile pour les institutions de dépôt d'implanter leur plan d'affaires visant à automatiser davantage leurs services pour les ménages du marché de masse, qui continueront de rechercher les conseils des représentants qui offrent des services personnalisés. Malgré une offre de produits restreinte, dominée par les institutions de dépôt, la préservation de réseaux de distribution et de représentants indépendants permettra au public d'accéder à des conseils objectifs et personnalisés. Les conseils seraient préservés pour les ménages du marché de masse et les représentants autonomes pourraient intéresser une relève pour leur clientèle.

20. Nous constatons que la distribution de séries à honoraires demeure relativement limitée au Canada par rapport à d'autres marchés. Existe-t-il des obstacles propres au Canada (sur le plan structurel, opérationnel ou réglementaire, ou du point de vue de la demande des investisseurs, par exemple) qui limitent l'utilisation de ces séries par les courtiers?

Réponse :

Le marché canadien est beaucoup plus petit que le marché américain, expliquant un développement plus faible des comptes honoraires. Les séries à honoraires pour les portefeuilles de moins de 1 million $ ne sont pas plus économiques pour la plupart des fonds de série « A » avec commissions intégrées à l'échéance des frais différés. La rémunération est également la même pour les représentants. Comme les séries « A » et « à honoraires » sont à peu près équivalentes pour l'investisseur et pour le représentant, il n'y a pas de raison que les séries à honoraires remplacement les séries « A » à l'échéance des frais. Comme la majorité des actifs des fonds mutuels sont détenus dans des régimes enregistrés, l'investisseur ne tire aucun avantage fiscal à transformer les commissions intégrées des fonds dans une série à honoraires.

Répercussions potentielles sur la concurrence et la structure du marché

21. Veuillez décrire les répercussions de l'abandon des commissions intégrées sur la concurrence et la structure du marché, et indiquer si vous acquiescez ou non à l'analyse présentée à la partie 4. Plus particulièrement :

Depuis l'année 2008, le resserrement des mesures de conformité par les régulateurs (ACVM) ont influencé d'une manière marquante la consolidation des cabinets de courtage de produits financiers.

La complexité des règles de conformité et la démesure des coûts engendrés pour les petits et moyens cabinets ont stimulé les grands réseaux nationaux à l'achat compulsif de petits et moyens cabinets régionaux.

Selon nos sources, 9 des plus importants distributeurs intégrés, détenteurs de plusieurs marques au Canada, accaparent aujourd'hui 95 % de la distribution des produits financiers des OPC.

1. Power corporation (IG, IPC, Mackenzie, Great-West, Putnam, London Life, Can.Life)
2. Assante Wealth Management (Banque Scotia)

3. Financière Manuvie (Gestion d'actifs Manuvie, Placements Manuvie, Manulife Ass.mgnt)
4. MD Managments Ltd
5. Sun Life Financial Services (Sun Life)
6. Mouvement Desjardins (Caisses Desjardins, Desjardins securities, SFLP, VMD, Fiducie Desj.)
7. Investia financial services, FundEx Investments (Industrielle-Alliance)
8. BMO Security
9. BNC Security
10. RBCsecurity
11. TD security
12. CIBC security
13. Scotia Bank security, Scotia McLeod

Le travail à commission de type entrepreneurial doit être cohérent avec le statut de travailleur autonome qui lui est associé

Dans le contexte d'un marché qui est très concentré, de nombreux travailleurs autonomes sont devenus des employés « bon marché » pour plusieurs institutions financières.

• Pensez-vous que la proposition aura des répercussions sur le niveau de regroupement ou d'intégration au sein du secteur? Qu'en est-il de la concentration des actifs des investisseurs du marché de masse placés dans des produits gérés par des courtiers appartenant à des institutions de dépôt?

Réponse :

Les institutions de dépôt cherchent à offrir des produits peu coûteux et automatisés au marché de masse. L'offre de produits des institutions de dépôt au marché de masse se fait en succursale où les produits et les conseils sont moins évolués. **Les institutions de dépôt seront moins vulnérables à des sorties de fonds, advenant qu'elles réduisent les services et les conseils pour les ménages du marché de masse, si elles ne subissent plus la concurrence de la part des conseillers travailleurs autonomes à commission.** À long terme, les jeunes ménages du marché de masse représentent un potentiel de croissance que souhaitent certainement préservées les institutions de dépôt. **Il est certain que l'abandon des commissions intégrées réduira la concurrence envers les banques et que la concentration des actifs entre leurs mains augmentera.**

• Quelles répercussions d'éventuels regroupements pourraient-ils avoir sur les résultats obtenus par l'investisseur et l'efficience du marché?

Réponse :

Les regroupements réduisent le choix pour les représentants indépendants et pour les investisseurs. La concentration de la distribution précède la concentration dans la gestion. **Les conseils sont offerts au niveau de la distribution; plus la distribution sera concentrée, moins les conseils seront objectifs et plus le choix de produits sera orienté.** Les gestionnaires indépendants doivent conclure des ententes avec les sociétés intégrées dans la gestion de fonds pour accéder à la distribution. **Au final, les gestionnaires indépendants demeurent à la remorque des sociétés intégrées qui contrôlent la distribution et qui dictent les choix de produits aux représentants indépendants ou exclusifs par leur contrôle sur les produits.**

Les ménages aisés peuvent accéder à une gestion privée et à des choix plus étendus de solutions d'investissement. Quant aux ménages du marché de masse, la concentration dans la distribution sera défavorable à la démocratisation financière, en raison d'une réduction du financement pour des conseils au niveau de la distribution. Les institutions de dépôt offriront des solutions moins coûteuses aux ménages de masse, en misant sur des produits qui peuvent être distribués par des systèmes automatisés, sans conseils en matière de finances personnelles.

Pour favoriser l'efficience du marché, la tendance à la concentration devrait être inversée dans la distribution des produits, en favorisant plus de concurrence entre les courtiers.[33]

Les conseils personnalisés sont recherchés et très prisés par les ménages du marché de masse et du marché intermédiaire dans le but d'améliorer leur situation financière. Malheureusement, les données présentées dans le document de consultation 81-408 ne mettent pas en lumière les préférences des ménages, qui quittent les institutions de dépôts en quête de conseils personnalisés auprès d'un « travailleur autonome ». **L'APCSF observe chez ses membres un flux largement positif de clients en provenance des institutions de dépôt, en raison de l'attrait pour des conseils personnalisés, mais que les statistiques présentées dans le document 81-408 ne permettent pas d'identifier.**

• Selon vous, quelles occasions la mise en œuvre de la proposition offrirait-elle et quels défis poserait-elle aux divers groupes de parties prenantes du secteur?

Réponse :

Croissance des grandes sociétés intégrées par acquisition, fusion de sociétés et disparition des services personnalisés abordables.

- Les courtiers indépendants : Disparition progressive par des fusions avec des gestionnaires indépendants ou par affiliation à une société intégrée (exemples : Option retraite, Assante et Fonds mutuels Cartier)

- Les sociétés de fonds indépendantes : Acquisition par des sociétés intégrées (exemples : Fonds Mackenzie, Fonds Dynamique, Fonds CI, Fonds AIC, Fonds Clarington, etc.).

- Les fournisseurs de services financiers intégrés : Acquisition d'actifs auprès de sociétés de gestion et de courtiers indépendants. Ils hériteront également d'employés qualifiés qui abandonneront leur statut d'entrepreneurs indépendants dans les services financiers.

[33] L'APCSF a déjà recommandé à l'Autorité des marchés financiers de favoriser la mobilité des conseillers indépendants dans un mémoire présenté le 24 octobre 2016 « Mémoire de l'APCSF sur les principaux enjeux de l'industrie des services financiers pour les conseillers à commission », section 4. Mobilité des conseillers financiers, pp.12-15.

- Les courtiers en épargne collective : Disparition progressive par des fusions avec des gestionnaires indépendants ou par affiliation à une société intégrée (exemples : Option retraite, Assante et Fonds mutuels Cartier).

- Les courtiers membres de l'OCRCVM; Les indépendants seront acquis par les sociétés de dépôt et les assureurs intégrés. Pour les autres qui sont déjà affiliés à une société intégrée, il n'y a aura pas de conséquences. Il y aura augmentation des honoraires de gestion pour les investisseurs bien nantis qui feront face à des choix plus limités.

- Les courtiers en ligne et les courtiers exécutants : Bien que les courtiers en ligne et exécutants pourraient connaître une augmentation les premières années, ce marché devrait demeurer limité à long terme puisqu'il répond aux besoins d'une faible proportion de la population qui répond aux caractéristiques des investisseurs « indépendants- efficaces ».[34] Les grands perdants seraient les investisseurs « indépendants-inefficaces » et les « délégants » qui connaîtraient une carence en matière de conseils, en particulier les 67% des ménages canadiens qui constituent le marché de masse.

• Quelle est la probabilité qu'apparaisse de l'arbitrage réglementaire sur les produits financiers similaires, tels que les fonds distincts et les produits d'institutions de dépôt, et quelle en serait l'ampleur?

Réponse :

L'ampleur serait massive chez les représentants affiliés à un assureur. L'APCSF a déjà indiqué à l'Autorité que 25% des détenteurs de permis en fonds d'investissements (22 662) étaient aussi détenteurs de permis en assurance de personnes ou en assurance collective (5 720 permis). On peut donc s'attendre à un arbitrage réglementaire rapide des détenteurs actuels de permis en assurances et à une augmentation substantielle du nombre de ces permis au sein des détenteurs de permis en fonds mutuels. Les courtiers de plein exercice ne devraient pas connaître de migration de permis, puisqu'ils ne desservent pas les ménages du marché de masse.[35]

• De quelle manière les courtiers en épargne collective et les agents d'assurance qui sont titulaires des deux permis seraient-ils touchés?

Réponse :

Dans un premier temps il y aurait arbitrage réglementaire massif. À terme, on assisterait à un tarissement de la relève, à des départs anticipés à la retraite et à des pertes de valeur des pratiques d'affaires. Les plus jeunes représentants indépendants pourraient renoncer à leur statut de travailleur autonome et joindre une institution de dépôt à titre d'employé salarié.

[34] Voir notre description des investisseurs « indépendants efficaces » à la question 17 plus haut.

[35] Note acheminée par l'APCSF le 6 avril 2017 dans un courriel à M. Éric Stevenson, Surintendant de l'assistance aux clientèles et de l'encadrement de la distribution à l'AMF, « Encadrement de la distribution des produits et services financiers ».

• La proposition favorisera-t-elle l'émergence de nouveaux fournisseurs à faible coût sur le marché? Pour quelles raisons et de quelle manière?

Réponse :

Tel qu'indiqué plus haut, le groupe des investisseurs « indépendants-efficaces » demeure marginal (6%). Il est vraisemblable que des investisseurs « délégants-efficaces » se dirigent vers un fournisseur à faible coût advenant des difficultés à trouver un conseiller financier. Un certain nombre de délégants pourraient aussi devenir des investisseurs « indépendants-inefficaces ». Comme ces investisseurs adoptent généralement des comportements de « trend follower », le développement des affaires des fournisseurs à faible coût devrait suivre les cycles de marché; avec des creux dans les phases de découragement et des hausses dans les fins de cycles et les marchés haussiers.

• L'interaction entre la présente proposition et celles énoncées dans le Document de consultation 33-404 des ACVM vous incite-t-elle à changer vos réponses aux questions ci-dessus et, le cas échéant, de quelle manière?

Réponse : Non, absolument pas.

Nous avons déjà indiqué dans notre mémoire dans le cadre de la consultation 33-404 que le rehaussement des obligations envers les investisseurs était incompatible avec une baisse de la rémunération qu'entraînerait l'abandon des commissions intégrées.

• L'abandon des commissions intégrées aurait-il pour effet de réduire le nombre de séries de fonds et la complexité des frais comme nous le prévoyons?

Réponse :

Les commissions intégrées sont enchâssées dans une seule série « A » ou « B », les autres séries ne comportent pas de commissions intégrées proprement dit.[36] Les affirmations à la page 57 du document 81-408 selon lesquelles les commissions intégrées sont responsables de la création de milliers de séries de fonds déforment la réalité.[37] Tout d'abord, un grand nombre de fonds sont constitués soit « en fiducie » ou « en sociétés », ce qui double le nombre de séries. Ensuite, plusieurs séries de fonds ont été créées afin d'offrir des avantages fiscaux aux investisseurs (séries T) et afin de leur offrir des avantages en termes d'économies d'échelle pour les investissements plus importants (séries P ou PW). **Les raisons de l'existence de plusieurs séries de fonds sont donc multiples et il est faux de les attribuer aux commissions intégrées.** Il faut considérer les avantages plutôt que les inconvénients, qu'apportent les différentes options de séries de fonds aux investisseurs en termes de flexibilité, des avantages fiscaux et des économies d'échelle réalisées sur les sommes investies. **Les investisseurs du marché de masse et ceux**

[36] Bien que les gestionnaires de fonds aient créé des séries (« I », « O ») qui permettent le prélèvement d'honoraires, on ne peut réellement les assimiler à des commissions intégrées, même si elles sont très semblables.

[37] Surtout, nous n'avons jamais reçu de commentaires de clients ou d'aucun de nos collègues dans la distribution de fonds à l'effet qu'il y aurait trop de séries de fonds. Cette problématique est probablement celle des gestionnaires de fonds.

du marché intermédiaire peuvent ainsi profiter des avantages fiscaux autrement réservés aux investisseurs plus fortunés.

• Les fournisseurs de services financiers intégrés seraient-ils avantagés du fait qu'ils peuvent faire de la vente croisée et de l'inter-financement entre leurs secteurs d'activité? Dans l'affirmative, de quelle manière?

Réponse : Absolument.

Les sociétés intégrées contrôlent la plus grande part des actifs afin qu'ils demeurent dans leur giron. Quel que soit le produit ou le service utilisé par le client d'une société intégrée, il pourra toujours lui être offert au sein de l'organisation, limitant sa capacité à comparer et à obtenir le meilleur coût et la meilleure qualité pour ce qu'il paye.[38] L'accès à des commissions intégrées permet aux conseillers « travailleurs autonomes » de desservir les ménages émergents du marché de masse qui souhaitent profiter de leurs conseils pour améliorer leur situation financière. **Par conséquent, les commissions intégrées représentent une occasion de « fuite » dans le cycle de recyclage des clients à l'intérieur des sociétés intégrées. En abandonnant les commissions intégrées, les Autorités limiteront les pertes de clients des institutions de dépôts, au détriment des conseillers financiers autonomes.**

• Quels effets le développement des conseils en ligne pourrait-il avoir sur la concurrence? Sont-ils susceptibles d'être importants et positifs?

Réponse :

Les conseils en ligne s'adressent aux gens qui font une démarche par eux-mêmes, soit les investisseurs « indépendants », qui constituent un marché limité. L'APCSF est d'avis que l'utilisation de ces services s'adresse à ces investisseurs indépendants, mais qu'un certain nombre d'entre eux (les indépendants-inefficaces) peuvent en arriver à se décourager, en raison des pertes financières encourues sur leurs placements.[39]

22. Quelles répercussions la proposition aurait-elle sur les procédés administratifs des gestionnaires de fonds d'investissement ou des courtiers en épargne collective? Plus particulièrement :

• Quelles répercussions opérationnelles ou technologiques particulières devrions-nous prendre en compte?

Réponse :

Certains gestionnaires de fonds ont déjà réagi et amorcés la réduction ou l'abandon du financement de commissions pour les ménages du marché de masse (exemple des fonds

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[38] Dans une vaste étude du système financier britannique, le Competition and Markets Authority (CMA) souligne les problèmes inhérents associés à la concentration et aux grandes banques qui dominent le marché dans un résumé intitulé « Making banks work harder for you », 9 août 2016.

[39] Brad M. Barber, Terrance Odean, « The behavior of individual investors", sept.2011. Dalbar, « Quantitative analysis of investor behavior », édition 2015.

Dynamique et Investors Group). Certains courtiers (Investia) ont pris des mesures abusives d'interdiction des commissions intégrées pour les investisseurs de 65 ans et plus, sans discernement. Les Autorités doivent clarifier rapidement les résultats de la consultation et annoncer un cadre réglementaire précis pour l'utilisation des commissions intégrées qui doivent être préservées.

23. À l'heure actuelle, le paiement des commissions intégrées oblige le courtier et le gestionnaire de fonds d'investissement à mettre en œuvre des mécanismes de contrôle et de surveillance (auxquels se rattachent des coûts de conformité) pour atténuer les conflits d'intérêts inhérents.

• Le passage à des mécanismes de rémunération directe rendrait-il inutiles certains de ces mécanismes?

Réponse :

Le passage à d'autres mécanismes de rémunération entraînerait aussi des conflits d'intérêt et des hausses de coûts pour les investisseurs dans certains cas.

• Dans quelle mesure, le cas échéant, le recours aux mécanismes de rémunération directe par les représentants actuellement (par exemple, lorsqu'un représentant fournit des services selon un mécanisme de rémunération à honoraires) rend-il inutiles certains de ces mécanismes de contrôle et de surveillance?

Réponse :

Les comptes à honoraires comportent généralement des balises édictées par les courtiers et les gestionnaires. Des balises pourraient également être édictées pour les commissions intégrées.

24. Les commissions intégrées, en particulier les commissions de suivi, procurent une source de revenus stable aux courtiers et aux représentants. Si elles sont abandonnées, les mécanismes de rémunération directe compenseront- ils la perte de ces revenus?

Réponse : Non, absolument pas.

Les commissions de suivi occasionnent un coût équivalent à une rémunération à honoraires fixes en % sur les actifs. **Cependant, l'avance de commissions pour de petites sommes investies sur plusieurs années ne peut être remplacée par un mécanisme à honoraires et la facturation directe.**[40] Une cédule de frais de rachat sur 6 ans permet le versement d'une avance sur les prélèvements des frais de gestion futurs et une rémunération plus équitable pour les services et les conseils rendus aux petits investisseurs. Il a été démontré aux tableaux 1.1 et 1.2 à la question 3 qu'une rémunération à honoraires pour des investissements de 10 000$ ou de 50 000$ ne permettait pas de financer le travail effectué pour la mise en place d'un dossier de recommandations. **Les coûts des conseils pour des recommandations doivent être financés**

[40] Pierre Lortie, "A major setback for retirement savings: changing how financial advisors are compensated could hurt less-than-wealthy investors most", University of Calgary, avril 2016, pp.18-21. Barreau du Québec, « La tarification à l'heure de la réflexion », février 2016. Michael S. Finke, Sandra J. Huston, and Danielle D. Winchester, "Financial advice: who pays", Association for financial Counseling and Planning education, 2011.

dès la mise en place d'un dossier car autrement un investisseur pourrait profiter des conseils et des services d'un conseiller, puis transférer son portefeuille auprès d'un autre courtier à bas coût. Sans une rémunération adéquate, la qualité des conseils pour le marché de masse se détériorera.

25. Mis à part les barèmes de commissions et les salaires, à quels autres modes de rémunération des représentants les courtiers pourraient-ils avoir recours si nous abandonnions les commissions intégrées? De quelle manière ces méthodes sont-elles susceptibles d'évoluer au fil du temps?

Réponse :

Il ne restera plus que les comptes à honoraires pour les investisseurs des marchés intermédiaires ou aisés. Ces mêmes catégories d'investisseurs ont aussi les moyens d'assumer des honoraires de consultation au besoin. Les sociétés de courtiers en épargne collective indépendants n'ont pas les moyens de financer des commissions comme peuvent le faire les gestionnaires de fonds. Les représentants à commission (travailleurs autonomes) devront segmenter leur clientèle et ils délaisseront progressivement les petits portefeuilles. Les plus petites pratiques disparaîtront et la qualité des conseils pour les épargnants du marché de masse diminuera.

26. Quelles répercussions la proposition aura-t-elle sur les représentants du secteur, en particulier sur ce qui suit?

• **le cheminement de carrière;** départs à la retraite hâtifs pour les plus âgés et abandon de la carrière pour les plus jeunes, un certain nombre se dirigeant vers les institutions de dépôt à titre d'employés.

• **l'attrait de la profession;** La profession deviendra très peu accessible pour la relève des travailleurs autonomes.

• **le profil type de la personne intéressée par la profession;** Employé à salaire dans une société de dépôt ou pour un courtier en ligne. Les exigences des professionnels seront fonction du marché auquel ils seront attitrés, avec des écarts élevés dans les compétences et la qualité des conseils offerts.

• **le recrutement;** Les nouveaux arrivants seront limités et ils devront se joindre à un cabinet ou à un conseiller de carrière établi, qui dessert une clientèle du marché aisé et intermédiaire. Le développement de nouvelles pratiques seront très peu courantes.

• **l'attrait relatif d'une carrière dans des branches d'activité concurrentielles des services financiers;** La carrière intéressera davantage les gens qui préfèrent travailler à salaire auprès d'une institution de dépôt et des représentants ambitieux auprès des courtiers de plein exercice.

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27. Les mesures d'atténuation que nous avons exposées sont-elles réalisables? Quel serait leur degré d'efficacité pour garantir :

Réponse : Non. Nous avons déjà répondu dans les questions précédentes.

• **l'accès des investisseurs aux conseils;** S/O
• **un choix de mécanismes de rémunération pour tous les segments d'investisseurs;** S/O
• **des règles du jeu équitables entre les produits d'investissement concurrents?** S/O

28. Quelles autres mesures les ACVM devraient-elles envisager en vue d'atténuer les conséquences involontaires susmentionnées?

Réponse :

Les ACVM pourraient réduire les obligations des courtiers et des représentants pour les investisseurs du marché de masse, de manière à réduire leurs coûts reliés à la conformité et à l'administration, permettant d'égaler les obligations des courtiers en ligne.

29. Outre les répercussions potentielles relevées dans la partie 4, quelles autres conséquences involontaires potentielles, notamment opérationnelles et fiscales, les parties prenantes et les investisseurs du secteur des fonds pourraient-ils subir à la suite de l'abandon des commissions intégrées? Plus particulièrement :

• Le paiement de la rémunération du courtier dans le cadre des mécanismes de rémunération directe entraînerait-il des répercussions fiscales défavorables pour les investisseurs? Plus particulièrement, le versement, par les investisseurs, de la rémunération du courtier au moyen de rachats périodiques de titres de fonds effectués par le gestionnaire de fonds d'investissement entraînerait-il des conséquences fiscales? Veuillez fournir des explications.

Réponse :

Le paiement d'honoraires par l'investisseur entraîne une disposition fiscale dans les comptes non-enregistrés. Il faut préciser l'impact fiscal des retraits des sommes des comptes et de l'impact pour les clients. Advenant l'abandon des commissions intégrées, la gestion de la TVH sera aussi un fardeau pour les travailleurs autonomes qui devra être débattue et qui pourrait avoir un impact sur les honoraires imputés aux clients.

• Si le passage aux mécanismes de rémunération directe mène à la rationalisation des séries de fonds, cette rationalisation pourrait-elle avoir des conséquences fiscales défavorables pour les investisseurs?

Réponse :

Les gestionnaires pourraient procéder à des fusions de fonds qui sont susceptibles d'entraîner des dispositions fiscales néfastes pour les comptes non-enregistrés. Les échanges entre séries d'un même fonds n'entraînent généralement pas de conséquences fiscales.

• Quelles mesures réglementaires ou autres, s'il y a lieu, pourraient contribuer à atténuer les répercussions opérationnelles et fiscales potentielles? S/O

30. En ce qui a trait à la perte d'une forme d'inter-financement provenant des investisseurs fortunés au profit des investisseurs moins aisés dans le même fonds à la suite du passage aux mécanismes de rémunération directe :

• dans quelle mesure (en la quantifiant, si possible) cette perte augmenterait-elle le coût de la prestation de conseils et de services aux investisseurs moins aisés dans le cadre des mécanismes de rémunération directe?

Réponse :

Le représentant travailleur autonome ne tire aucun avantage à cet égard. Il n'y a pas d'inter-financement, ni de pertes en raison des commissions intégrées.[41] L'entrepreneur en services financiers investit son temps et ses connaissances auprès d'épargnants du marché de masse afin de construire une relation qui sera mutuellement profitable à long terme.

• l'existence de cette forme d'inter-financement indique-t-elle que les investisseurs fortunés paieraient indirectement des honoraires qui ne correspondent pas aux services qu'ils reçoivent (autrement dit, les honoraires qu'ils versent excèdent-ils le coût réel des services et des conseils qu'ils reçoivent)? S/O

• quelles mesures pourraient atténuer les effets potentiels de la perte de l'inter-financement sur les courtiers, les représentants et les investisseurs?

Réponse :

Le coût de la rémunération relativement aux commissions intégrées est fixe pour tous les investisseurs. S'il y a inter-financement, il se produit entre les investisseurs au bénéfice du gestionnaire de fonds, et non pas à la faveur des représentants et des courtiers.[42]

31. Quelles mesures les participants au secteur des fonds pourraient-ils adopter de façon proactive pour atténuer les conséquences involontaires pouvant découler de l'abandon des commissions intégrées?

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[41] Nous avons abordé le sujet de l'interfinancement dans notre réponse à la question #2 du document de consultation.

[42] Nous avons abordé le sujet de l'interfinancement dans notre réponse à la question #2 du document de consultation.

Réponse :

Les fonds Dynamique ont déjà annoncé des rabais de frais de gestion pour les séries « A » et pour les comptes de plus de 250 000$, suite à l'abandon des frais de rachat sur 6 ans. Quant aux conseillers, plusieurs se tournent vers d'autres gestionnaires qui leur permettent d'offrir des frais de rachat sur 6 ans pour les petites sommes investies sur des horizons à long terme. Les représentants peuvent passer au mode « honoraires » pour les portefeuilles plus importants afin de maintenir une rémunération régulière pour les services constants offerts à ces clients. Ils peuvent également segmenter leur clientèle afin d'identifier les investisseurs qui devront être délaissés advenant l'abandon des commissions intégrées.

32. Pour chacune des options de transition, veuillez indiquer les changements opérationnels ou structurels que votre entreprise (gestionnaire de fonds d'investissement ou courtier) pourrait devoir apporter à ses systèmes et processus, ainsi que les conséquences financières qui en découleraient. Dans la mesure du possible, veuillez fournir des données sur les coûts estimatifs. S/O

• Existe-il des coûts ou des difficultés propres à des domaines d'activité en particulier? S/O
• Quelle serait la période de transition appropriée? S/O
• Les calendriers de rachat établis sous les options de souscription avec frais d'acquisition reportés et avec frais d'acquisition réduits devraient-ils être maintenus jusqu'à la réalisation prévue des rachats ou prendre fin à la date de transition? S/O

33. Quelle option de transition préférez-vous? Pourquoi? Devrions-nous examiner d'autres options? S/O

34. Comme il est exposé dans l'Annexe B, les ACVM n'ont pas retenu l'option du plafonnement des commissions intégrées, soit comme solution autonome aux enjeux principaux exposés dans la partie 2, soit comme mesure provisoire en vue de l'abandon des commissions intégrées. Les ACVM devraient-elles poursuivre leur réflexion sur un plafonnement des commissions à titre de mesure transitoire? Pourquoi?

Réponse :

Les ACVM devraient certainement revoir leur position afin de réformer les commissions intégrées si nécessaire, non pas à titre transitoire ou provisoire mais plutôt permanente. **L'APCSF est d'avis qu'une réforme visant à encadrer l'utilisation des commissions intégrées est de loin préférable à l'abandon radical des commissions intégrées, compte tenu des dommages irréparables à toute l'industrie, aux investisseurs et à l'économie.**

Partie 6 du document 81-408

35. Veuillez indiquer si vous estimez que les mesures analysées ci-dessus pourront, individuellement ou collectivement :
• régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2;

Réponse : Non.

• régler ou non tout autre problème ou enjeu que vous auriez relevé.

Réponse :

Nous avons déjà exposé notre position que l'abandon des commissions intégrées n'est pas une réponse adéquate pour les enjeux soulevés. Néanmoins, nous croyons que des aménagements pourraient être apportés en vue de réformer les commissions intégrées qui existent dans leur forme actuelle depuis 1995 environ. Quant aux enjeux identifiés, nous avons déjà répondu à la question #1 comment ils pourraient être abordés.

36. Existe-t-il des solutions ou des mesures de rechange, sur le plan réglementaire ou sur le marché, susceptibles de régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2? Dans l'affirmative, veuillez fournir des explications.

Réponse : Oui.

Le premier enjeu soulève des conflits d'intérêt identifiés dans les pratiques de rémunération des sociétés intégrées qui distribuent des produits exclusifs. Devant l'harmonisation des frais et des commissions intégrées pour l'ensemble des gestionnaires indépendants, les membres de l'APCSF ne voient pas comment les commissions intégrées sont une source de conflits d'intérêt.

Par conséquent, dans le but d'assainir les mœurs de rémunération chez les sociétés intégrées, les ACVM devraient examiner la possibilité d'interdire les commissions intégrées pour la distribution de fonds par des sociétés qui leur sont affiliées. Elles pourraient cependant utiliser les commissions intégrées de gestionnaires non-affiliés dans leur réseau de distribution, malgré le fait qu'ils fassent partie d'une société intégrée concurrente. **Il serait alors étonnant que des politiques de rémunération mettent en valeur des produits concurrents pour d'autres motifs que leur qualité pour l'investisseur.** L'APCSF rappelle qu'à l'origine, les commissions intégrées ont été créées par des gestionnaires indépendants pour la distribution de fonds auprès de courtiers indépendants, sans affiliation entre eux.

Quant au 2e enjeu, l'APCSF souhaite que les Autorités soient vigilantes afin que tous les intervenants respectent à la lettre l'obligation de divulguer la rémunération versée au courtier sur les relevés. Nous sommes d'avis que la simplification du prospectus par l'aperçu de fonds et les mesures de divulgation MRCC2 sont de nature à répondre aux doutes quant à la compréhension des clients des coûts de la rémunération. Nous croyons cependant que la mesure d'évaluation de la valeur ajoutée la plus efficace pour l'investisseur, demeure le rendement net de son portefeuille et la progression de son patrimoine, qui sont disponibles sur le relevé consolidé. **En s'assurant que le public profite d'un environnement en concurrence, dans un marché sans contrainte pour les conseils et les produits, les ACVM contribueront efficacement à ce que les investisseurs profitent des meilleurs conseils et des meilleurs produits au prix qui leur convient.**

Enfin, le 3e enjeu soulève des questions sur la valeur que reçoivent les investisseurs pour ce qu'ils paient, mais sans véritablement fournir de mesure d'évaluation des conseils et des services fournis pour les différentes catégories de professionnels de l'industrie. De plus, la notion de la gestion des risques est évacuée dans les considérations qui justifient les commissions intégrées.

Il est vrai qu'il est très difficile d'évaluer de manière précise tous les avantages que reçoivent les investisseurs pour le coût des services. **C'est la raison pour laquelle l'APCSF croit que la meilleure mesure ne peut être que celle qui peut s'obtenir dans un marché libre et en concurrence. Les pays qui ont procédé par la voie de la réglementation en sont encore à trouver des ajustements qui ne remplaceront jamais le jeu de la concurrence.** Le système financier de notre pays doit reposer sur des bases financières saines et solides. En cela le Canada fait figure de meneur, ayant surmonté la crise financière de 2008 mieux que quiconque. Cependant, comme nous l'avons fait remarquer en citant l'étude de la *Competition and Markets Authority* du R-U, nos banques ont aussi besoin d'un environnement concurrentiel sur le marché domestique afin d'offrir la meilleure valeur pour les canadiens. **Nous avons mentionné que la concurrence de la part des conseillers financiers « travailleurs autonomes » doit être préservée et même encouragée par la réglementation. La concentration ne sert pas l'intérêt du public.** En favorisant une réglementation qui encourage la concurrence et qui préserve un équilibre juste pour tous les intervenants, les Autorités assureront aux investisseurs les meilleurs services, les meilleurs produits, au prix qu'ils désirent payer.

Il y a plus de 30 ans, le Canada a choisi le décloisonnement des 4 piliers de la finance, entraînant la concentration que nous connaissons aujourd'hui. Serions-nous allés trop loin? **À la lumière des défis des régulateurs, dans la recherche de marchés financiers efficaces et pour la protection du public, nous recommandons la création d'un compte autogéré obligatoire, pour tous les détenteurs de produits sous la loi des valeurs mobilières. Nous recommandons que ce compte autogéré soit indépendant du gestionnaire de fonds et du courtier distributeur, par la création d'un pilier fiduciaire indépendant qui permettrait de répondre à plusieurs préoccupations des autorités. Ainsi, la conformité pourrait être effectuée par le fiduciaire du compte ou un cabinet de services de conformité indépendants.**

Nous croyons qu'un fiduciaire indépendant pourrait exercer un rôle efficace en matière de conformité, de l'administration des comptes autogérés et de la divulgation des coûts des services. Le coût des services du fiduciaire indépendant pourrait être assumé par les gestionnaires de fonds et les sociétés de courtiers.

Nous croyons que notre recommandation augmenterait la transparence des comptes des épargnants québécois, qu'elle stimulerait la concurrence dans les services financiers et qu'elle favoriserait la venue de nouveaux arrivants grâce à une diminution des coûts. L'obligation d'un fiduciaire indépendant favoriserait la mobilité des clients et des représentants, sans incidence de coût pour les clients et sans perte de données pour leur compte. Dans une analyse exhaustive de l'efficience du secteur bancaire au Royaume-Uni, il a été démontré que la concentration du marché ne favorisait pas le public et les entreprises. Les innovations technologiques permettraient d'ailleurs plus de mobilité pour les clients selon un modèle appelé « open banking ». [43] **Nous croyons cependant que ce rôle reviendrait plutôt à un fiduciaire indépendant, jouant le rôle d'une institution tiers, pour une plus grande protection du public.**

[43] Competition and Markets Authority, « Making banks work harder for you », 9 août 2016

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INCLUDES COMMENT LETTERS

FINANCIAL PLANNING STANDARDS COUNCIL

Financial Planning Standards Council

Response to CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Submitted June 9, 2017

FINANCIAL PLANNING STANDARDS COUNCIL

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British Columbia Securities Commission
Alberta Securities Commission
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Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
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Introduction

Financial Planning Standards Council (FPSC) is pleased to comment on Canadian Securities Administrators (CSA) Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (“the Consultation Paper”).

FPSC is a national, not-for-profit standards-setting and certification body that develops, promotes and enforces professional standards for financial planning through CERTIFIED FINANCIAL PLANNER® certification. FPSC certifies and oversees approximately 17,000 CFP® professionals and approximately 2,000 FPSC Level 1® Certificants in Financial Planning across Canada. With FPSC’s formal partnership with the Institut québécois de planification financière (IQPF), which is the only organization authorized to certify “Financial Planners” in Quebec, there are more than 23,500 “Financial Planners” in Canada who have met, and continue to meet, FPSC’s unified financial planning standards.

General Comments

As an organization that represents the public interest, FPSC fully supports transparency and disclosure of fees and services, and views them as critically important to the protection and empowerment of consumers. We believe that for consumers to achieve their financial goals, they require all relevant facts so that they can make informed choices regarding whom they work with and what fee model meets their needs.

The CSA has made tremendous strides over the past few years in improving the transparency of costs associated with financial products and advice, especially through the Client Relationship Model-Phase 2 (CRM2) and Point of Sale (POS) reforms. FPSC believes these and other regulatory reforms have the potential to greatly enhance clients’ awareness and understanding of the fees they pay for the services they receive.

In commenting on the Consultation Paper, we are mindful of the fact that that the CSA has not yet made the decision whether to discontinue embedded commissions, and that the goals of the Consultation Paper are to identify and understand the potential impacts such a change would have on the fund market, fund managers, dealers, advisors and ultimately the investors they serve. It is from this perspective that we have provided comments.

To help supplement our own views, and to provide additional information to the CSA regarding the potential issues and impacts such a change to compensation models may have, we conducted a survey of those we certify and oversee—CFP professionals and FPSC Level 1 certificants—to better understand the challenges of, and to gain insights from, the most highly qualified individuals who stand to be affected by this regulatory proposal.[1]

[1] FPSC surveyed CFP professionals and FPSC Level 1 certificants on issues raised in the Consultation Paper. The survey was conducted online from May 17-24, 2017, and consisted of a combination of multiple choice, “yes/no” and open-ended survey questions. A total of 2,451 individuals responded to the survey. These respondents were representative of the overall population of CFP professionals and FPSC Level 1 certificants in terms of age and gender.

The results of this survey showed that there is overwhelming support for our position that there should be complete transparency and disclosure of costs and fees associated with investing and with the financial planning services offered. However, the results clearly indicate a considerable degree of confusion and concern about the implementation and potential impact of the CSA's proposal to eliminate the option of offering embedded commissions.

Accordingly, if the CSA ultimately elects to eliminate the option of embedded commissions as a compensation method for financial products and advice, then for the benefit of consumers and the industry that serves them, we would urge the CSA to first resolve the confusion and specific concerns that have been raised.

Issues to Consider

Uncertainty About Direct Pay Arrangements

As stated above, FPSC supports requiring full transparency and disclosure of all material facts so that consumers can make informed choices about the services being offered, and how they may pay for such services. An overwhelming majority of CFP professionals surveyed agree with us. Further, 80% of respondents to our survey did not see disclosure or transparency of costs or fees as a concern or as a threat to their business viability or success.

While fee and cost transparency are imperative, it is also important to ensure that consumers have options for how to structure their advisor or planner relationship, in a way that will meet their unique circumstances. For example, in some cases it may be more advantageous for a client to choose an Assets Under Management compensation model, whereas in other cases, clients may elect for the services of their advisor to be paid up front. Less direct arrangements may also make sense for clients with limited resources who are just beginning to use an advisor, and an option where the fees are paid ultimately out of the cost of the product may be appropriate, provided the client understands and supports such a model. FPSC believes it is essential that the CSA does not unnecessarily limit payment options or structures, but at the same time does ensure regulations that afford clients the opportunity to make an informed choice regarding fee and payment models that suit their particular needs.

In reviewing the comments from survey respondents, and in our conversations with industry groups, we note that there still exists much confusion as to what “direct pay” may actually mean in practice. Contrary to the CSA's intent, many have interpreted “direct pay” as requiring consumers to pay up front via a cheque for the types of financial services they access.

In our survey of CFP professionals and FPSC Level 1 certificants, we explained that “direct pay” arrangements might include the product manufacturer or fund manager facilitating payment to the dealer on the investor's behalf, as proposed by the CSA. We then asked if this would alleviate their concerns about consumers not getting access to advice because they may be unwilling to pay for the services up front. Among survey respondents who are primarily compensated through trailing commissions, more than 50% indicated acceptance of such an arrangement. The CSA should ensure advisors, planners and consumers are aware that this particular option is contemplated under this proposal, and work with fund manufacturers and managers to ensure such arrangements would be viable should the proposals go through.

It is imperative that the CSA make perfectly clear to consumers, advisors, planners and all industry participants all of the types and forms of compensation arrangements that would be permitted under this proposal, and should particularly focus on raising awareness of those options that would not require consumers to pay up front to access products, advice or planning.

Risk of Magnifying Asymmetrical Relationship

We do wish to raise a concern that was also noted by several of our survey respondents. That is, certain groups of investors—such as new investors, seniors or other vulnerable consumers—are less likely to be skilled at "negotiating" an appropriate compensation arrangement with their advisor, which could lead to potential overcharging or an increase in fees charged for mass-market clients than is currently being charged in direct pay arrangements. While we recognize the CSA has identified this concern within the Consultation Paper,[2] FPSC firmly believes that this risk must be effectively mitigated before proceeding.

We further note that a contributing factor to this risk is consumers not understanding that advisors can have varying degrees of qualifications, proficiency and capabilities. In the absence of robust rules around titles, designations and proficiency requirements, consumers may find it difficult to accurately assess the value of an advisor's advice or services when they are negotiating. Accordingly, we urge the CSA to continue its work to implement targeted reforms pertaining to titles, designations and proficiency requirements to assist in mitigating these concerns.

Importance of Mitigating Disruption for Investors

The discontinuation of embedded commissions would be a significant regulatory change, with the potential for disruption that would adversely impact some investors if not implemented effectively. Accordingly, if the CSA decides to move ahead with implementation, it is imperative that due consideration be given to various measures that may assist in alleviating disruption and unintended negative consequences.

Important to Provide an Adequate Transition Period

If the CSA decides to move forward with this proposal, providing industry participants with enough time to manage the transition to direct pay arrangements will be crucial to successful implementation and to reducing the possibility of adverse effects for investors. While the majority of those we certify indicated that a 36-month transition period would be sufficient to allow for necessary process, communications and client education to occur, depending on the details and scope of the final rule (if any), we suggest a longer transition period would be prudent to help avoid or minimize consumer harm.

[2] CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (pp.79-80). http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf.

We feel that the CSA has accurately captured many of the most likely and substantial transition impacts in the Consultation Paper.[3] Nonetheless, for the CSA's reference, we have outlined some of the specific transition concerns among CFP professionals and FPSC Level 1 certificants in Appendix A.

CSA Should Weigh the Option of "Grandfathering"

To assist in the transition process, we believe that consideration could be given to various grandfathering provisions that may be available. We recognize that the CSA has already identified the possibility of allowing existing redemption schedules to be maintained until the redemption schedule is complete in the Consultation Paper.[4] Thought could similarly be given to other, potentially broader grandfathering measures so long as they ensure consumers are appropriately served and protected, and given options for transitioning to a different model.

Conclusion

FPSC would like to thank the CSA for the opportunity to provide comment. Should the CSA decide to proceed with the discontinuation of embedded commissions and transition to direct pay arrangements, then for the benefit of both consumers and industry participants, we would urge the CSA to identify ways to effectively address the confusion and concerns described in this submission before proceeding.

As with all major change, communication will be the key to successfully preparing the advisory community and consumers on the implications of these changes if enacted. We would be pleased to lend our counsel as your deliberations continue.

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[3] CSA Consultation Paper 81-408 (p.77).
[4] CSA Consultation Paper 81-408 (p.82).

Appendix A – Overview of Survey Findings

This Appendix provides an overview of the survey results referenced throughout this submission. The results and comments received from CFP professionals and FPSC Level 1 certificants have been included for the CSA's information and reference only, and do not form part of FPSC's submission.

1. Challenges the Discontinuation of Embedded Commissions and Transition to Direct Pay Arrangements Would Create

FPSC asked survey respondents the following question to learn more about their major concerns with respect to implementation of this regulatory proposal:

> ***The CSA is considering eliminating embedded commissions as a method of compensation, and transitioning to direct pay arrangements. If this were to occur, what would be the most significant challenge(s) this change would create for your business?***

Given the significant number of responses to this open-ended question, we have summarized responses by theme.

Transition Challenges

Among respondents who are primarily compensated for their services today through trailing commissions, some of the most commonly cited challenges with transitioning to direct pay arrangements included:

- The volume of paperwork required to transition all existing clients to fee-based accounts;
- The need to adopt new billing/invoicing methods, collection processes, software, etc.;
- The ostensibly high costs to successfully transitioning, which some believed would require hiring staff to assist in completing the transition and managing ongoing tracking and collection of payments from clients;
- The time and effort required to educate clients on the change and negotiate and establish a new fee structure with potentially hundreds of clients;
- The time and effort required to successfully manage the transition, which may cause disruption and reduce time providing actual financial planning/advisory services for clients; and
- Potential direct costs to clients (such as tax consequences) resulting from liquidation of funds with embedded compensation.

Perceived Inability to Continue Servicing Small Clients

A number of respondents expressed belief that this regulatory change might impact their ability to serve small investors. The following were among the more commonly cited reasons for this:

- Small clients may have difficulty affording certain direct payment arrangements;
- Many dealers already have, or may raise annual minimums for fee-based accounts, pricing out small investors; and
- Fees could increase due to the costs associated with this transition, with these costs being passed on to these investors.

Perceived Unwillingness of Some Clients to Pay Directly

A number of respondents expressed concern that even though their clients understand how much they are paying for service, they may be less willing to pay should they have to do so more directly or “out of pocket”. For some, this belief was anecdotally based on their previous experiences discussing fees and compensation arrangements with clients.

2. Direct Pay Arrangements

FPSC asked survey respondents the following questions regarding the CSA’s proposed direct pay compensation arrangements:

If the CSA discontinued embedded commissions, but allowed the advisor and client to negotiate a fee structure that was acceptable to both parties, which included the ability to have the dealer/advisor’s payment facilitated directly by the product manufacturer either at the time of purchase and/or on an annual basis out of the value of the funds held:

- ***Would this be an acceptable model for compensation?***
- ***What specific challenges would this cause?***

Acceptability of Direct Pay Arrangements

In total, 53.5% of all respondents indicated “Yes” to the question of whether this would be an acceptable model for compensation, with 28.0% indicating “No” (18.5% indicated “No opinion”).

Among respondents who are primarily compensated through trailing commissions, 53.2% indicated “Yes”, with 31.2% indicating “No” (15.6% indicated “No opinion”).

Challenges

Most of the challenges identified in response to this question were similar or identical to those provided in response to the previous question, including:

- The time, costs and administrative work required to transition all clients to direct pay arrangements and to change established processes and systems;
- The perceived unwillingness of small clients to pay out of pocket as proposed; and
- The perceived inability to serve small clients in a cost-effective manner.

Support for Allowing Fund Manufacturer or Manager to Remit on Investor's Behalf

Although there was a degree of confusion and uncertainty as to how this would work in practice, many of the respondents who provided comments expressed support for allowing this form of direct pay arrangement. However, there were some potential issues identified by respondents, including:

- The potential complexity and/or difficulty of receiving payments from multiple manufacturers or managers, which could possibly result in advisors focusing on fewer products and limiting client choice;
- The potential for conflicts if not all product manufacturers or managers offered to facilitate direct payment arrangements;
- For clients with small portfolios, potential issues selecting which funds to redeem for payment, as a large redemption may require rebalancing the portfolio to meet regulatory requirements; and
- Tax concerns, which do not affect embedded compensation arrangements and which, if not resolved, could reduce the attractiveness or feasibility of this option.

3. Transition Considerations

FPSC asked survey respondents the following questions in relation to the contemplated transition period:

In considering various transition options, the CSA suggests that a transition period of 36 months would provide sufficient time for representatives, dealers, and fund managers to make all the necessary changes to ensure a successful transition. For representatives and dealers, such changes would include things such as designing and implementing direct pay arrangements, meeting with clients to explain the upcoming changes and their associated impact, making necessary system, compliance, procedural and process changes, and coordinating with issuers to manage the associated client impact.

- ***Is a 36-month transition period sufficient from your perspective?***
- ***Is there a specific, alternative transition period or methodology the CSA should consider?***

36-Month Transition Period

In total, 53.2% of all respondents indicated "Yes" to the question of whether a 36-month transition period would be sufficient, with 33.0% indicating "No" (13.8% indicated "No opinion").

Among respondents who are primarily compensated through trailing commissions, 43.7% indicated "Yes", with 44.4% indicating "No" (11.9% indicated "No opinion").

Alternative Transition Period

Respondents suggested a range of alternatives to the proposed 36-month transition period. Among respondents who are currently compensated through trailing commissions, the most commonly suggested alternative to a 36-month transition period was 5 years/60 months.

Grandfathering

Several individuals raised the idea of "grandfathering" for existing clients to assist in the transition to direct pay arrangements. Some of the specific suggestions included:

- Grandfathering existing accounts, with any new rule applying to accounts opened after the rule comes into force;
- Allowing clients to consent to having their account and current compensation arrangement grandfathered. To facilitate this, investors could be required to sign off on a disclosure form that outlines all payment options and costs in full detail; and
- Maintaining embedded commissions as a payment option for small accounts only, while requiring "large" accounts (e.g. above 250k in assets) to transition to direct pay arrangements.

Appendix B – List of All Survey Questions

The following is the complete list of questions that FPSC asked of CFP professionals and FPSC Level 1 certificants.

1. What is your age range?
   - Under 31
   - 31-40
   - 41-50
   - 51-60
   - 61-64
   - 65+

2. What is your gender?
   - Female
   - Male
   - Other

3. How long have you been a CFP professional or FPSC Level 1 certificant?
   - Less than 5 years
   - 5-10 years
   - 11-15 years
   - 16+ years

4. Indicate which of the following best describes your primary professional role?
   - I work directly with clients (client facing).
   - I work indirectly with clients (offer back office client services).
   - I work mostly in a supervisory capacity.
   - I am not involved with clients in any capacity.
   - I am retired.

5. In thinking about changes underway in the financial services industry, on a scale of 1 to 5, please rate each the following issues in terms of how much they concern you from a business standpoint, with 1 being “not concerning” and 5 being “very concerning”:

   Uncertainty regarding regulatory change
   1 2 3 4 5

   CRM2, fee disclosure and transparency
   1 2 3 4 5

   Robo-advisors and automation of investment advice
   1 2 3 4 5

   The costs of compliance
   1 2 3 4 5

Possible discontinuation of embedded commissions
1 2 3 4 5

Lack of consumer distinction between CFP professionals and other financial advisors
1 2 3 4 5

Lack of regulatory or legislative recognition for financial planners
1 2 3 4 5

Other (please specify)

6. What is the most common way that your clients pay you for the products you offer?
    - I do not sell products
    - Front-end load
    - Deferred Sales Charge
    - No load
    - Fee for Assets Under Management (AUM)
    - Other (please specify)

7. How do your clients generally pay for your services?
    - Trailing commissions
    - Fee for Assets Under Management (AUM)
    - Hourly fee
    - Flat or retainer fee
    - Not applicable
    - Other (please specify)

8. The CSA is considering eliminating embedded commissions as a method of compensation, and transitioning to direct pay arrangements. If this were to occur, what would be the most significant challenge(s) this change would create for your business?

If the CSA discontinued embedded commissions, but allowed the advisor and client to negotiate a fee structure that was acceptable to both parties, which included the ability to have the dealer/advisor's payment facilitated directly by the product manufacturer either at the time of purchase and/or on an annual basis out of the value of the funds held:

9. Would this be an acceptable model for compensation?
    - Yes
    - No
    - No opinion

10. What specific challenges would this cause?

In considering various transition options, the CSA suggests that a transition period of 36 months would provide sufficient time for representatives, dealers, and fund managers to make all the necessary changes to ensure a successful transition. For representatives and dealers, such changes would include things such as designing and implementing direct pay arrangements, meeting with clients to explain the upcoming changes and their associated impact, making necessary system, compliance, procedural and process changes, and coordinating with issuers to manage the associated client impact.

11. Is a 36-month transition period sufficient from your perspective?
    - Yes
    - No
    - No opinion

12. Is there a specific, alternative transition period or methodology the CSA should consider?

MACKENZIE Investments | CONFIDENCE IN A CHANGING WORLD

VIA E-MAIL:
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June 9, 2017

British Columbia Securities Commission
Alberta Securities Comission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Maire Beaudoin
Corporate Secretary
Autorité des marches financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (Consultation Paper)

About Mackenzie Investments

We are pleased to provide comments on behalf of Mackenzie Financial Corporation (Mackenzie Investments) on the CSA's Consultation Paper dated January 10, 2017.

Mackenzie Investments was founded in 1967 and is a leading investment management firm providing investment advisory and related services to retail and institutional clients. The company is registered as a portfolio manager and investment fund manager with total assets under management as at April 30, 2017 of approximately $68.2 billion including mutual fund assets under management of approximately $54.2 billion. We distribute our products to over 1 million clients across Canada through approximately 175 dealers representing over 30,000 financial advisors.

Mackenzie Investments is a wholly owned subsidiary of IGM Financial Inc., which in turn is a member of the Power Financial Corporation group of companies.

Overview of Key Comments

Everything we do starts with the needs of investors, whether they are saving for a child's postsecondary education, setting money aside for the future needs of a family member with a disability, or funding their own retirement. In fact, our focus is summed up in our Vision statement: we are committed to the financial success of investors, through their eyes.

With this in mind, Mackenzie Investments fully supports the CSA in its efforts to build better alignment of interests of investment fund managers, dealers and representatives with those of investors; to provide greater clarity of the services provided to investors and their costs; and to empower investors in the dealer and representative compensation process. We see such recent regulatory initiatives as the newly implemented Fund Facts pre-sale delivery (POS) and Client Relationship Model (CRM) projects, as well as the current proposals in CSA Consultation Paper 33-404 (the CSA CP 33-404),[1] all contributing to these important objectives.

We believe that when fully implemented, the outcomes that will be achieved by these regulatory reforms, together with market changes already underway, will substantially address the key investor protection and market efficiency issues identified in the Consultation Paper. In our view, any potential incremental or possible "complementary" benefit that the CSA anticipates may be achieved through the discontinuation of embedded commissions will be minimal, by comparison to the very real and significant adverse impact such a regulatory action will have on some dealers, their representatives and most importantly, their clients.[2]

We are also very concerned with the impact discontinuing embedded commissions could have on the efficiency and competitiveness of the financial services industry in Canada. What struck us as very problematic in the framing of the Consultation Paper is the CSA's position that because the "majority" of mass-market households purchase mutual funds through a deposit-taker owned dealer, whose representatives are generally not compensated via embedded commissions, the impact in transitioning away from embedded commissions (particularly for mass-market households) will be negligible. We strongly disagree. Any outcome that may cause there to be fewer independent dealers will not be without 'impact' to investors. An even more concentrated fund distribution industry

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[1] CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients (April 28, 2016).

[2] Source: MFDA Bulletin #0721-C - *MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients* (May 23, 2017) ("MFDA Client Research Report").

will mean fewer product and financial advisory choices, reduced price competition as well as less innovation in the market.

In the Consultation Paper the CSA also seems to suggest that active management is somehow an undesirable outcome for investors that will be remedied through the discontinuation of embedded commissions. We strongly believe that passive and actively managed investment products are both important for investors and for maintaining efficient and vibrant capital markets. As currently expressed by the CSA, we are concerned that some registrants will be inclined to favour index managed products, not because it is what's most suitable for the client, but because of the perceived regulatory bias against actively managed funds solely based on cost relative to index managed products. This, in our view, is contrary with the CSA's stated objectives for dealers and their representatives to offer clients products that are most suitable to their particular investment needs and objectives.

In our submission, we provide insights and specific data of our experience in the Canadian market. We also put forward alternative regulatory options for the CSA to consider that we believe addresses the investor protection and market efficiency issues identified by the CSA, but without the significant negative impact to some dealers, their representatives and clients and the market, that a ban on embedded commissions may cause. In the appendix to our letter, we provide more detailed responses to some of the operational and tax questions posed in the Consultation Paper and also give some insights into the value of active management. At the centre of our submission is the desire that (i) we retain an innovative, competitive and efficient financial services industry in Canada, which provides investors with access to a broad range of choices of products and advisory services, and (ii) financial advice in Canada remains accessible and affordable, particularly for modest investors.

Finally, we believe it is noteworthy that while regulators globally have been focused on issues similar to those articulated by the CSA in the Consultation Paper, a growing number of regulators and their respective governments have explicitly chosen not to ban embedded commissions. Their reasoning, in part, includes the recognition that it would be detrimental to impose a reform that will have a negative impact on independent and smaller firms and manufacturers and create further concentration of asset management with deposit-takers. In these jurisdictions, they have instead moved forward with disclosure and conduct regulation.

We encourage the CSA to consider and provide a more detailed analysis as to why the approaches taken in such countries such as Sweden, Hong Kong, Germany, New Zealand and Singapore, all of whom have chosen to not ban embedded commissions, would not be appropriate approaches for the Canadian market and for Canadian investors.[3]

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[3] Currently, we are aware of only four countries that have imposed a ban on embedded commissions: Australia, Netherlands, South Africa and the United Kingdom. In the Netherlands, the discontinuation of embedded commissions is a voluntary arrangement among the five large banks that dominate investment fund distribution. While under the MIFID II reforms, the imposed ban on embedded commissions only applies to independent financial advisors, which make up only 11% of the European market. Despite MIFID II, a number of jurisdictions have concluded not to impose a ban on embedded commissions, including:

1. Current Regulatory Initiatives Will Substantially Achieve Key Investor Protection and Market Efficiency Issues Identified

In our view, the POS and CRM projects together with the proposals in CSA CP 33-404, significantly address each of the issues the CSA has identified with respect to embedded commissions. To the extent there remains any gap, we believe market changes underway (which we discuss later in our submission) as well as other regulatory actions, can achieve the CSA's desired objectives without the need to ban embedded commissions.

Issue 1: Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

Investment Fund Managers

To suggest that investment fund managers who pay embedded commissions to dealers and their representatives may be incentivized to rely more on those payments than on generating performance to attract and preserve assets under management is simply not our experience, nor do we believe it is an accurate portrayal of today's competitive market environment.

As we identify below in our discussion of market forces driving changes independent of regulation, our data indicates that while a few outliers remain, the majority of embedded commissions offered by investment fund managers are substantially the same across asset classes and series and that manufacturer margins and costs (management expense ratios) are decreasing. We also note that the trend of firms and advisors is to shorten the number of fund manufacturers with whom they are working, with the key drivers for firms and advisors in their choice of fund manufacturers being overall cost of the company's products and consistent performance.[4] All of this means that investment fund managers today are aggressively competing on fund costs and performance.

At Mackenzie Investments, performance metrics for our portfolio managers are aligned to generating performance. For instance, a substantial part of annual compensation for our portfolio managers are based on performance against the relevant peer group. More importantly, compensation aligns with the long-term interests of our investors with almost

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Belgium, Denmark, France, Germany, Ireland, Italy and Sweden. Additionally, we have seen a number of other jurisdictions decide not to proceed with the regulatory option to discontinue embedded commissions, among them: Brazil, Hong Kong, India, Israel, Japan, New Zealand, Singapore and South Korea. While in the United States, we note that the Department of Labor (DOL) fiduciary rule still permits firms and their individual advisers to receive most common forms of compensation for advice to retail customers under the best interest contract (BIC) exemption, so long as the firm and adviser provide advice in the client's best interest, charge only reasonable compensation, and avoid misleading statements about fees and conflicts of interest (see: The While House, Office of the Press Secretary, *Factsheet – Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings,* April 6, 2016).

[4] Source: Environics Research, *2015 Adviser Perceptions in Canada: A focus on the Future & Consumers* (2015).

50 percent attributed to 5-year returns. We compete on price and performance and it's on these efforts that we expect to attract and retain market share.

The introduction of the proposals in CSA CP 33-404 will only further increase, in our view, the scrutiny by dealers and their representatives on investment fund costs and performance.[5] The explicit requirements in the know-your-product (KYP) and suitability proposals require registrants to take into account the impact on the performance of the product of all fees, costs and charges, including any embedded commissions paid, as part of the suitability analysis. The reforms also propose that dealers and their representatives must assess whether any remuneration, including trailing commissions, could reasonably be expected to inappropriately influence how representatives deal with their clients.

We strongly believe that with the introduction of such factors as costs and performance in the assessment of KYP and suitability, as well as the focus on eliminating conflicts of interest found in CSA CP 33-404, the CSA has effectively addressed any residual reliance there may still be today for investment fund managers to compete on embedded commissions to prompt sales.

Dealers and their Representatives

The central purpose of the proposals in CSA CP 33-404 is "to better align the interests of registrants with the interests of their clients". As noted above, we believe the CSA achieves this aim, and addresses the concerns expressed in the Consultation Paper that embedded commissions may encourage dealers and their representatives to recommend higher cost fund products, or promote a particular purchase option, that pays them a higher commission to the detriment of investor outcomes.

In fact, we consider the breadth of the proposed conflicts of interest requirement and accompanying guidance in CSA CP 33-404 on compensation arrangements and incentive practices to capture much more than simply any potential for influence caused by embedded commissions. The proposed reform will require firms to assess whether any remuneration could reasonably be expected to inappropriately influence how representatives deal with their clients. We support this more principle-based approach to addressing all types of compensation bias, as it recognizes that conflicts of interest and the potential for misalignment of interest may exist in any fee model, not just with embedded commissions. As recognized in the Mutual Fund Fee Research prepared for the CSA by The Brondesbury Group (the Brondesbury Report), "all forms of compensation affect advice and outcomes".[6]

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[5]Please see our comment letter dated September 30, 2016. http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160930_33-404_mcinerneyb.pdf September 30, 2016

[6] Mutual Fund Fee Research prepared for the Ontario Securities Commission on behalf of the Canadian Securities Administrators, written by Dr. Edwin Weinstein, PhD The Brondesbury Group (Spring, 2015) ("The Brondesbury Report") p 4.

Alternative Regulatory Options to Address Issue 1

***Cap Embedded Commissions* –** To the extent that the CSA is not satisfied that the current regulatory reforms underway together with market changes does not fully address the issue of misalignment of interest of investment fund managers, dealers and representatives with those of investors, we believe the CSA should re-consider examining the option of a maximum limit (cap) on the amount of the trailing commission that investment fund managers may pay to dealers or representatives, as an alternative to discontinuing embedded commissions.

As noted in the Consultation Paper, this option would not preclude dealers and their representatives from directly charging their clients commissions or fees, either as a supplement or a substitute to embedded commissions. It surprises us that the CSA states that in pursuing this option it would be taking on a "non-traditional role" to set fee caps and that it would be very challenging to determine and justify the appropriate cap rate in the circumstances. We note that the U.S. Financial Industry Regulatory Authority (FINRA) imposes limits on 12b-1 fees. We would also point out that the CSA does, in fact, set fees, most recently lowering the cap on active trading fees that are listed on a Canadian exchange.[7] We believe that the CSA could, through a public consultation process, come to similar appropriate caps for trailing commissions.

***Allow Embedded Commissions Within Established Parameters* –** The CSA could also consider alone or together with a cap on embedded commissions providing guidance on when the use of an embedded commission arrangement (including DSC) would be permissible, having regard to such factors as the client's income and time horizon. We note that the Financial Services Board in South Africa (FSB) is currently working towards creating an exemption to their ban on embedded commissions for the low income sector.[8]

Issue 2: Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

We respectfully disagree with the CSA that the POS and CRM projects will not effectively address the issues identified in the Consultation Paper with respect to embedded commissions limiting investor awareness, understanding and control of dealer compensation costs.

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[7] CSA Amendments to National Instrument 23-101 Trading Rules and Companion Policy 23-101CP to National Instrument 23-101 Trading Rules (January 26, 2017).

[8] The FSB has indicated that it recognizes "there is a need to find a balance between remunerating advisers sufficiently so that they are encouraged to service the low income sector whilst ensuring access to fair and affordable advice and products that deliver fair outcomes for customers". Factors under consideration by the FSB in allowing embedded commissions include product standards to allow products to qualify for embedded commissions, the types of intermediary and advice services qualifying for embedded commissions, permissible commission limits and permissible product supplier/intermediary relationships (Source: Financial Services Board, *Treating Customers Fairly, General Status Update: Retail Distribution Review*, December 2015 at p 29).

From the beginning, the POS project was intended to increase investors' awareness and understanding of such costs, as well as better equip investors to compare the costs of one mutual fund to another, and to understand the impact of such costs on their investment returns. In fact, in an early release, the CSA indicated that some anticipated benefits of a more effective disclosure regime would include a heightened engagement of investors in determining the product and compensation costs, with "less risk of investors buying inappropriate products or not fully benefiting from the advice services they pay for."[9]

Similarly, the CRM project introduced, in the first phase, new relationship disclosure to investors at account opening, explaining the types of products and services provided by the dealer as well as more fulsome information on charges, including transaction charges which investors may expect to pay in connection with their investment (including the initial sales charge and DSC options and any trailing commissions or other embedded commissions paid). Phase 2 of the CRM project (CRM2) next introduced new annual account level reporting on charges and other compensation of commissions and other amounts paid to dealers, including any embedded commissions in dollar amounts. Like the POS project, the CRM project was intended not only to increase investors' awareness and understanding of dealer compensation costs, but to also lead to better, more informed investor decision making when it comes to dealer compensation costs and the corresponding level of service that's being provided.

The CSA is currently measuring the impact of POS and CRM2 on investor knowledge, attitude and behaviour, on registrant practices and on fees and product offerings.[10] For the CSA to suggest that discontinuing embedded commissions is now necessary to create greater investor fee awareness, or opportunities to negotiate and have greater control over dealer compensation, without yet having the results of this research, seems very premature. This position also appears inconsistent with the continued regulatory initiatives by the Mutual Fund Dealers Association of Canada (MFDA) and the CSA[11] that look to CRM2 disclosures as an effective way to make investors more aware of the embedded fees paid to issuers and the non-cash incentives that may be paid to the dealer or adviser and its representatives.

Alternative Regulatory Option to Address Issue 2

***Dealers Offer a Direct-Pay Option* –** If the CSA concludes there continues to be a need to further investor awareness, understanding and control of dealer compensation, we recommend the CSA consider the regulatory option of requiring all dealers who offer an embedded commission arrangement to also have a direct-pay option accessible to all

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[9] CSA Notice and Request for Comment Implementation of Point of Sale Disclosure for Mutual Funds (June 19, 2009).

[10] See press release: CSA to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model (August 22, 2016).

[11] MFDA Bulletin #0671-P – Report on Charges and Compensation – Consultation Regarding Cost Reporting for Investment Funds (December 18, 2015) and CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103, Companion Policy 31-103CP and National Instrument 33-109 (July 7, 2016).

clients. We envision that this direct-pay option could be facilitated by investment fund managers collecting payments from the investor's fund investment in much the same way as the Consultation Paper proposes. This is consistent with the structure of Mackenzie Investments' FB series today. The inclusion of a direct-pay option would allow both compensation arrangements to be offered and explained to the client at account opening, or by notification to existing clients, preserving investor choice.

***Enhance Annual Report on Charges and Other Compensation* –** CRM2 does not extend to the ongoing costs of owning securities, such as mutual fund operating and management fees. As a way to make clients even more aware of such fees, the CSA could also consider proceeding with the amendments published in July, 2016,[12] which propose to add a general notification in the client annual report that would remind clients invested in mutual funds, or other securities with embedded fees, about these costs, and that they may reduce the client's investment returns.

As a member of the Investment Funds Institute of Canada (IFIC), we also support IFIC's recent letter to the CSA, MFDA and the Investment Industry Regulatory Organization of Canada (IIROC) dated April 21, 2017, indicating that its members are ready to discuss a plan for extending disclosure requirements to encompass the full management expense ratio of investment funds, commonly referred to as CRM3. Should this work proceed, we believe that it will be important that there be corresponding disclosure to investors of the ongoing costs of similar financial products with embedded commissions, such as the spread on guaranteed investment certificates (GICs) and daily interest accounts (DIAs).

Issue 3: Embedded Commissions paid generally do not align with the services provided to investors

The final issue identified in the Consultation Paper with respect to embedded commissions is the need for advice and services to better align with the costs paid by investors. We agree. However, in our view this is a potential issue that is <u>not limited</u> to embedded commissions, nor solved by discontinuing such payments. Clients selecting direct-pay arrangements today may not be aware of the fee levels other clients are paying, have little to no market strength to negotiate fees and may not realize or be able to calculate the impact those (now external) fees have on the returns of their portfolio.

Today the most common direct-pay arrangements are fee-based accounts, which are generally based on a percentage of assets under administration. From our analysis of a sampling of MFDA and IIROC dealer fee-based program pricing grids, we have found that the majority of firms require investor assets to reach approximately $1 million before the account fee is at or below 1 percent, without necessarily any differentiation of the services provided.

[12] Ibid.

Recently, we have seen IIROC in their focus on compensation related conflicts indicate that fee-based accounts may not always be in the best interests of clients.[13] This, says IIROC, can be the case with a "buy and hold" strategy where the client will be paying for ongoing fees without receiving a commensurate level of ongoing service. As noted in the Brondesbury Report, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation.[14]

We believe the increased performance reporting and saliency of fund costs and dealer compensation created by the POS and CRM projects will lead to better alignment of overall services and advice with dealer compensation paid. The CSA has indicated that these initiatives are expected to cause investors to question the overall level of services and advice they are receiving, which in turn is anticipated to prompt representatives to better demonstrate their value proposition or, lead to investors switching to lower-cost alternatives. If the CSA's articulated aims for the POS and CRM projects are met, investors will be empowered to make more informed decisions on whether the commissions they're paying are commensurate with their specific needs, expectations and preferences for service and advice.

We further dispute the CSA's claim that the proposals in CSA CP 33-404 will have no impact whatsoever on the concerns they've expressed that embedded commissions paid may not align with services provided to investors. We believe the reforms, particularly the enhancements to know-your-client (KYC) and suitability, will create a more consistent minimum standard of service and advice that must be provided to all investors. This, in turn, will prompt greater price and service competition of dealers and their representatives to demonstrate their value proposition.

Alternative Regulatory Options to Address Issue 3

***Enhanced Dealer Supervision of Advisory Services* –** We would propose that if the CSA wants to address the issue of better alignment of the costs paid by individual investors with the services and advice provided, a more impactful and fulsome regulatory response for the CSA to consider is to focus on the dealer's supervisory obligations. Specifically, the CSA could consider enhancing the guidance related to dealer supervision of their representatives to indicate that this includes ensuring that a commensurate level of advice and service is in fact being provided in exchange for the payment by the dealer to the representative.

***Greater Specificity at Account Opening* -** The CSA could also consider enhancing the guidance related to CRM relationship disclosure, to strengthen the specificity in the disclosure related to the advice and services that will be provided by the dealer and representative in exchange for the compensation to be paid.

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[13] See IIROC Notice 16-0297 Managing Conflicts in the Best Interest of the Client – Status Update (December 15, 2016) and IIROC Notice 17-0093 Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review (April 27, 2017).

[14] The Brondesbury Report, p 18.

Mandating only "D" Series be Available on Discount Brokerage Product Lists - Finally, while we agree with the CSA that it may not be desirable for the CSA to compel investment fund managers to create a new "execution only" or non-advice series (typically denoted "D" series), we would encourage the CSA to proceed with mandating that discount or order-execution only (OEO) dealers not be permitted to offer an advice commission series (typically denoted "A" series) on their product list.

In our view, proceeding with this initiative will address the issue identified in the Consultation Paper that the majority of mutual fund series sold through the online/discount brokerage channel are the full trailing commission fund series despite the increased availability of Discount/DIY fund series (D series) in the market. We agree with the CSA that investors who do not seek services and advice should not inadvertently have to pay for them. We believe this change could be easily implemented by amending IIROC Member Rule 3200, which sets out the minimum requirements for IIROC dealer members seeking approval under Rule 1300.1(t) to offer OEO services.

2. Market Forces are also Driving Changes Independent of Regulatory Response Aligned to Regulatory Objectives

We strongly believe that market changes underway are already effecting many of the outcomes that the CSA believes a ban on embedded commissions will achieve. In particular, we are already seeing (a) the growth and availability of direct-pay (negotiated advisory fee) options to all investors in all channels; (b) reductions in fund fees and fund fee complexity; (c) increased price competition and decreasing fund management costs and (d) market innovations in product distribution and advice. In our view, these changes together with the outcomes of the regulatory reforms discussed above, significantly address each of the issues identified in the Consultation Paper.

(a) Fee-based and Direct-pay Options Continue to grow in all Channels

The CSA is correct to identify that the share of mutual fund assets held in fee-based purchase options (F series) is growing, and growing quickly. Competitive market pressures are driving the growth of F series for many fund manufacturers, with frequent changes to the F series offering or pricing. Fee-based program assets as a percentage of total assets is gaining ground in IIROC platforms, and in full-brokerage the shift in advisor compensation is in line with the shift to fee-based.[15] Our experience at Mackenzie Investments is that F series has had the most net new money, which is in line with the experiences of other independent fund manufacturers. In 2016, approximately 30 percent of Mackenzie Investment's gross sales were in fee-based series, and we expect our fee-based series sales will increase to above 40 percent, in line with the industry during 2017 and beyond.

Where we disagree with the CSA is the discussion in the Consultation Paper that direct-pay options today are not available to all investors in all channels. While it is correct that dealers generally do not offer fee-based programs to mass-market households, generally because of a lack of scale and the cost to implement, there are direct-pay options available

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[15] Source: Strategic Insight, Retail Brokerage and Distribution, Summer 2015.

to representatives today looking for fee-for-service for smaller investors where the dealer program may be restrictive to high minimum investments or fees for the reasons identified.

At Mackenzie Investments, we launched a negotiable advisor fee series, FB series, in October, 2015 for dealers and their representatives who are registered with the MFDA. This manufacturer sponsored solution allows for the negotiation of an advice and service fee directly between the investor and dealer, through the representative, pursuant to an explicit agreement, and then for Mackenzie Investments to facilitate the investor's payment of dealer compensation by collecting payments from the investor's fund investment (through periodic redemptions). Our FB series works in much the same way as the CSA's proposal to allow investment fund managers to facilitate investors' payment of dealer compensation. While it is our understanding that only a few other fund manufacturers have an FB series equivalent, we know there are a number of other fund manufacturers who offer the same negotiable attributes of the FB series in an existing series.

(b) Reduction in Fund Series and Fund Fee Complexity Underway

In the last few years, we have seen a number of proactive actions taken on the part of investment fund managers aimed at reducing fund fee complexity and series simplification. In fact, at Mackenzie Investments we continue to consolidate the number of series available on our shelf in an effort to continue to reduce complexity and improve advisor and client navigation.

Our own experience has also been that fund management and embedded distribution fees have become more uniform, and are continuing to decline. We have also of course seen the introduction of automated conversions to the lowest priced series upon the investor or house-hold meeting a minimum threshold requirement. We launched this service in April, 2017.

Finally, we continue to see fund managers either simplifying asset house-holding programs or move to a flat fee pricing strategy. While we believe there will always be some differences across the asset management industry, in part because of competition and innovation, this dynamic innovative and competitive environment has led to improved investor experiences and investment outcomes.

(c) Increased Price Competition Occurring

In the last few years, we have seen a number of investment fund managers announcing fee cuts, trailer fee cuts, administration fee cuts, preferred pricing programs as well as an increasing number of share classes with lower MERs year-over-year.[16]

Asset-weighted management expense ratios (MERs) and management fees for long-term funds also continue to decline. In fact, since 2015, the investment fund industry has

[16] December 2014 – December 2015, source: Insight Advisory Service, July 2016.

experienced a significant amount of re-pricing. In total, at least 6000 share classes lowered MERs between December 2014 and December 2015.[17]

(d) Market innovations in product distribution and advice

Canada is now home to more than 80 fintech firms.[18] The CSA is correct to identify the growth of online advice within the Canadian market. We were surprised, however, to see the CSA imply that the adoption by incumbents of online platforms will somehow have a negative impact on the pricing pressures these new entrants have brought to the market. We find no evidence in the Consultation Paper to support this assertion.

In our view, the increasing innovation and technology we're seeing in the market from both fintech start-ups and from incumbents, will continue to offer investors choices in product distribution and advice.[19] It will also continue to put increased price and competitive pressures on incumbents to demonstrate alignment of fees with the overall level of services and advice provided. We welcome this, and anticipate that we will see representatives differentiating themselves from asset allocation, advice 'light' platforms, all to the benefit of investors.

3. Importance of Preserving an Innovative, Competitive and Fair Financial Services Industry in Canada

Avoiding Regulatory Arbitrage

Mackenzie Investments has long advocated that it's important to remember that the securities industry is only one part of the financial services sector in Canada. Insurance and deposit investment products are also significant segments of the industry, and compete directly with the sale of investment funds. As the CSA is aware, there are embedded commissions and costs built in to <u>many</u> of these other financial products, notably segregated funds, as well as spreads on GICs and DIAs.

From the investor perspective, we believe it is critical to have a harmonized approach to the regulation of all financial products and the intermediaries who sell them. This is particularly important in an increasingly more concentrated and vertically integrated distribution landscape dominated by deposit-taker and insurer owned dealers. Different regulatory regimes for different financial products and financial intermediaries can create complexity and confusion for investors, and may lead to inconsistent client experiences and outcomes.

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[17] Excludes funds with performance fees, funds with management fees charged at account level and labour sponsored funds, source: Insight Advisory Service, July 2016.

[18] Source: PwC, Canadian Banks 2016 Embracing FinTech movement, 2016.

[19] Among Canadians, there's still a strong preference for taking guidance from a human financial advisor over advice generated through an algorithm powered by artificial intelligence (Source: HSBC, *Trust in Technology: Country Report/Canada*, May 24, 2017).

We believe it is noteworthy that in each of the jurisdictions that has introduced a complete ban on embedded commissions, the ban has extended beyond investment funds. This is a very important distinction from the Consultation Paper. While we welcome the CSA's support for a harmonized regulatory approach for similar products, and we appreciate that the Canadian Council of Insurance Regulators (CCIR) has indicated it will review the CSA policy direction on embedded commissions and assess its appropriateness for segregated funds, the potential for regulatory arbitrage remains. In addition, the Consultation Paper gives no indication of the timeline for the CCIR's review or a commitment for coordinated action with the CSA, nor is there any discussion in the Consultation Paper of whether a similar review is being considered by the Office of the Superintendent of Financial Institutions (OSFI) with respect to banking products.

As part of the CSA's deliberations, the potential impact of product and regulatory arbitrage cannot be disregarded or discounted. We found it particularly disconcerting that the CSA suggests in the Consultation Paper that the high level of horizontal integration at deposit-taker owned dealers somehow leads these firms to focus less on any one business line and more on "gathering assets across all business lines and on directing clients to the appropriate business line". With the recent CBC Go Public releases, we would submit there is overwhelming evidence to the contrary.[20]

We therefore strongly urge the CSA to work collaboratively with insurance and banking regulators to develop consistent regulatory responses to the issues identified in both this consultation and CP 33-404. We do not believe it is sufficient for the CSA to indicate that it "assumes" that the self-regulatory organizations and regulators of non-securities products will remain vigilant and take any necessary action in the case of non-compliance. If a decision is made by the CSA to proceed with discontinuing embedded commissions, we believe any such securities regulatory reform must only move forward if it is accompanied by concurrent and consistent regulatory initiatives for investment fund-like products across the insurance and banking industries.

Preserving a Competitive and Innovative Industry

The CSA acknowledge that discontinuing embedded commissions will have more of an impact on some dealers than others. In fact, the Consultation Paper notes that a ban on embedded commissions will have little to no effect on deposit-takers and insurer owned dealers. As noted in the Consultation Paper, most households who purchase investment funds purchase them through a deposit-taker or insurer owned dealer, who today dominate investment fund distribution. The concentrated and vertically integrated distribution landscape in Canada has made it increasingly difficult for independent dealers

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[20] See: CBC News reports by Erica Johnson, http://www.cbc.ca/news/canada/british-columbia/td-tellers-desperate-to-meet-increasing-sales-goals-1.4006743 (March 6, 2017), http://www.cbc.ca/news/business/td-bank-employees-admit-to-breaking-law-1.4016569 (March 10, 2017), http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575 (March 16, 2017), http://www.cbc.ca/news/canada/british-columbia/bank-s-deceptive-titles-put-investments-at-risk-1.4044702 (March 29, 2017) and http://www.cbc.ca/news/business/financial-investment-rules-client-interests-1.4069847 (April 17, 2017).

and investment fund manufacturers to effectively compete and ensure investors have choices in terms of financial advice as well as access to high performing funds.[21]

At Mackenzie Investments, we've identified that over 92% of our retail client base currently hold assets in either client name, nominee or intermediary accounts, which will be affected by the discontinuation of embedded commissions. As we describe in greater detail in the appendix, system enhancements to transition clients to fee-based accounts (the most common direct-pay arrangement), particularly client name accounts, will be challenging and costly and may in fact be prohibitive for many smaller independent firms. We firmly believe that any regulatory action that may prompt an even less competitive financial services industry will effect cost competition and product innovation, to the detriment of investors. We also noted these concerns in our response to CP 33-404.[22] As the CSA now contemplates discontinuing embedded commissions, a consideration of how such a regulatory change will affect the vibrancy of the financial services industry in Canada is critical, as this too has a significant impact on the investor experience and outcomes.

In our view, the assertion in the Consultation Paper that "investment funds are less popular than traditional savings vehicles with mass-market households" is more a result of the oligopoly and horizontal integration of the banks, than a testament to investor preference. We therefore strongly disagree with what seems to be the CSA's position that avoiding an "advice gap", because deposit-taker owned dealers in Canada will continue to service mass-market households, somehow negates the adverse impacts that discontinuing embedded commissions will have on some independent dealers and fund manufacturers, who today already face the challenge of a distribution network that is dominated by the banks.[23] In our view, fewer independent firms and manufacturers will mean a less competitive financial services industry in Canada, to the detriment of investors.

4. Retaining the Accessibility and Affordability of Financial Advice

Mackenzie Investments strongly believes in the value of advice provided to Canadians by financial advisors. Among other things, advised households (i) are twice as likely to save for retirement at all ages; (ii) have significantly higher levels of investable assets at all ages; (iii) improve their regular saving for retirement at all income levels; (iv) rate themselves as more financially knowledgeable; and (v) are more confident in their ability

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[21] As of March, 2017 the top 5 deposit-takers rank 6th, 7th, 8th, 10th and 11th in terms of percentage of proprietary 4 and 5 star Morningstar ratings (Source: Morningstar Direct, March, 2017).

[22] Ibid., footnote 4.

[23] We refer to independent fund manufacturers as those manufacturers not owned by a bank, credit union or life insurance company. In 2005, independent fund manufacturers accounted for 56.4% of the net assets in the industry, while the banks and the credit unions only made up 32%. In 2015, the banks and the credit unions had 43% of the market share, while the independents dropped to 41% (Source: Investor Economics, 2016; see also: Clare O'Hara, *Banks taking share from independent mutual-fund firms,* The Globe and Mail, May 25, 2015).

to achieve a comfortable retirement.[24] We also know that investors' primary source of financial information comes from their advisors.[25]

As the CSA moves forward with its review of whether or not to discontinue embedded commissions, it is important for the CSA to ensure that advice not only remain accessible for mass-market households, but that modest investors continue to have choices in financial advisory services and that such services remain affordable.

Modest investors (those with under $100,000 in investible assets), make up 80% of all Canadian households[26] and 83% of the households that use MFDA representatives.[27] We also know that in 40% of cases where there is a financial advice relationship, it was initiated with financial assets of not more than $10,000. The benefit of wealth accumulation is exponentially greater the longer the advice relationship. Investors who receive professional financial advice save more, accumulate more wealth and feel better prepared for retirement than non-advised individuals with similar socio-economic characteristics.[28]

Research shows that fewer choices of compensation models can limit access to advice, and result in higher overall costs, particularly for households with more modest investment levels.[29] Where regulation has been changed to ban or limit commissions, the absence of embedded compensation has been found to lower the cost of the product, but the cost of advice was seen to go up. As noted in the Brondesbury Report, it has also been found that in jurisdictions that have moved to fee-based compensation, those with less wealth or income have found it more difficult to get advice than others.[30]

Ultimately, we believe it is critical that as the regulatory framework continues to evolve in Canada, that we retain choice for investors not only in how they pay for financial advice,

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[24] Sources: CIRANO, *Econometric Models on the Value of Advice of a Financial Advisor* (2012) and *The Gamma Factor and the Value of Financial Advice* (2016). Advised households, at all age levels, are twice as likely to save regularly for retirement than non-advised households, with advised households having higher net worth than non-advised households across all ages and income levels (Source: IFIC *The Value of Advice,* 2011).

[25] Key Highlights CSA Investor Education Study 2016 prepared for the CSA by Innovative Research Group, Inc., April 2016.

[26] Source: Investor Economics, *Household Balance Sheet*, 2015.

[27] Source: MFDA Client Research Report, p 6.

[28] Sources: CIRANO, *Econometric Models on the Value of Advice of a Financial Advisor,* 2012 and *The Gamma Factor and the Value of Financial Advice* (2016).

[29] Source: Investor Economics & Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canada-U.S. Perspective,* 2015. The willingness to pay upfront for advice depends on the level of wealth, formal education and financial knowledge of the investor (Source: Michael S. Finke, Sandra J. Huston and Danielle D. Winchester, *Financial Advice: Who Pays*, (Association for Financial Counselling and Planning Education) 2011.

[30] The Brondsbury Report, p 5.

but in the type of advisory service model, so that the benefits of the client-registrant reforms contemplated in CSA CP 33-404 will remain accessible and affordable to all Canadians.

We firmly believe that the effects of the regulatory initiatives undertaken to date, once fully implemented, together with the rapid changes underway in the market, will substantially address the issues identified in the Consultation Paper. To the extent that any residual issues remain, we submit there are a number of alternative regulatory actions available to the CSA that could address such issues, without the resulting significant adverse impacts discontinuing embedded commissions may cause.

As the CSA moves forward with both this consultation and CP 33-404, we recommend the CSA establish working groups, comprised of members of the CSA, MFDA, IIROC and market participants, to ensure that the impacts of any rule proposals, as well as all operational or transition issues, can be efficiently and effectively identified and addressed.

We thank you for the opportunity to provide comments on the Consultation Paper. Please feel free to contact Donald MacDonald, Senior Vice-President, General Counsel & Secretary at (204) 956-3387 or myself if you have any questions or require additional information.

Yours truly,
MACKENZIE FINANCIAL CORPORATION

Barry S. McInerney
President and Chief Executive Officer

Appendix - Tax Impacts

Overview

Generally, mutual funds pay a management fee to the investment fund manager, and the investment fund manager then compensates the dealer out of its management fees. Within this structure, the management fees paid to the investment fund manager are deducted by the fund to arrive at taxable income. Typically, in a mutual fund, distributions are paid to the investors to eliminate taxable income in the mutual fund. If there is a ban on embedded commissions, then the management fees paid by the mutual fund are reduced, and conversely the taxable income of the mutual fund would increase. There would be additional taxable income in the mutual fund requiring additional distributions to be paid to investors to eliminate taxable income in the mutual fund.(1)

In a direct-pay model, the investor is responsible for compensating the dealer. Generally, these advisory fees are tax deductible to the extent that these fees are reasonable, are for non-registered accounts, are not commissions, and are:

- For advice as to the advisability of purchasing or selling a specific share or security of the taxpayer, or;
- For services in respect of the administration or management of shares or securities of the taxpayer.

Generally, the additional distributions paid to investors should be offset by the advisory fees paid to the dealer.

In order to facilitate the payment/collection of the advisory fees, the investment fund manager/investor/dealer may agree to redeem units to fund the payment of the fees. The advisory fee is subject to GST/HST/QST (Sales Tax).

We set out below our observations of the key implications to investors, investment fund managers and dealers in transitioning all clients to direct-pay arrangements.

Impact of Removing Embedded Commissions	**Investor**	**Investment Fund Manager**	**Dealer/Advisor**
More fund series are likely to require distributions and quantum of distributions are likely to increase	Additional administration required to track distributions and report for tax purposes.	Increased demand on system resources to process higher volume of distributions.	Additional system resources to track the transactions. Additional investor support to track and understand transactions
Tax neutrality of “embedded commission” component not ensured	Tax deductibility of fees paid by the investor to its dealer dependent upon the services being provided in exchange for the advisory fees being charged.	N/A	Communication with the investor to be managed
Additional volume of transactions as a result of redemptions to fund direct-pay fees	Additional administration required to track transactions and report gains/losses for tax purposes including monitoring superficial losses.	Increased demand on system resources to process higher volume of transactions.	Additional system resources to track the transactions.
Advisory Fee subject to Sales Tax	Amount of Sales Tax payable by the investor on the advisory fee will be determined by the investor’s province of residence as opposed to the “blended rate” of the fund.	Impacted to the extent the investor’s units in the funds are redeemed to pay for the advisory fees. The investment fund manager requires the systems to determine the quantum of the Sales Tax to withhold on behalf of the dealer.	Exempt commission paid by the investment fund manager being replaced by a taxable advisory fee paid by the investor. Systems to be enhanced to handle the additional administration and

	Generally, Sales Tax paid will be added to the cost of the advisory fee.		compliance required to collect, report, and remit the Sales Tax (and related taxable revenue).
Rationalization of fund series would require an exchange of investors' units within a fund	Generally, an exchange of units from one series of a fund to another can be accomplished on a tax deferred basis. Eliminates a level of complexity in understanding offering.	Initial increased demand on system resources to process transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Simplifies investment fund manager's offering.	Initial additional system resources to track the transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Eliminates a level of complexity in product offering.

(1) A mutual fund corporation can only distribute (by way of dividend) its net capital gains and dividends to shareholders. A reduction of management fees within the corporation could result in trapped income, which would be subject to tax. The end result is double taxation on the income; once in the corporation and again in the investor's hands upon redemption.

Appendix – Operational Impacts

General operational impacts of discontinuing embedded commissions on the back office service processes of investment fund managers and dealers

Many investment fund managers and dealers will face operational challenges in transitioning to direct-pay arrangements, namely because of systems complexities and associated costs. This, in turn, may impact both the client experience, as well as overall costs for the client.

At Mackenzie Investments, over 92% of our retail client base currently hold assets in either client name, nominee or intermediary accounts that will be affected by the discontinuation of embedded commissions. A move to fee-based accounts (the most common direct-pay arrangement and the model we anticipate will most likely be utilized) will be particularly challenging for dealers with client name accounts. Nominee accounts allow for a cash position through which all security buys, sells and daily calculations and accrued account fees can be processed. A cash position enables the client to maintain a cash balance and allows the dealer to collect client fees from the cash balance without having to sell any mutual fund positions to cover the fee. It also enables the dealer to automate the collection of the client's accrued fees part way through the month based on the client's transactions through the cash position. Client name accounts, on the other hand, are challenging to automate and effectively administer because transactions to collect the fee must be charged directly to one or more mutual fund positions held within the account.

The move to direct-pay arrangements will likely cause an increase in the number of transactions we currently see in client accounts which hold mutual funds with embedded commissions. This, in turn, will raise the costs of administering these accounts. These increased transactions will be due to increased fund distributions as a result of additional taxable income in trust funds (with the discontinuation of embedded commissions), the introduction of client fee transactions and possibly additional redemption transactions to facilitate client payments. We envision there will be a need for systems upgrades to process these increased transaction volumes and the additional reporting to clients by both the dealer and the manufacturer.

Adding to the challenges facing dealers in transitioning to direct-pay arrangements for all clients, whether in nominee or client name accounts, is that many dealers rely on third-party systems vendors today for transfer agency functions, client confirmations and client statements. These vendors typically provide such services to many dealers, which means that the transition to direct-pay arrangements will place higher demand on them from the dealers they service. Vendor resources and cost constraints may also limit their ability to meet the needs of dealers within the CSA's proposed transition period. In addition, vendors will have to deal with the complexity of each dealer potentially choosing a slightly different direct-pay arrangement which may further impact the timing of transition and cost to the dealer.

The recent experience of implementing the POS and CRM2 projects provide good insights into the extent to which systems, procedural and educational enhancements will be needed by dealers, investment fund managers and systems vendors to effect a smooth transition to direct-pay arrangements. Our experience is that there have already been significant cost expenditures in these project implementations with systems and website changes; file enhancements to provide additional details on advisor fees and commissions; and enhanced training and ongoing advisor support. We are mindful of the additional complexity and costs that a transition to direct-pay arrangements will cause some dealers, particularly smaller and medium size independent dealers, and that this may create business viability concerns.

Other unintended consequences that may arise for fund industry stakeholders and investors with the discontinuation of embedded commissions

An additional challenge with transitioning to direct-pay arrangements within a prescribed period of time will be that while business and pricing models will continue to be contemplated and evolve, investment fund managers and dealers will have to begin to plan for the process of moving existing clients to some type of direct-pay arrangement and platform immediately. This will likely require the creation of client/nominee fee-based platforms to minimize switches, which have the potential for triggering negative tax consequences for clients (i.e. capital gains). In addition to a consideration of immediate tax impacts, additional reporting and the implementation of new administrative procedures will be required, along with the associated costs, for existing clients.

Discontinuing embedded commissions may also adversely impact the account minimum and maximum calculations for registered retirement income funds (RRIFs) and life income funds (LIFs), and how fee payments are made from registered education savings plan (RESPs) and registered disability savings plan (RDSPs) accounts today.

For RRIFs and LIFs, the minimum and maximum calculations will be impacted by the decrease of the market value due to the application of fees in the account. RRIF and LIF minimums are calculated based on year end market value. The application of the fees will decrease the year end market value and consequently the minimum in the following year. LIF maximums are also calculated based on year end market value but can also be calculated based on the growth realized in the previous year. The application of fees in these instances will decrease the maximum in the following year.

For RESPs and RDSPs, based on the Promoter Agreement signed with Employment and Social Development Canada (ESDC), Mackenzie Investments as a promoter cannot charge fees on the grant portion of these accounts. Therefore, the fee, if charged, will have to be on the income portion and then the capital portion (not against the government's incentive portion).

Transition and timing

For dealers and investment fund managers, we anticipate multiple internal and external systems upgrades will be required to manage transaction workflow, data management, fee payments and fund distributions if the CSA moves forward with discontinuing embedded commissions. These changes will impact various procedures on how we manage, process and report transactions, adjustments, taxes and documents.

The required system development, training, reporting (confirmations and statements) and change management costs for us at Mackenzie Investments, however, will only be fully understood when each dealer determines and provides us with details of how they intend to structure their direct-pay arrangement and the degree to which they want us to assist in the facilitation of the payment. We can, however, anticipate significant vendor costs to prepare our specialized registered and income plan accounts.

The current securities regulatory framework requires client approvals of switches between mutual fund series and moving clients from client name accounts to nominee accounts as well as changing from an embedded commission to a direct-pay arrangement. Such transitions also require significant client communication and administration challenges, all of which can mean additional expenses for dealers and investment fund managers and most often, significant disruptions to the client. The ability for dealers and investment fund managers to notify clients of these changes as part of an automatic transition to direct-pay arrangements, instead of obtaining and administering client approvals, would significantly simplify the process and most importantly, minimize client disruption.

The CSA proposes two possible alternatives for dealers to transition to direct-pay arrangements. From both an operational and client experience perspective, we believe the best approach is to set a definitive transition date that allows dealers, investment fund managers and systems vendors sufficient time to determine how best to manage the transition. In our view, a phased account transition approach as described in the Consultation Paper may not fit the particular circumstances of a client holding multiple account types, and may be very difficult to achieve without significant client disruption.

In light of all the above, we believe that a transition period of 36 months may be too aggressive a timeframe to allow for a seamless transition for all stakeholders, particularly clients. Should the CSA determine to proceed with discontinuing embedded commissions, we strongly encourage a commitment by the CSA to engage with the industry at various points, to ensure that a smooth transition is underway, and to consider and address operational issues throughout the process.

Appendix – The Value of Active Management

Overview

Active and passive management are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors should view investing from a total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers subscribe to a common belief that markets are not perfectly efficient, which creates an opportunity for portfolio managers to exploit security mispricing and outperform the overall market. Passive managers, on the other hand, seek to replicate the return of a given market index.

Market efficiency describes the degree to which the price of securities reflects all public and non-public information (timeliness and interpretation). Hypothetically, if the capital markets were perfectly efficient, active managers on average would not outperform the markets as securities would already reflect their fundamental value. On the contrary, if markets could be described as inefficient, there would be many opportunities for active managers to identify and profit from mispriced securities and hence outperform the overall markets. In practice, capital market efficiency resides somewhere in between these two scenarios. Active management can add value to portfolio returns over a broad range of different asset classes.

Active management generally refers to an investing strategy whereby a portfolio manager makes specific investment decisions with the typical goal of outperforming an investment benchmark or index. Active management can have advantages over market capitalized indices - and more importantly - protecting investor wealth over full market cycles - particularly during market downturns.

Actively managing asset allocation enables investors to be focused on individual objectives beyond benchmarks and the short term. This is essential for aging investors as they move from wealth accumulation into decumulation, where the emphasis is on consistency and persistency of income. It is much more difficult for wealth levels to recover from an investment loss when capital is being liquidated in retirement.

To better protect investors' capital, active managers are able to purchase securities that are undervalued and sell securities that become overvalued. They are also able to minimize losses by avoiding troubled securities and overly concentrated sectors or regions. Many active investment strategies also have the ability to hedge currencies, buy put options to lessen drawdowns, retain cash to reduce volatility, and utilize other tools to minimize potential investment losses. Furthermore, actively managed funds are able to effectively diversify their assets by avoiding the limitations of the benchmark through the avoidance of security and sector overconcentration.

Challenges

Successful active management is by no means an easy task. By simple definition, and for the most part, it can be a “zero sum game” where the gains of one investor come at the expense of another. Vanguard Asset Management describes it as follows:

> “The concept of a zero-sum game starts with the understanding that at any one time, the holdings of all investors in a particular market make up that market. As a result, for every invested dollar that outperforms the total market over a given period, there must by definition be another dollar that underperforms. Another way of stating this is that the asset-weighted performance of all investors, both positive and negative, will equal the overall performance of the market.”

Writing in The Financial Times, Yves Choueifaty CEO of TOBAM noted an additional challenge:

> “By definition the average active manager cannot outperform the benchmark because the benchmark is determined by the sum of activity carried out by both active and passive managers. And because passive managers have no impact on the benchmark – they merely follow it – it is, in fact, the sum of all the bets taken by active managers that determines the benchmark. It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers”.

Investing in the index does not on its own however ensure a positive outcome. For example, over the 25 year period beginning in 1929, the S&P 500 index did not recover to its former high until 1954. Yet, considerable wealth was amassed during this period through effective trading of individual securities. As cited by the CMG Capital Management Group:

> “It’s a little-known but startling fact: The average buy-and-hold stock market investor spends 74% of his or her time recovering from cyclical downturns in the market (from 1900 – May 2015). We like to think of investment approaches as types of aircrafts. Passive investments are like hot air balloons. In favorable conditions, they can indeed carry passengers to their financial goals.
>
> Active investments, on the other hand, are like planes. When winds are fair, they, too, can carry you in the right direction. They also have the flexibility to maneuver through bad weather, protecting their passengers from harm and keeping them moving toward the destination”.

The relevance of these numbers gain even greater importance in the context of Deutsche Bank’s Bradley Jones whose analysis revealed that a portfolio comprised of 60% equities and 40% bonds produced negative real returns over a rolling ten year holding period for almost a quarter of a 111 year period in the US market commencing in 1900. This is perhaps even more pervasive in a low interest rate environment where negative returns have come into existence and depending upon global events, could become more prevalent.

With this in mind, arguably the ultimate goal and value of active management is to provide downside protection, with secondary consideration given to muting volatility and out performing in bull markets. MFS Investment Management stresses this importance in their piece, “There’s No Substitute for Skill”:

> "To outperform in falling markets, active managers must have differentiated risk management. It should be an important part of their investment process, rather than an overlay, using active security selection to view risk from multiple perspectives before adding a security to a portfolio. Through a strong risk framework, they must manage risk on several levels, from the security to the portfolio to the firm. Investors consider this capability a high priority."

Opportunities

Russell Investments has stated:

> "Dynamic active management – the real-time management of portfolio exposures to specific factors, countries, sectors, or currencies – can be used to help to avoid downside risk in chosen asset allocations. With this kind of focus, active management works to help create a smoother ride that can help to keep investors from exiting the market at the worst possible time".

Perhaps most importantly for the retail investor, Russell also singles out the importance of after-tax returns, for of all the costs incurred by an investor - be it trades, investment management, or advice, the greatest cost will be taxation.

> "As so many of us have heard over the years, 'It's not what an investor earns. It's what they keep.' Being active around after-tax returns is often an underappreciated way active managers can help to provide value to investors. Unlike index-based passive investing, active management can use an expanded toolkit to actively maximize after-tax returns. This includes active loss harvesting – potentially increasing the absolute return an investor sees. Active, by its very nature, strives to do better".

For many managers active management employs innovative factor weightings to outperform market capitalized indices. Morgan Stanley identifies these new approaches as:

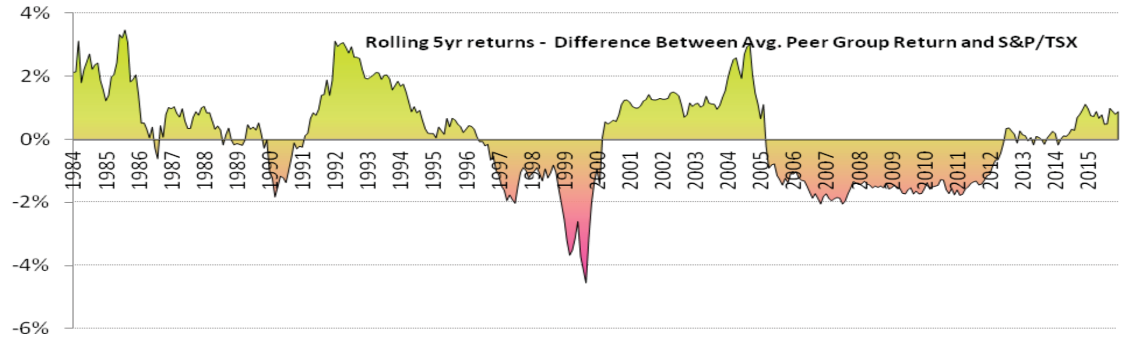
> "'Smart-beta' strategies which attempt to replicate pure factor strategies (like value, momentum or low volatility) are the next evolution in the active/passive debate. While their systematic approach may be a low-cost replacement for some active managers, we still believe that 35 to 40% of the top managers add idiosyncratic alpha over long periods of time and thus their investment selections can be additive to diversified portfolios."

Employing new approaches to challenge long held beliefs enables diverse opportunities for active managers**.** MIT's Andrew Lo, well known for his paper, "Physics Envy May Be Hazardous to your Wealth!" (that demonstrated how the economic system developed by financial markets created a false sense of mathematical precision as the models developed were not as predictive as those used in physics) urges investors to view financial markets and institutions from the perspective of evolutionary biology rather than physics:

> "Markets are well behaved most of the time, but like any other human invention, they are not infallible and they can break down from time to time for understandable and predictable reasons".

Analysis

According to data from Morningstar Canada, the average performance of the actively managed Canadian Equity peer group (Canadian Investment Funds Standards Committee (CIFSC) category) has exceeded that of the benchmark S&P/TSX index 58% of the time since 1980. Even more impressively, 1st quartile funds in the same category outperformed the index 79% of the time.



During each bear market since 1980, the benefits of active management have been quite evident as the average return of the CIFSC Canadian Equity peer group exceeded that of the passive index as can be seen in the following table.

Start	End	S&P/TSX Composite	25th Percentile Return	50th Percentile Return	Cdn. Equity Avg. Fund Return
Jun-81	Jun-82	-36.7	-26.7	-29.1	-30.8
Aug-87	Nov-87	-25.4	-20.8	-25.0	-24.1
Jan-90	Oct-90	-20.1	-10.5	-15.1	-12.8
May-98	Aug-98	-27.5	-23.7	-25.7	-25.5
Sep-00	Oct-02	-22.6	-12.0	-14.9	-14.5
Jun-08	Feb-09	-43.5	-39.8	-43.4	-42.6

Various studies and writings in recent years have pointed to the seeming inability of most actively managed funds to match or beat their index benchmarks. Most of these studies, however, looked only at average equity funds without making distinctions between those that were truly active and those that were not.

A more discriminating study in 2009 by Martijn Cremers and Antti Petajisto found that investment funds that were truly active, taking positions that significantly deviated from their benchmarks, were able to outperform those benchmark indices both before and after expenses.

Supporting Strong Capital Markets

Passive investment vehicles have low costs mainly because they do not do any of the research and trading that active managers do. Without this research and making prices informative, individual securities can become mispriced and markets distorted. According to Lasse Pedersen of AQR Capital Management:

> "If most investors were passive, the liquidity in individual securities not included in the index would vanish as investors would only trade the index. Securities could become severely mispriced. The collapse of liquidity and the lack of active management would make the process much less informative. When the secondary market is illiquid and uninformative, buying in the primary market becomes much riskier."

A lack of liquidity in the market is not an issue if you don't have to sell or buy immediately. Actively managed funds are not forced to liquidate securities to meet investors' needs as they usually maintain a cash reserve. This cash reserve also benefits active management strategies by allowing them to exploit the market when mispricing occurs. In fact, the more investors use ETFs and other passive strategies, the more opportunities are created for active managers and the larger those opportunities are.

A further benefit is that within the market, active managers can profit at the expense of passive strategies in assessing the value of an initial public offering (IPO). Pedersen continues:

> "Research has shown that IPO securities are, on average, sold at a discount relative to their price in the secondary market when the shares start trading on the exchange. Informed investors can buy the new shares cheaply and then sell some in the secondary market to other (passive) strategies at a premium. As a result, passive investors are not guaranteed the same IPO performance as the group of active investors since they trade at different prices and quantities."

In competing for outperformance, active managers seek relevant information, analyse it to determine value, and select securities accordingly. In the process, they help to set prices and provide trading liquidity. The efficient allocation of capital in our market-based economy relies on this mechanism. According to Nitin Mehta, managing director of the CFA Institute for Europe, the Middle East and Africa:

> "Passive investors are relative free riders, having to pay only the marginal cost of market participation as price takers, rather than the higher average cost for making fair prices and supporting the real economic purpose of financial markets".

Conclusion

Active and passive investments are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors need to view investing from total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers have shown they have the ability to outperform the index and can be less volatile than the index during bear markets. They are able to avoid less attractive, slow growing companies and provide greater exposure to companies with superior valuations or growth potential. Equities are inherently risky and active strategies can diversify that risk by investing in stocks with lower correlations, and by underweighting sectors that are overly concentrated in the index.

Effective diversification is about maintaining the right balance of stocks, not simply owning a basket of the largest stocks. Active management does not aim to invest only in the largest companies nor look to match the weight of the best performing stocks in the index. Instead, the focus is on selecting the most fundamentally sound and profitable companies, as well as those that are not highly correlated and so can be expected to react differently to market events.

Given the many uncertainties that global capital markets present, investing in stocks and bonds has never been more challenging. Actively managing those risks is critical for those who depend on stocks to grow their wealth and bonds to add an element of stability to their investment portfolios.

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Credential

June 9, 2017

VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
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Attention: Ms. Grace Knakowsi, Secretary of OSC
Me. Anne-Marie Beaudoin, Corporate Secretary of AMF

Re: Comments on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*

Dear Ms. Knakowsi and Me. Beaudoin:

I write on behalf of Credential Financial Inc., a national wealth management firm, including its subsidiary companies Credential Securities Inc. ("CSI") and Credential Asset Management Inc. ("CAM") (collectively "Credential"), to provide comments on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (the "Consultation Paper").

Through CSI (an IIROC-registered Investment Dealer) and CAM (an MFDA-registered Mutual Fund Dealer), Credential provides dealer services, trading and custodian services, and an online brokerage to credit unions and independent financial institutions across Canada. Credential offers a full suite of products and services to over 225 organizations and more than 1,800 advisors with $32 Billion in assets under administration.

Credential

At Credential our vision is to enable *sustainable financial strength for all Canadians*. We strongly believe that access, at all income levels, to affordable wealth management advice is essential to promoting the security and prosperity of Canadians.

We commend the CSA on its well-articulated and well-researched Consultation Paper. We have studied the document for several months and carefully considered its contents. We are supportive of the regulatory initiatives designed to elevate client interests, in particular where clients will demonstrably receive a clear benefit, such as improving transparency of dealer compensation, eliminating compensation-related conflicts and reducing the complexities involved with investing generally.

Credential participated in a review of the Consultation Paper by industry discussion groups, including through the Investment Industry Association of Canada ("IIAC"). Credential is in support of discontinuing embedded commissions, however, we believe that certain aspects of the proposal may lead to unintended outcomes. Many of these are well articulated in the IIAC letter. We are concerned about a potential expansion of the advice gap in Canada and, in particular, its potential impact on economically vulnerable senior citizens who may be 'priced out' and need to rely on automated advice as their senior years progress. Health and other factors (such as being unable to keep up with the rapid progress of technological change) could exacerbate the challenge faced by these clients. We respectfully request the CSA to consider these issues carefully in its review process.

Should a ban on embedded fees proceed, we submit that it would be reasonable to provide firms with a safe harbour to automatically transition accounts to direct pay arrangements in instances where clients fail to respond to a firm's reasonable efforts to contact clients to explain the transition options.

Credential appreciates the opportunity to participate in this consultation. Our comments are intended to promote a constructive dialogue on the relevant issues. On behalf of Credential, I thank you for considering our comments. Please contact me with any additional questions or requests for further information.

Yours very truly,

Yasmin Lalani
SVP, Legal, Risk Management & Chief Counsel
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June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Me Anne-Marie Beaudoin, Corporate Secretary
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Dear Sirs/Mesdames:

RE: Canadian Securities Administrators Consultation Paper 81-408
Consultation on the Option of Discontinuing Embedded Commissions

AGF Investments Inc. ("**AGF**") is writing to provide comments in respect of the Canadian Securities Administrators (the "**CSA**") Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the "**Paper**"), which describes "*potential investor protection and market efficiency issues arising from the prevailing practice of remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions, paid by investment fund managers* ("**embedded commissions**")".

AGF is an independent Canadian-based firm (founded in 1957, and celebrating our 60th year) that provides asset management services globally to institutions and individuals. AGF's products include a diversified family of mutual funds, mutual fund wrap programs and pooled funds. AGF also manages assets on behalf of institutional investors including pension plans, foundations and endowments. AGF is registered in the categories of Investment Fund Manager, Mutual Fund Dealer, Exempt Market Dealer, Portfolio Manager, and Commodity Trading Manager.

AGF appreciates the opportunity to provide feedback to the CSA's concerns raised in the Paper with regard to the perception that embedded commissions "*give rise to conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of the investors they serve*". AGF certainly acknowledges and appreciates that the CSA's mandate toward the *protection of investors* is of the utmost importance, and that the continued safeguarding of investors is a paramount standard for the investment fund industry to observe and be regulated within. Like the CSA, AGF upholds the principles that (i) investors should undeniably be protected against harmful risks associated with conflicts of interest; and (ii) investors should absolutely be fully aware of the compensation they pay to dealers and their representatives. With respect, however, AGF does not agree with the suggestion that discontinuing embedded commissions is a necessary or even viable option toward furthering investor protection outcomes.

SUMMARY OF AGF'S POSITION

AGF is an ardent supporter of a financial industry that not only protects investors, but also upholds the principle of providing investors with options and choice.

As outlined in AGF's submissions below, AGF believes that regulatory reforms should not be subjectively advanced under the auspice of "investor protection" where:

- **(i) there is no credible evidence that the current system of embedded commission compensation is harmful to investors;**
- **(ii) the unintended consequences from such reforms will invariably undermine investor interests (limiting investor choice, as well creating an "advice gap" and "wealth gap" for investors); and**
- **(iii) there is limited "call to action" from investors themselves.**

In advancement of the assertion that embedded commissions should not be discontinued, AGF makes the following submissions, supported by substantive and empirical data (where applicable). These submissions reinforce our overarching position that the existing dealer/advisor compensation framework should be retained. At the same time, AGF does also acknowledge that this an opportunity to consider certain enhancements that may be feasible within the industry. To that end, this letter also includes certain proposals (**ALTERNATIVES**) for the CSA to consider in lieu of the proposed ban.

A. PERCEPTIONS OF CONFLICTS OF INTEREST

The Paper is predicated on the argument that risks of harm may exist within the embedded commission compensation model due to potential conflicts of interest. We agree – such risks may exist. That said, we also contend that such "potential risks" should only elevate to the need for commensurate regulatory reform when there is actual harm occurring (to investors) that warrants intervention.

As outlined in The Gandalf Group's Report[1] (the "**Gandalf Report**"), their data shows that a substantial number (66%) of all investors acknowledge and agree that advisors have a conflict of interest based on how they earn commissions. However, 54% of all such investors (including 61% of advised investors) agreed that advisors are transparent about potential conflicts, while only 34% disagreed. Further, most advised investors reported satisfaction with the degree to which investment recommendations they receive are free from conflict of interest: 50% were very satisfied, and only 8% were very dissatisfied. More investors agreed that advisors care about how their clients' investments perform (74% agreed, 21 % disagreed) than agreed that advisors have a conflict (66%). To this end, investor sentiment clearly reveals that the risks of actual harm associated with potential conflicts of interest within the embedded commission compensation model are not as profound as may be perceived by the CSA. **In fact, there does not appear to be an accumulation of evidence-based data to substantiate the view that there is widespread harm being experienced by investors under the current embedded commission compensation structure.** As articulated in PricewaterhouseCooper LLP's Research Report[2] (the "**PwC Report**"), "*there is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour*".

AGF also notes that the Paper does not provide any indications in support of any one compensation model being absent of potential conflicts of interest. AGF argues that eliminating embedded compensation systems in favour of fee-based compensation arrangements will not eradicate all possible conflicts of interests within the dealer compensation realm. In fact, the PwC Report cautions that "*in principal-agent relationships, any compensation scheme creates a potential for conflicts of interest…under a fee-based platform, for instance, advisors might be incentivized to take undue risks to boost their own fees even where this is not in the best interest of their clients*". A recent Investment Industry Regulatory Organization of Canada Report[3] (the "**IIROC Report**") further warns that "*a significant number of dealers provide additional incentives to representatives in the form of performance bonuses linked to fee based assets*", leading to clients potentially being moved to these accounts unnecessarily (clearly a potential conflict of interest).

AGF is not averse to fee-based compensation arrangements – in fact, AGF acknowledges that this type of compensation model may be ideal for some investors. As stated in the IIROC

[1] "The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services" (May 30, 2017) by The Gandalf Group. This third-party survey, as conducted by The Gandalf Group (a Toronto-based consultancy firm that specializes in survey research), was commissioned by AGF. Designed by The Gandalf Group, this recent survey of a core sample of 1299 Canadian investors investigated issues relating to individual investors, the advisory services industry, fund providers and regulators, including: (i) satisfaction with advice, fees, transparency and investment options; (ii) the role of advisors, and their strengths and weaknesses; (iii) the perception of fee disclosure, transparency and new reporting obligations; (iii) general awareness and assessments of various types of commissions and fees (notably trailing commissions), and (iv) investors' preferences for advisor compensation (i.e. fee-based or commission-based charges). **A copy of this report from The Gandalf Group is attached as Appendix A to this letter.**

[2] "Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds" (June 2017) by PricewaterhouseCoopers LLP. This research report was commissioned by The Investment Funds Institute of Canada to provide an independent economic assessment of the likely impacts that would result from a ban on embedded commissions in the sale of mutual funds in Canada through financial advisors.

[3] "Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review" (April 27, 2017) by the Investment Industry Regulatory Organization of Canada.

Report, "*whether a commission or fee-based account is appropriate for a client will depend on the circumstances of the client*". **This leads to the logical interpretation that reforms suited to advancing the interface/dialogue between dealers/advisors and their clients is where regulatory efforts should be focused.**

AGF strongly encourages the CSA to consider that Canada currently has a robust regulatory framework governing the provision of investment advice to investors. Investors are inherently protected by the duty of dealers and advisors to act fairly, honestly and in good faith within a system of rules designed to capture, amongst other things, disclosure and management of conflicts and compensation disclosure. The existing rules and regulations of the securities commissions and the self-regulatory organizations require advisors to observe high standards of ethics and conduct in the transaction of business with investors, and to provide proper disclosure in the area of conflicts of interest, as well as compensation. **Accordingly, focus might rather be better directed at enhancing compliance within the already established regulatory framework to better address areas of concern highlighted by the CSA in the Paper.** Recent statements and proposed initiatives from IIROC and the MFDA suggest that this approach is already occurring.

Notwithstanding the strength of regulatory environment already applicable to dealers (and their representatives), AGF submits that if further regulatory reform is deemed essential, the CSA's proposals under Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward their Clients* ("**Consultation Paper 33-404**") are better suited toward developing a set of regulatory rules designed to combat conflicts of interest that may be perceived as resulting in tangible harm to investors. While AGF does have concerns with certain of the targeted reforms suggested under Consultation Paper 33-404 (as conveyed in our response letter dated September 28, 2016), we recognize certain merit within those reforms, and moreover implore the CSA to allow for that regulatory initiative to take shape and effect before making a broader assumption that there are additional "harms" being experienced by investors (within the embedded commission compensation model) that warrant even further regulatory intervention.

The CSA has expressed its view within the Paper that "*the discontinuation of embedded commissions could be complementary to recent reforms and proposals in that those existing and ongoing initiatives were not designed to, and may not fully address, the key investor protection and market efficiency issues*" identified in the Paper. **AGF challenges this presumption on the basis that (as supported above) the "risks for potential conflicts of interest" associated with embedded commission compensation should not be equated to "indications of actual harm", given that there does not appear to be any credible evidence suggesting that the existing compensation framework gives rise to any pervasive abuse.**

B. INVESTOR TRANSPARENCY & DISCLOSURE

In the Paper, the CSA indicated that its research shows that it is "*clear that the majority of Canadian fund investors are not aware of what they pay for financial advice or that they pay for financial advice at all*". In addition, the CSA has raised concern that "*investors' high level of trust and reliance on their advisors for investment decisions may cause them to not thoroughly* *review disclosure documents and reports, and thus limit the benefits to be derived from disclosure*".

With regard to transparency, AGF agrees with the expectation that investors should be aware of what they pay for financial advice. **AGF submits that investors are in fact made fully aware of the fees and commissions they pay when they invest.** This transparency has been enhanced by the CSA's recent CRM2 and Point of Sale reforms. Under CRM2, dealers must provide clients with annual reports which include disclosure of the total amount of trailing commissions in dollars and cents. And, with the Fund Facts documents (Point of Sale disclosure), investors are made aware of whether compensation is paid by the fund manager to the dealer, as well as the amount as a percentage of the client's investment. These initiatives have undeniably increased the level of transparency in relation to investment fund fees, and made the associated disclosure more prevalent than ever. In addition, AGF also acknowledges IFIC's proposals with respect to CRM3 to advance even further levels of transparency for investors. Again, the positive impacts of these current and future reforms must be given time to take shape.

Of all advised investors surveyed under the Gandalf Report, a noteworthy 62% were very satisfied with regard to their advisors' transparency about fees and commissions they pay to invest, and only 7% were very dissatisfied. **AGF suggests that it is therefore not transparency that is an issue.**

When it comes to disclosure, AGF respectfully disagrees with the CSA's assumption that investors may not be reviewing disclosure provided to them. According to the Gandalf Report, most investors said they read the details included in statements provided to them by advisors, financial institutions or fund providers about the fees and commissions they are charged: 53% said they read this information in every statement, and an additional 36% read that information occasionally. These percentages do not vary significantly between the advised and non-advised investors that were surveyed. **To this end, AGF submits that the intake of disclosure by investors also does not appear to be an issue.**

AGF concurs with the indicative and insightful statement made in the PwC Report that "*transparency, financial literacy and long-term relationships between advisors and investors are the ultimate assurance for a well-functioning financial advisory market, where interests of advisors and investors are aligned*". Evidence in the investment fund marketplace suggests that transparency and long-term relationships with advisors are already established to be in existence. What is therefore lacking from PwC's equation is investors' financial literacy.

The Gandalf Report provides recognition that while investors are fully informed (i.e. there is transparency) and they do in fact read disclosure, there is an inherent gap in commensurate knowledge/understanding about the fees and commissions they are charged. Most investors would appear to have at best a moderate level of knowledge about fees they pay in respect of funds they own: 38% said they were very knowledgeable, another 38% had a moderate level of knowledge, and 16% admitted they knew very little about the fees and commissions they pay. Few have heard a great deal about trailing commissions per se: only 13% of investors surveyed had heard a great deal about these commissions recently; 31% felt they had heard something; 28% very little; and 24% said they had heard nothing about these commissions. This does not mean that the embedded commission compensation framework is risky or harmful (or in need of discontinuance in favour of other compensation models under which investors' knowledge-level does not appear to have been proven to be more profound); it simply means that investors may need more tools to *understand* and *appreciate* the fees/commissions (and corresponding disclosure). The PwC Report even challenges that "*the increased transparency rules that were fully implemented in Canada in 2016 are capable of mitigating the fee information gap that existed prior to this legislation…we do not have yet empirical data to test the validity of the effectiveness of these rules in conveying fee information to investors…however, the relatively high education profile of Canadian investors and the fact that currently the majority of Canadian investors in mutual funds are informed support the hypothesis that Canadian investors would be able to understand information disclosed about their investments, even upon a cursory review of the statements sent to them*".

As a result of the foregoing, AGF encourages the CSA to focus ALTERNATIVE efforts on the "financial literacy" of investors. PwC's analysis suggests that existing reform, given more time to assess the impact, may already be impactful in bridging the financial asymmetry gap. In addition, the Gandalf Report indicates that 39% of all investors (including 42% of advised investors) have noticed improvements in the amount of information being disclosed to them in recent years. More time is clearly needed to allow for the positive impacts of transparency and disclosure to continue to be felt among investors, and assessed by the regulators. Nonetheless, in the event that more work is proven to be more imminently warranted in this area, AGF believes that the industry would be extremely supportive in working together with the CSA on developing tactical initiatives toward the advancement of financial literacy in the area of dealer/advisor compensation generally, and embedded commissions specifically.

AGF also urges the CSA to re-examine its position on the ALTERNATIVE of "enhancements to disclosure". Given that the data shows that investors do read disclosure, if investors are given the tools to increase their knowledge (the alternative indicated above) to be able to understand and interpret additional information to benefit from added/enhanced disclosure, this should be put back in contention as a plausible option for reconsideration by the CSA.

C. VALUE OF ADVICE

One of the most fundamental concerns associated with discontinuing the embedded commission compensation model is that investors will ultimately be impacted in a negative way – i.e. in contravention of the "investor protection" standard being advocated by the CSA. Perceptions of conflicts of interest and misconceptions around transparency and disclosure aside, research and data signals are leading to the unfortunate (and unintended) realization that **the CSA's proposal to discontinue embedded commissions would undermine the tenet of the "value of advice", and would create an "advice gap" to the detriment of investors**.

The PwC Report succinctly outlines the unintended consequences associated with the Paper's proposals: "*banning embedded commissions in Canada would likely lead to negative consequences for the mass-market investors in the form of: (a) less access to financial advice; (b) lower savings available at retirement; and (c) higher cost of advice for those who would want to continue receiving financial advice*". This clearly would be a negative outcome for investors, and underscores the critical need for the CSA to focus efforts on analyzing these adverse consequences.

The PwC Report makes it clear that the repercussion of discontinuing embedded commissions is that "*advisors who serve mass-market investors will not find it economically worthwhile to continue to serve some of those clients, if they are forced to reduce their fee significantly below what they currently receive from embedded fees…in those cases, mass-market investors who wish to continue being served by a financial advisor will find the cost of advice higher as a result of the need to compensate for the dis-economies of scale involved in serving smaller accounts*".

The recent MFDA Client Research Report[4] (the "**MFDA Report**") identifies that notwithstanding deposit taking firms are responsible for servicing the majority of MFDA Member households, financial advisory firms do still form a significant part of the industry – servicing 2.36 million mass market households. The MFDA Report contends that financial advisory firms would be the most likely to experience an impact from a ban on embedded compensation. The MFDA Report provides that (i) "*approximately 56% of advisors licensed with financial advisory firms have small books of business and primarily rely on DSC commissions to finance their operations*"; and that (ii) "*mass market clients are more likely to purchase DSC funds and therefore are also more likely to experience an impact from discontinuing embedded commissions*". This is clearly an unintended consequence that would result from the proposals in the Paper.

Fee-based compensation arrangements in Canada require minimum size portfolio assets – and, many investors who currently use an advisor simply do not meet the $100,000-$300,000[5] threshold. Aside from the investable asset threshold limitations, advised investors (as evidenced in the Gandalf Report) also appear to have a clear preference to pay for advisory services indirectly (out of the funds they buy, and with the payment made by the fund provider or financial institution) as opposed to paying directly by way of a payment (cash, cheque, bank payment or credit card): 55% (indirect) versus 33% (direct).

Based on survey data from the Gandalf Report, 24% of all investors surveyed expressed that if mutual funds no longer had embedded commissions paid from the funds (and advisors instead charged for advice and service directly), they would be less likely to seek out advice from an advisor. In addition, for this subset of investors who would be impacted by the "advice gap", such investors are expected to ultimately save less for their futures. The PwC Report suggests that "*those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice*" (i.e. the "wealth gap").

AGF maintains that the advice and wealth gaps articulated above should not be overlooked or downplayed. AGF believes that investors' access to advice, and their incentives to invest,

[4] "MFDA Client Research Report: A Detailed Look Into Members, Advisors and Clients" (May 23, 2017) by the Mutual Fund Dealers Association of Canada.

[5] PWC Report – p.52.

should be protected – not only to the benefit of those individuals, but also in an effort to continue to propel Canada's socio-economic expectations and priorities.

The importance and value of advice lies at the foundation of the Canadian financial marketplace. Academic research, as cited in the PwC Report, confirms that *"while financial advisors are not able in their investment choices to consistently beat relevant market benchmarks after fees, their advice generates significant net benefits to investors in terms of a more disciplined savings behaviour, overall higher asset values, more efficient tax planning, and retirement confidence"*. Investors trust and rely upon advisors to guide them with respect to financial decision-making. Of the investors surveyed under the Gandalf Report, nearly half (48%) said that they rely on advisors to help them with most or all of their investment decisions. Further, a large majority (79%) of investors surveyed under the Gandalf Report agreed that advisors play a very important role in encouraging people to start saving and investing; and 77% concurred that advisors can mean the difference between investors meeting and missing their financial objectives. When it comes to overall satisfaction, it is also important to note that a striking majority (70%) of advised investors surveyed under the Gandalf Report expressed high satisfaction levels with their financial advisors.

All of this evidence and research points to the critical importance of access to advice for the Canadian investing public. The above-noted unintended consequences associated with discontinuing embedded commissions will undoubtedly result in Canadians being deprived of a resource (financial advice) that they clearly rely upon heavily.

AGF also cautions the CSA from relying upon robo-advice and other passive investing options as a panacea to resolving an advice gap that would be caused by banning embedded commissions. AGF agrees with The Investment Funds Institute of Canada's ("**IFIC**") reasoning that the widespread use by mass market investors of online advice and passive investment strategies "*has yet to weather a full market cycle*", and therefore should not be conveyed as a preferred alternative for investors. Similarly, with regard to passive investing, AGF echoes the view of IFIC that while active and passive investing can/should co-exist in the Canadian financial marketplace to meet the varying needs and interests of investors, the regulators "*need not 'tip the scale' in favour of one product of another…in fact, doing so may result in unintended consequences*".

AGF also points the CSA to recent research data published by HSBC[6] which revealingly reported that of 1001 Canadians represented in the survey, only 7% said that they're likely to trust recommendations delivered by a robo-advisor, and only 18% felt that rob-advisors would be able to offer more accurate advice than human advisors. Canadians clearly are not at the forefront of embracing this sort of technology-driven advice channel. As a result, the CSA should not place strong reliance on robo-advice to counteract the negative effects of banning embedded commissions.

[6] "Trust in Technology" Report (May 2017) commissioned by HSBC.

D. Preserving Investor Choice

In the Paper, the CSA articulated an anticipatory recognition of the impact of discontinuing embedded commissions on independent investment fund manager stakeholders: "*independent investment fund managers will still be at a disadvantage as they may not be able to gain access to those firms with closed, proprietary only, product shelves*". AGF submits that this outcome would only prove to be detrimental to investors. **Availability of investment choice should be at the forefront of any regulatory initiatives aimed at protecting investor interests. Moreover, AGF contends that in implementing any associated regulatory reforms, it is vital that the CSA ensure that they do not produce outcomes that limit or reduce investment choice and access to affordable investment advice.**

Presuming, as the CSA suspects, that the proposals in the Paper could have the effect of narrowing product shelf offerings, AGF submits that this adverse outcome would reduce the diversity of investment products available for investors. AGF accordingly argues that this is not beneficial to investors, nor can it be viewed as being in the best interest of investors.

AGF urges the CSA to expand the scope of its analysis toward improving avenues for open architecture (versus closed product shelves) within distribution channels in an effort to safeguard investor choice. Moreover, AGF agrees with IFIC's assertion (as supported by the PwC Report) that banning embedded commissions will only "*further concentrate the market for investment products and services by favouring scale and affiliated vertically integrated financial institutions….the end result will be a market with less choice, less access and less competition*". None of these outcomes best serves investor interests. AGF suggests that by instead targeting avenues for change within the captive sales force/closed distribution networks, the CSA could effectively negate any disruption that would otherwise be felt by pursing the proposals set out in the Paper.

Foreign Jurisdiction Experience

Notwithstanding the CSA's position in the Paper that "*while observations about the impacts of relevant reforms in other jurisdictions are informative and insightful, we* [the CSA] *consider that the potential impacts from similar reforms in Canada might not be the same*", AGF believes that the determinations and experiences from foreign jurisdictions must be reviewed with a lens toward informing the Canadian financial marketplace about comparative jurisdictional similarities and/or rationale for action (or no action).

Analysis recently published by IFIC[7] reveals a number of significant trends that should not be disregarded by the CSA in assessing the proposal to discontinue embedded commissions:

1. **Few jurisdictions have banned embedded commissions**

"*The option of banning embedded commissions has been evaluated by securities regulators in many jurisdictions. Only four (Australia, the Netherlands, the U.K. and South Africa) have opted to proceed. In three of these countries, the decision to ban embedded fees was triggered*

[7] "Global Regulatory Developments and Impacts" Report (April 2017) by The Investment Funds Institute of Canada.

by unique local circumstances. In both the U.K. and the Netherlands, a commission ban was introduced following a number of miss-selling scandals in the insurance and mortgage sectors. The Australian reforms were established in reaction to the collapse of three major financial firms.

Securities regulators and governments in seven countries have explicitly ruled out a total ban on embedded commissions (Denmark, Ireland, Sweden, Hong Kong, Germany, New Zealand and Singapore).

In all, only 13% of total worldwide mutual fund assets of $39.4 trillion are covered, or slated to be covered, by a ban on embedded commissions."

2. Early evidence of unintended consequences

While the IFIC report acknowledges that "*it is too early to evaluate success in the markets that have made sweeping changes*, the report also contends that *early evidence can serve as a guide to other regulators that are considering similar changes*". In the United Kingdom, for example, the Financial Advice Market Review (FAMR) has found that accessibility to financial advice "*has been reduced such that advice is primarily available and affordable only for the more affluent*".

3. Enhanced disclosure is the favoured regulatory option in most jurisdictions

"*The majority of markets have made enhanced disclosure a key element of newly developed financial principles and policies. Enhanced disclosure initiatives have been implemented in every country reviewed except the U.S. The majority of disclosure has come in the form of detailed information on fees and commissions to improve transparency.*"

AGF disputes the proposition that Canada's circumstances are so unique as to warrant special consideration for the banning of embedded commissions. As expressed throughout this letter, no evidence has been presented by the CSA to suggest that Canada's investors are experiencing <u>actual</u> harm associated with the embedded commission compensation model. In fact, Canada-specific data instead suggests that the unintended consequences associated with a ban would far outweigh any perceived benefits to investors.

As articulated throughout this letter, AGF maintains that there is <u>no investor demand for the discontinuance of the embedded commission compensation model in Canada</u>. The Gandalf Report independently suggests that "*there is limited dissatisfaction with the current system of financial advice in Canada and the way advisor compensation is calculated*". To that end, AGF strongly encourages the CSA to reconsider its views expressed in the Paper.

For over 60 years, AGF has had the privilege of serving Canadian retail mutual fund investors, and has been fortunate to be able to sustain its independence in an increasingly global and consolidating environment. As a result, AGF is a fierce proponent of the principles of investor "options and choice", and believes that securities regulators should strive to sustain such principles in all aspects of regulatory reform. AGF does not believe that "investor protection" reforms should be subjectively advanced where: (i) there is no

evidence that embedded commissions are innately harmful to investors; (ii) the unintended consequences from such reforms will invariably undermine investor interests (limiting investor choice, as well creating an "advice gap" and "wealth gap" for investors); and (iii) there is limited investor "call to action". The expected disruption to the industry (which will inevitably cascade down to investors in the form of less access to investment choice and financial advice) is, in AGF's view, an extremely high price to pay for very little upside advancement in improving investor outcomes.

Notwithstanding our principled (and data-supported) view that the current system is not broken, nor is it riddled with inherent risk of harm for investors, AGF does accept that there is room for certain improvements within the realm of compensation awareness within the investment fund industry. Certain of our proposed **ALTERNATIVES** (with respect to re-focusing efforts on **financial literacy** and **enhanced disclosure**) have been identified above. AGF also submits that the following **ADDITIONAL ALTERNATIVE REFORMS** (as raised and further explained in IFIC's response letter) may warrant further analysis:

- **With investor agreement, allow for dealer fees to be paid by investment fund managers out of redeemed fund units/shares**
- **Allow for Series A (or equivalent) units/shares to be sold only in channels where advice is permitted**
- **Allow DSC funds to be available only within established guidelines (i.e. suitable, given the client's age or time horizon)**
- **Simplify pricing, and standardize naming conventions for fund series**

We thank you for the opportunity to raise the above issues with you. We look forward to continued constructive dialogue with respect to the optimal methods for improving the experience of investment fund investors in relation to the compensation payments they make to dealers and their representatives.

Yours very truly,

AGF INVESTMENTS INC.

Per: ____________________
Blake C. Goldring
Chairman

APPENDIX A
GANDALF REPORT

INCLUDES COMMENT LETTERS

The Canadian Investors' Survey

An Opinion Research Study on Fees & Advisory Services

May 30, 2017

the gandalf group

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Introduction & Methodology

The following is a report on a survey of Canadian investors conducted on behalf of AGF Investments Inc. The survey was designed to probe into issues relating to individual investors, the advisory services industry, fund providers and regulators, including:

- Satisfaction with advice, fees, transparency & investment options
- The role of advisors & strengths, weaknesses
- Perceptions of fee disclosure, transparency and new reporting obligations
- Awareness & assessments of various types of commissions & fees, notably trailing commissions
- Preferences for advisor compensation: e.g. fee-based or commission-based charges

The survey was designed by the Gandalf Group Inc., a Toronto-based consultancy that specializes in survey research and other quantitative/qualitative research methods. The Gandalf Group has extensive experience conducting research with specialized audiences both in respect of financial services and customer satisfaction as well as public policy development and regulation. For more about the firm, please visit GandalfGroup.ca or to inquire about this work contact info@gandalfgroup.ca or 416-644-4120.

Methodology

Survey interviews were completed online between April 7th and May 5th, 2017, and offered in both English and French. The core sample of 1299 investors that forms the basis for the findings was drawn from a larger general population sample of survey respondents; a sample that was representative of the Canadian adult population online (e.g. with respect to age, gender, region) using quotas and weighting where necessary. As a result, we can derive a profile of the Canadian individual investor population relative to the general population.

To be deemed an investor for the purposes of this project and to qualify for the survey, a respondent had to meet basic criteria:

- share responsibility or be the sole decision-maker for household investments;
- own stocks, mutual funds or exchange traded funds, identifying amount they had invested/Assets Under Mgt. in that case;
- and not be employed in the financial services industry.

This investor population represents 39% of the Canadian adult population surveyed online.

The core sample size of this study (n=1299) is sufficiently large to allow comparisons with a fair amount of reliability between the views of small portfolio investors (i.e. <$50,000 invested in funds, bonds, stocks etc., not including real estate or workplace pension plans), and other investors with a medium-sized portfolio (up to $250,000) or greater (e.g. including high-net-worth investors with at least $500,000).

This report focuses on the “Total” population of investors (i.e. n=1299 survey interviews,) as well as key subgroups within the total pool of investors where noted, including:

- Advised investors, those who use an advisor to help make some or most investment decisions (79% of investors surveyed)
- Non-advised investors, those who say they don’t receive any advice (20% of investors)
- Low Net-worth/small investors (less than $5o,000 invested – 35% of investors)
- Mid to High Net-worth investors ($50,000 to $250,000 – 38% of investors; $250,000 to $500,000 - 16%)
- High Net-worth ($500,000+ - 11% of investors)
- High-knowledge/Sophisticated investors – i.e. those who rated themselves as very knowledgeable about investing vs. those with less or a low-degree of knowledge.
- By advisor type – i.e. those who rely on different types of advisors, planners, brokers and other professionals or services, based on the firm, institution or service they work with, including:
  1. Independent (A financial advisor or planner at an independent investment brokerage or planning firm) (28% of investors)
  2. Advisor with a bank or credit union (An advisor/representative at a bank branch - 45% of investors OR at a credit union - 13%)
  3. Bank brokerage (An advisor at bank brokerage firm – 23% of investors)
  4. Insurance (An insurance agent - 17% of investors)
  5. Counsellor (An Investment Counsellor or Portfolio Manager – 17%)
  6. Robo (Digital or “robo”- advisor – 7% of investors)

To better understand two of the smaller niches of advice types, we conducted an oversample (n=100, in addition to the n=1299 core sample) among those who receive advice from a credit union and from a “robo”-advisor, to augment the proportions working with each and to study each group with more reliability.

Executive Summary

The Role of Advisors

- Most Canadian investors surveyed said they rely on advisors at least somewhat when it comes to helping with decisions about their portfolio. Nearly half said they rely on advisors to help make most or all investment decisions with them.
- Those who go without advice tend to be younger or see themselves as relatively knowledgeable investors.
- However, most investors (including most non-advised investors) agreed that advisors can mean the difference when it comes to achieving financial objectives and play an important role in encouraging people to start saving and investing.
- Advised investors were more satisfied than other investors when it came to satisfaction with investment performance and the range of investment choices available to them.

Satisfaction

- When it comes to overall satisfaction, a clear majority of advised investors gave their advisors very positive ratings. Across various aspects of the advisor relationship, the proportion of advised investors that were very dissatisfied with the service or advice they received was less than 10%.
- A small proportion of all investors surveyed (22%) raised the issue or potential of conflict of interest when it comes to commissions as a top-of-mind weakness of advisors. However, most advised investors gave very high satisfaction ratings to their advisors when it comes to providing unbiased advice, being transparent about fees and helping manage costs of investing.

Disclosure & Reporting

- Most investors read their statements at least occasionally; half said they read every statement. Most said they were satisfied with the information they receive from their advisors, fund providers and financial institutions.
- A significant proportion (39%) has noticed improvements in the amount of information disclosed in their statements in recent years.

Fees & Trailing Commissions

- While the cost of fees may be a top-of-mind concern for some investors, the way in which advisors are compensated appears to be less of a concern for most.
- Investors agreed there was a potential for conflicts of interest relating to these types of commissions, however a larger majority of advised investors believed their advisors were concerned about the performance of their clients' portfolios.
- Less than half of investors are very familiar with the range of fees and commissions they are charged. Many claim to be somewhat familiar with the type of fees and commissions they pay.
- And there is only moderate awareness of trailing commissions per se – about half have heard very little or nothing about them. This suggests there is neither a high degree of concern about these commissions nor strong support for this advisor compensation.
- However, when a brief explanation of these commissions was provided to respondents, most said they considered them to be acceptable and no different than other forms of advisor compensation. Those who considered themselves to be relatively knowledgeable about investing were in fact more likely than others to say trailing commissions were acceptable.

Advisor Compensation Options

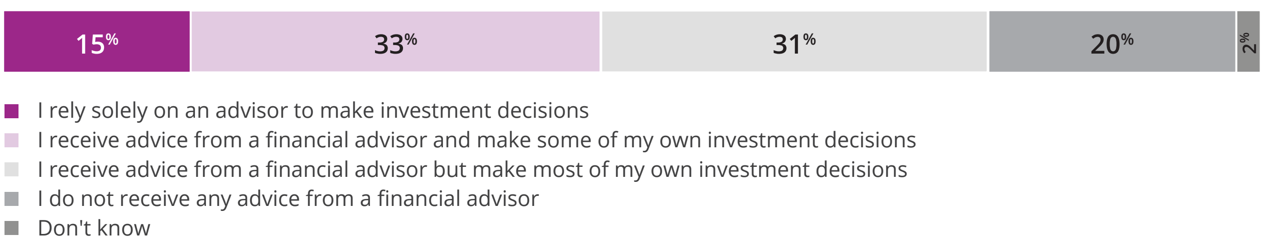
- Investors surveyed tended to express a preference for fees that are based on investment value/ performance rather than on service provided and hourly rates.
- Investors expressed an even clearer preference for having advisors' fees deducted from their portfolios rather than paid as a result of a direct charge or invoice to the client, payable by credit or other means of payment.
- While some said that a move to eliminate trailing commissions might make them more likely to seek out financial advice, a comparable proportion (about 1 in 4) said they would be less likely to seek out professional advice if trailing commissions were replaced by a fee-for-service model of payment to advisors.

Detailed Findings

Assessing the Performance & Importance of Advisors

Most Canadian investors surveyed said they rely on advisors to help with at least some financial decision-making; nearly half said they rely on them to help with most or all their investment decisions.

Table 1



Advised investors tend to have more assets invested than non-advised investors.

- The non-advised investor tends to have less invested: half have less than $50,000.
- 32% of advised investors have less than $50,000 invested.

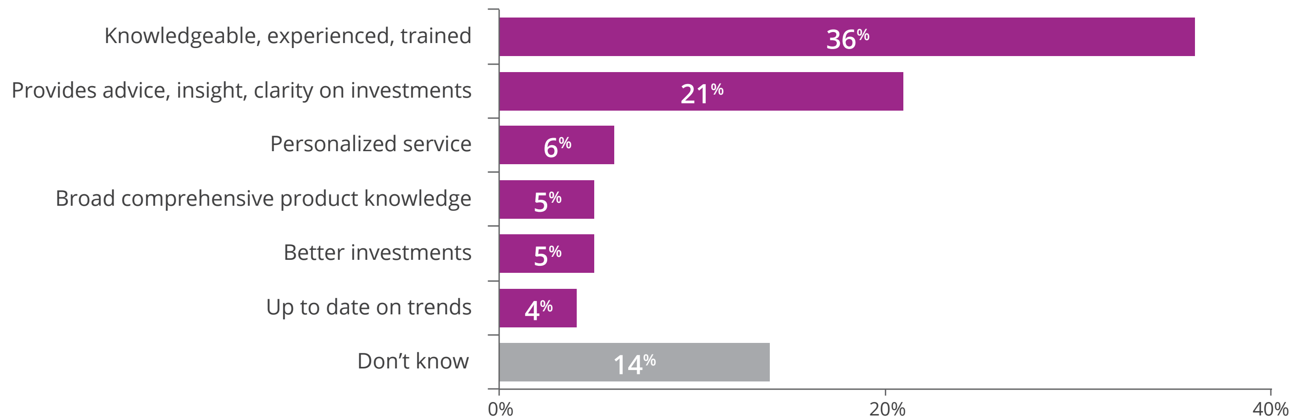
Both groups report relative similar levels of knowledge about investing. Only about 4 in 10 of both groups said they considered themselves very knowledgeable about investing.

Most investors said they were likely or certain to seek out the services of a financial advisor in the next year (53%) and another 22% said they possibly would. Only 17% were unlikely or certain not to.

Those who were less likely to seek the advice of an advisor tended to say the reasons involved a preference for self-directed online approaches (41%) or that they no longer wanted outside advice (29%). Fewer (24%) said they no longer wanted to pay an advisor and 16% said they simply would not be investing in the near future.

Investors see the upside of financial advisors. They identified many advantages that advisors provide; knowledgeable, trained, can give insightful advice and clarity.

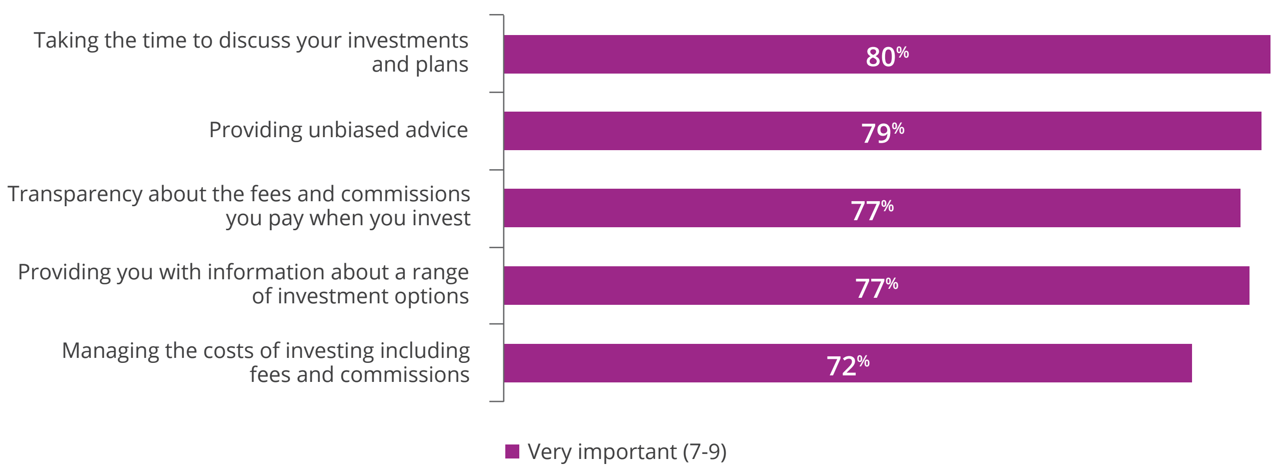
Table 2



"What is the biggest advantage that a financial advisor provides an investor?"
***Responses >4%**

Advised investors have very high expectations of advisors on a range of deliverables. Providing unbiased advice and being transparent about fees is as important as taking the time to understand clients' needs and helping to keep costs low *(See table 3)*.

Table 3

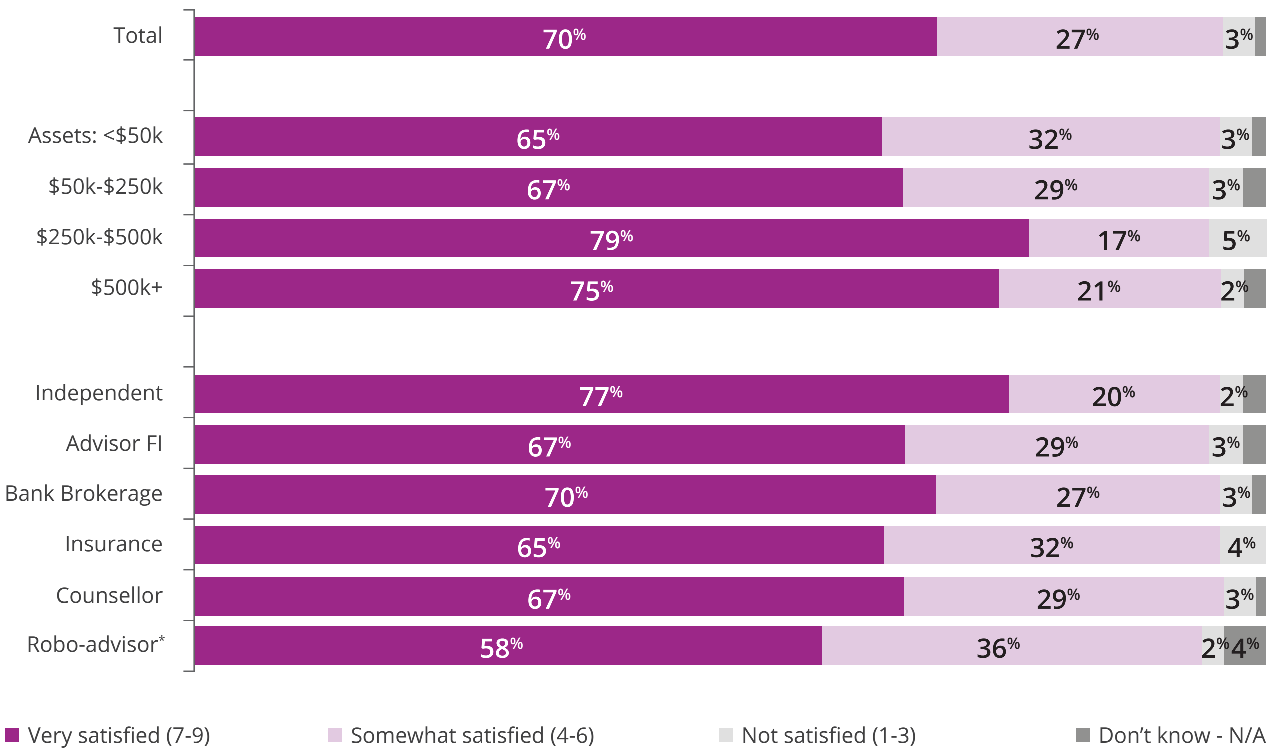


"When it comes to services a financial advisor could provide, how important are each of the following to you?" (Among advised investors only, n=1041)

When it comes to overall satisfaction, a clear majority of advised investors gave their advisors positive ratings. While satisfaction is lower among those with relatively less invested, a clear majority of all advised investors in all asset groups give their advisors very high satisfaction ratings. Those working with a financial advisor or planner at an independent investment brokerage or planning firm tended to give significantly higher ratings on average than others.

Advised investors were also more satisfied than other investors when it came to satisfaction with investment performance and the range of investment choices available to them.

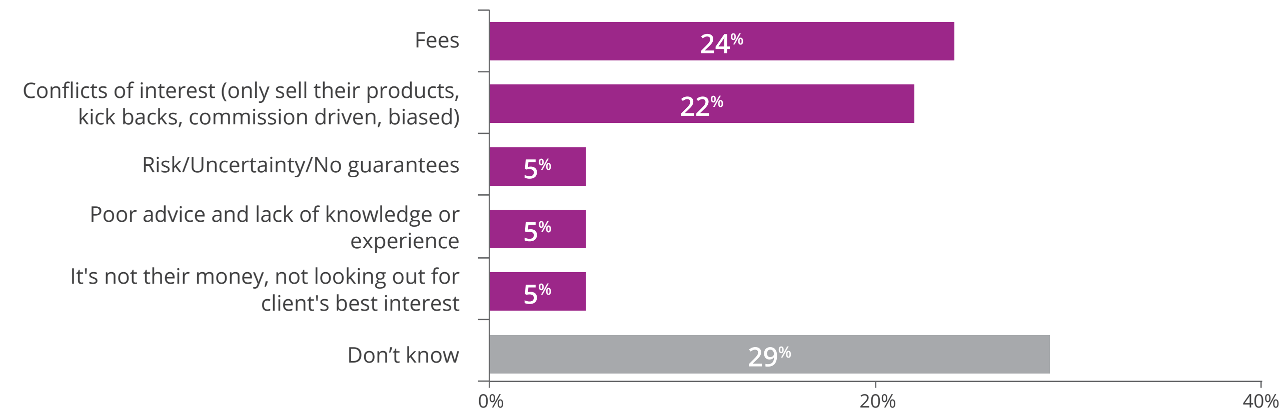
Table 4



"Taking everything into account, how satisfied are you with your financial advisor?" (Asked of those with advisors, n=1041)
***"Taking everything into account, how satisfied are you with your digital or "robo" advisor?"**
Subsample: Those with a "robo" advisor n=123

When asked about weaknesses, minorities mention fees (24%) and conflicts of interests such as those raised either by commissions or proprietary products they are inclined to sell (22%) *(see table 5)*.

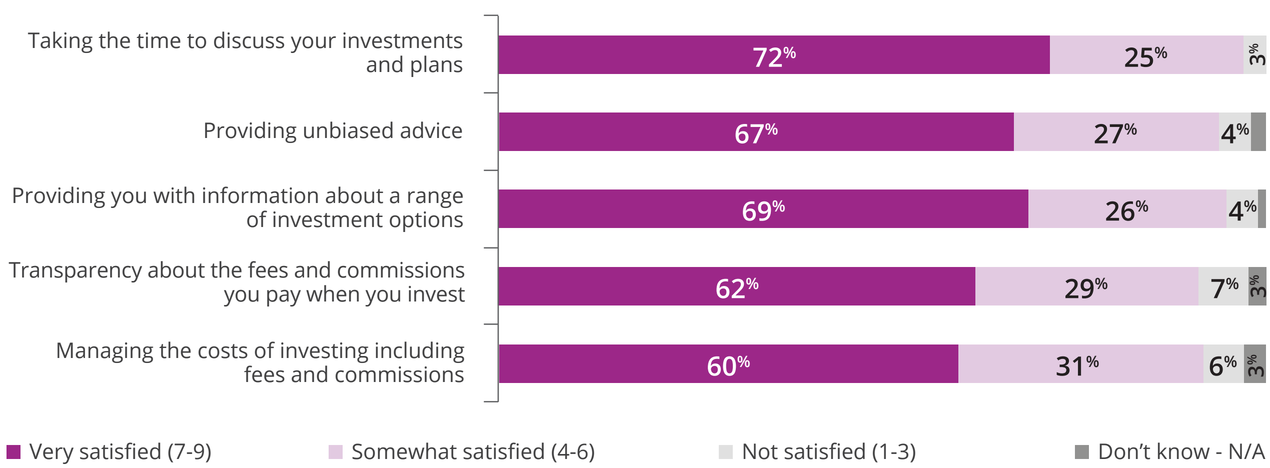
Table 5



"What is the biggest weakness of financial advisor when it comes to the services they provide?"
(Among all investors, n=1299) *Responses >4%

While a proportion raised conflict of interest or self-interest as a top-of-mind weakness of advisors, most advised investors gave high satisfaction ratings to their advisors when it comes to providing unbiased advice, being transparent about fees and helping manage costs of investing *(see table 6)*.

Table 6



"How satisfied are you with your financial advisor when it comes to offering or doing each of the following?"
(Asked only of advised investors, n=1041)

Advised investors were more likely than other investors to be satisfied with the choice in investment products available to them and the returns they receive on investments *(see tables 7 & 8)*.

- 58% of "advised" investors were very satisfied with the amount of choice in investment products available to them vs 36% among non-advised.
- 46% of "advised" investors were very satisfied with the rate of return on their investments compared to only 29% among the non-advised.

Advised investors are also more satisfied than those without advisors with:

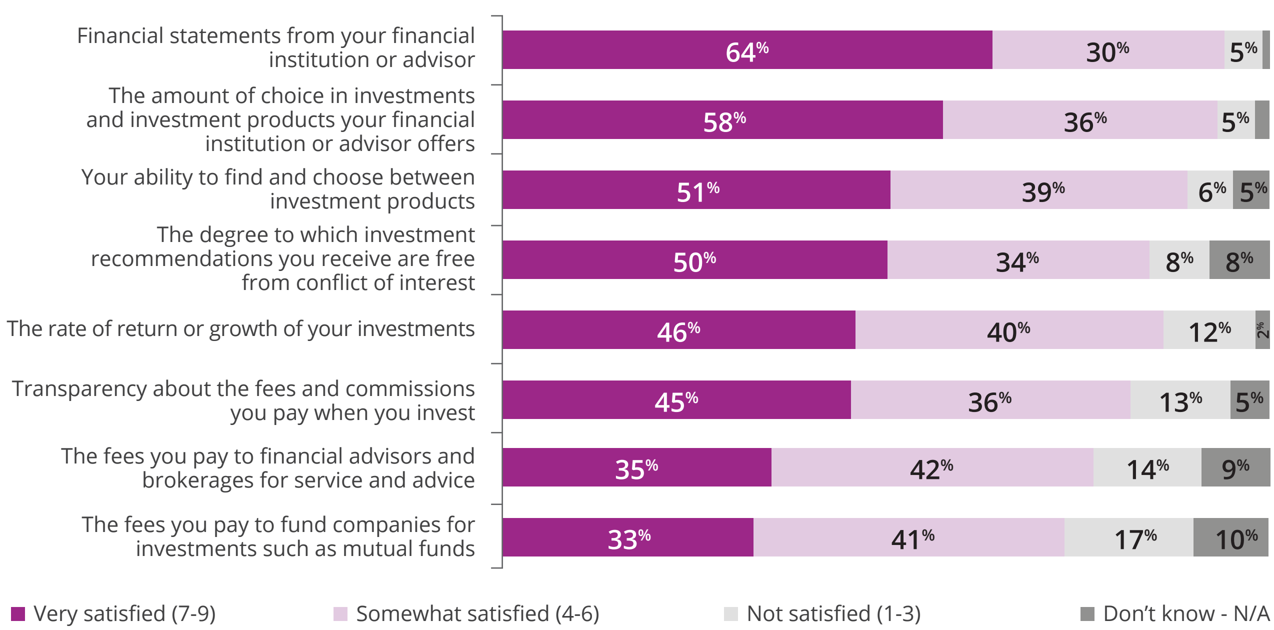
- The degree to which recommendations are free from conflict of interest
- Fees paid to fund companies and for advice services.

Above all, advised investors are most satisfied with the financial statements provided to them by their advisors and financial institutions.

- 64% are very satisfied with the financial statements they receive

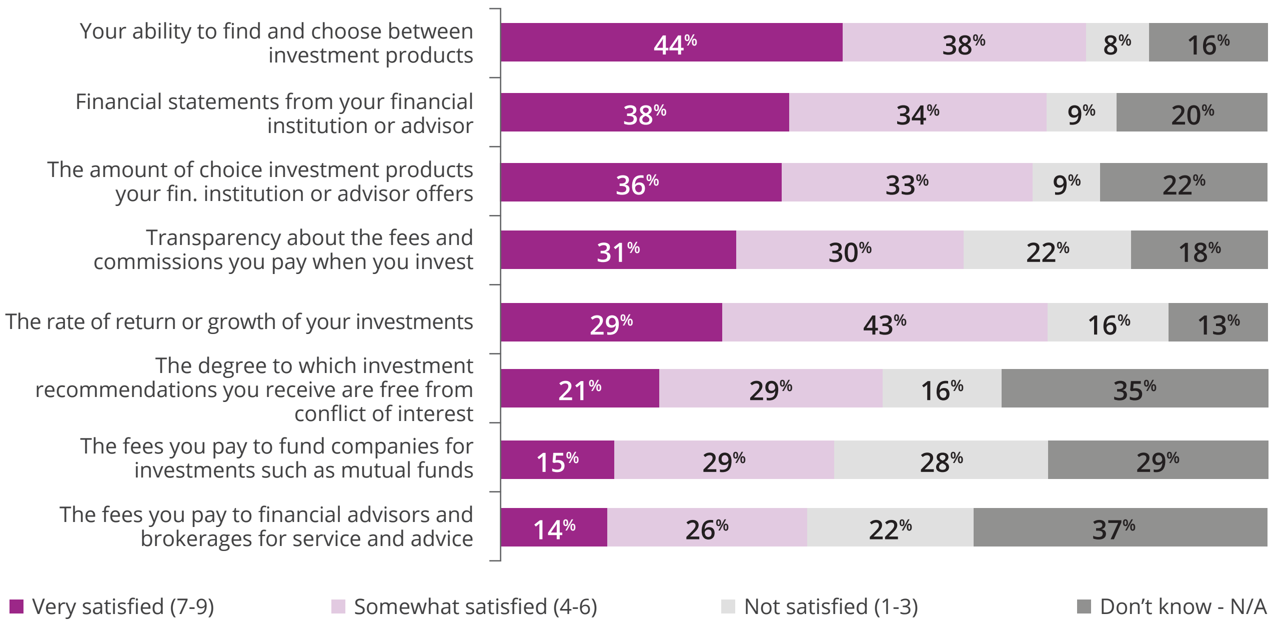
While there is dissatisfaction with the fees they pay only 14% of advised investors are very dissatisfied with the fees paid to brokerages and advisors. Advised investors are relatively satisfied with the transparency around those fees (45% are very satisfied with transparency around the fees they pay, and only 13% are very dissatisfied – *see table 7)*.

Table 7 – Advised Investors



"How satisfied are you with each of the following?" (Among advised investors, n=1041)

Table 8 – Non-Advised Investors



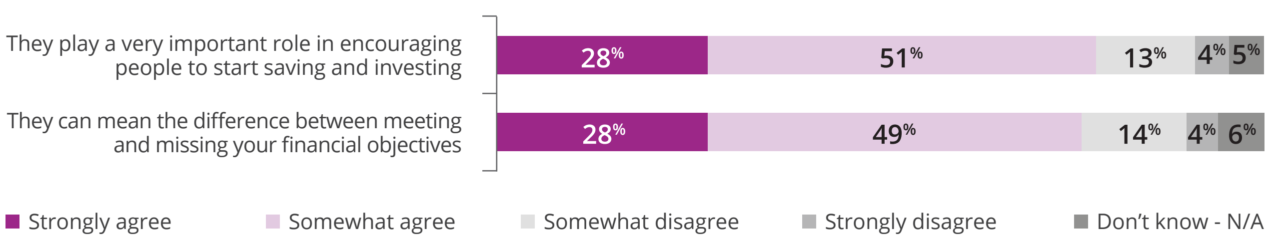
"How satisfied are you with each of the following?" (Among non-advised investors, n=258)

High net-worth investors and more knowledgeable investors were more likely than others to be satisfied with fees, statements, investment recommendations, and fee transparency.

Yet even small investors (lower net-worth) tended to be more satisfied than not with advisors' services and their performance on key ratings.

Most advised investors (79%) agreed that advisors play a very important role in encouraging people to start investing and most agreed they can mean the difference when it comes to reaching financial objectives.

Table 9

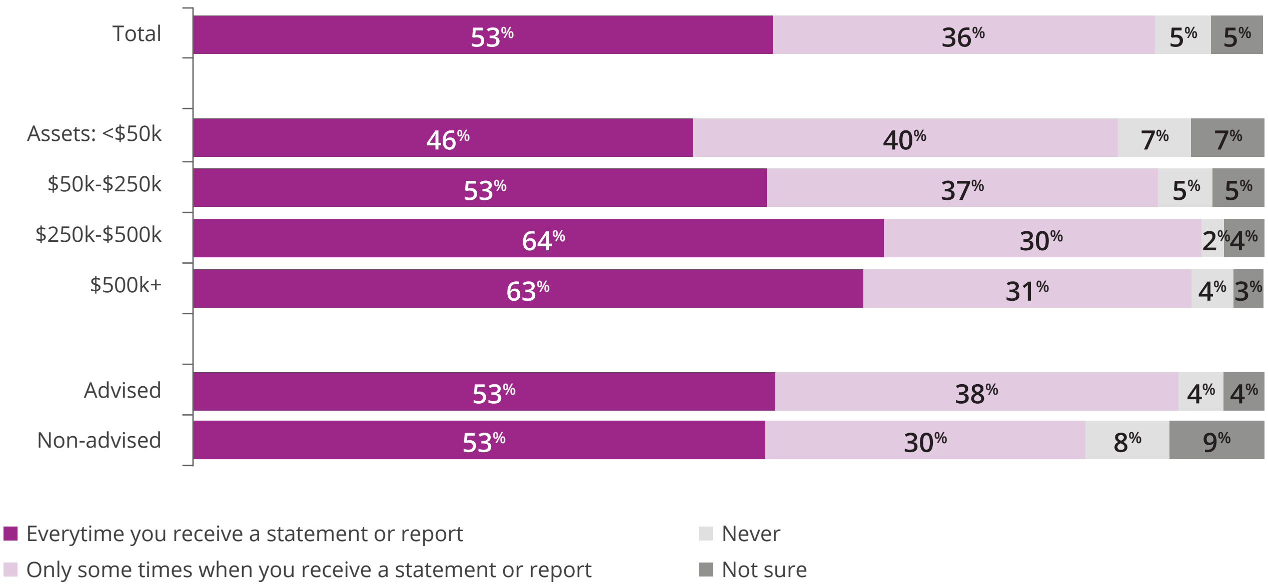


"How much do you agree or disagree with each of the following statements about financial advisors?" (Among all investors, advised and non-advised n=1299)

Assessments of Disclosure & Reporting Provided to Investors

Most investors said they read the statements provided to them by advisors, financial institutions or fund providers about the fees and commissions they are charged: 53% said they read every statement. The proportion that does is higher among those with at least $250,000 invested.

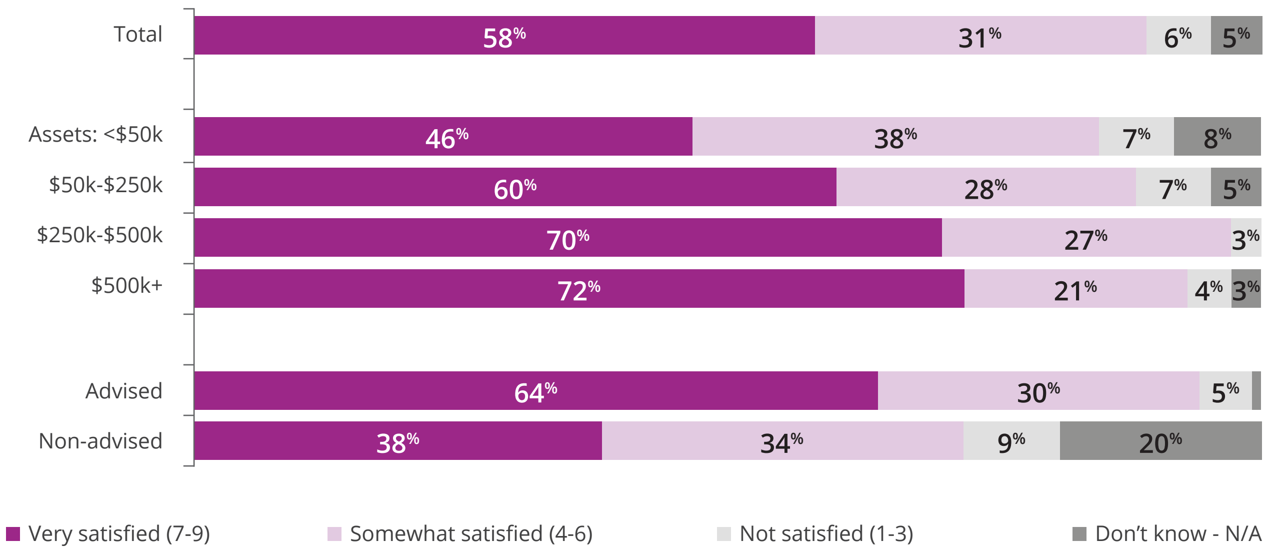
Table 10



"How frequently do you review the information disclosed in statements your receive from your financial institution and advisor(s) about fees and commissions you are charged for owning mutual funds and similar investment products?" (Among all investors, n=1299)

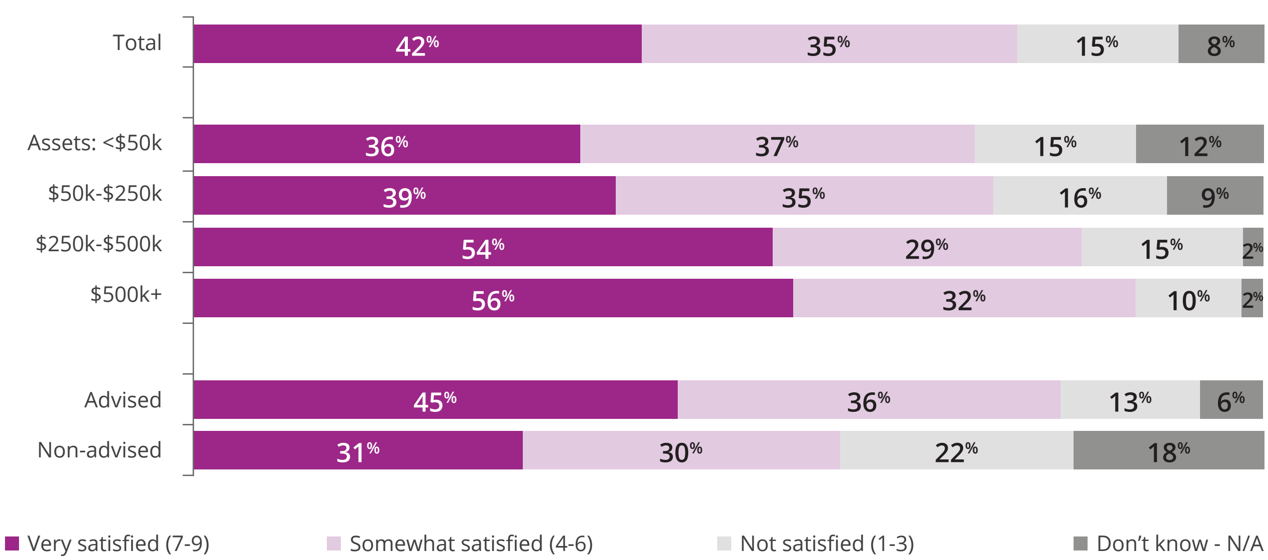
Most investors said they were very satisfied with the information they receive from their advisors and financial institutions overall. They were not as strongly satisfied with transparency around fees and commissions they pay, although the level of strong dissatisfaction was 15% of all investors and satisfaction was relatively higher among advised investors and among those with at least $250,000 invested.

Table 11



“How satisfied are you with each of the following: Financial statements from your financial institution or advisor” (Among all investors, n=1299)

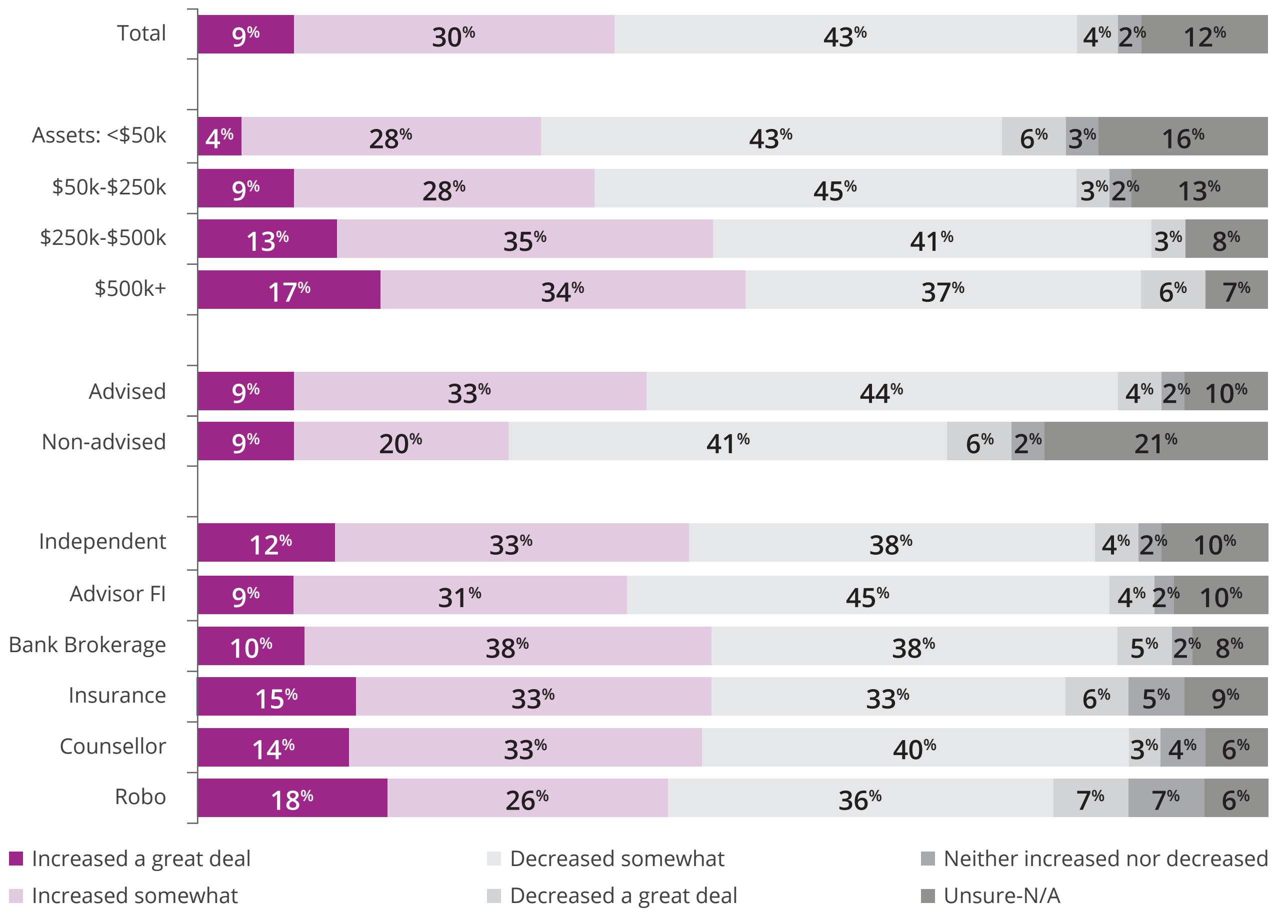
Table 12



“How satisfied are you with each of the following: Transparency about the fees and commissions you pay when you invest” (Among all investors, n=1299)

While few have heard a great deal about new industry rules that require improved disclosure to customers, just over half have heard at least something about this and a significant proportion (39%, *see table 13*) has noticed improvements in the amount of information their statements have disclosed to them in recent years. Advised investors are more likely to have noticed improved reporting, disclosure and statements. The degree of awareness of improved reporting and disclosure is not so much associated with the type of advisor an investor has (and the institution or firm they work with) as it is with the amount they have invested.

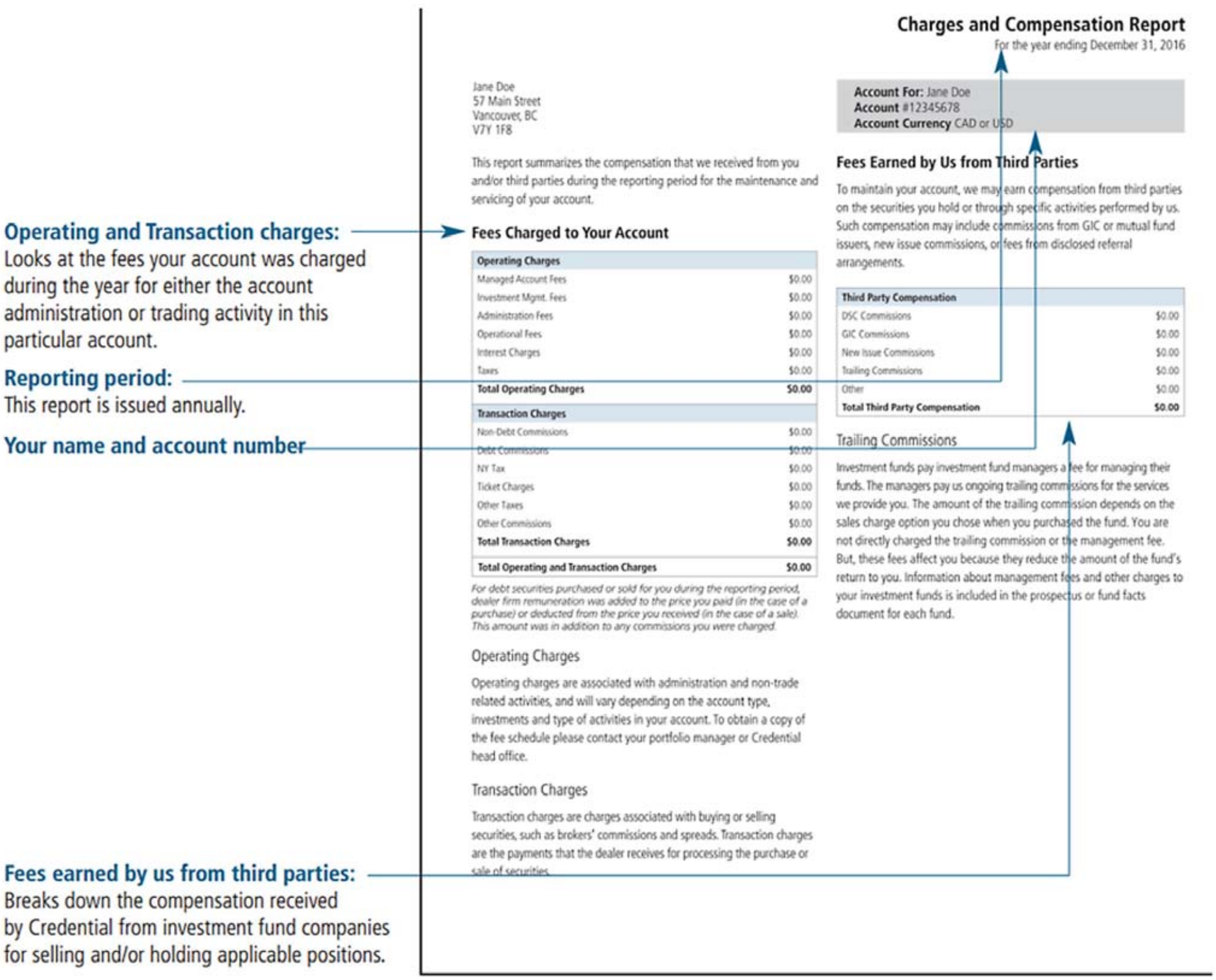
Table 13



"Over the past three years, would you say that the amount of information disclosed to you in statements, reports or purchasing and offering documents by your financial institution or advisor about fees and commissions you are charged for mutual funds and similar products you own has...increased/decreased a great deal/somewhat?"
(Among all investors, n=1299)

Survey respondents were provided with a description of recently mandated disclosure requirements and a visual sample of how a standard statement discloses fees advisors earn from fund providers, financial institutions and third parties *(see table 14 below)*.

In 2016, new rules developed by Canadian investment industry regulators required that investors receive adequate information about how their investments are performing and what they cost. Financial advisors and institutions must provide an annual Performance Report, an annual Charges and Compensation report and a regular summary of how much financial advisors, firms or institutions receive from you and from third parties for servicing of your account. You can see a sample of this reporting below: "



Charges and Compensation Report
For the year ending December 31, 2016

Jane Doe
57 Main Street
Vancouver, BC
V7Y 1F8

Account For: Jane Doe
Account #12345678
Account Currency CAD or USD

This report summarizes the compensation that we received from you and/or third parties during the reporting period for the maintenance and servicing of your account.

Fees Charged to Your Account

Operating Charges	
Managed Account Fees	$0.00
Investment Mgmt. Fees	$0.00
Administration Fees	$0.00
Operational Fees	$0.00
Interest Charges	$0.00
Taxes	$0.00
Total Operating Charges	**$0.00**
Transaction Charges	
Non-Debt Commissions	$0.00
Debt Commissions	$0.00
NY Tax	$0.00
Ticket Charges	$0.00
Other Taxes	$0.00
Other Commissions	$0.00
Total Transaction Charges	**$0.00**
Total Operating and Transaction Charges	**$0.00**

For debt securities purchased or sold for you during the reporting period, dealer firm remuneration was added to the price you paid (in the case of a purchase) or deducted from the price you received (in the case of a sale). This amount was in addition to any commissions you were charged.

Operating Charges

Operating charges are associated with administration and non-trade related activities, and will vary depending on the account type, investments and type of activities in your account. To obtain a copy of the fee schedule please contact your portfolio manager or Credential head office.

Transaction Charges

Transaction charges are charges associated with buying or selling securities, such as brokers' commissions and spreads. Transaction charges are the payments that the dealer receives for processing the purchase or sale of securities.

Fees Earned by Us from Third Parties

To maintain your account, we may earn compensation from third parties on the securities you hold or through specific activities performed by us. Such compensation may include commissions from GIC or mutual fund issuers, new issue commissions, or fees from disclosed referral arrangements.

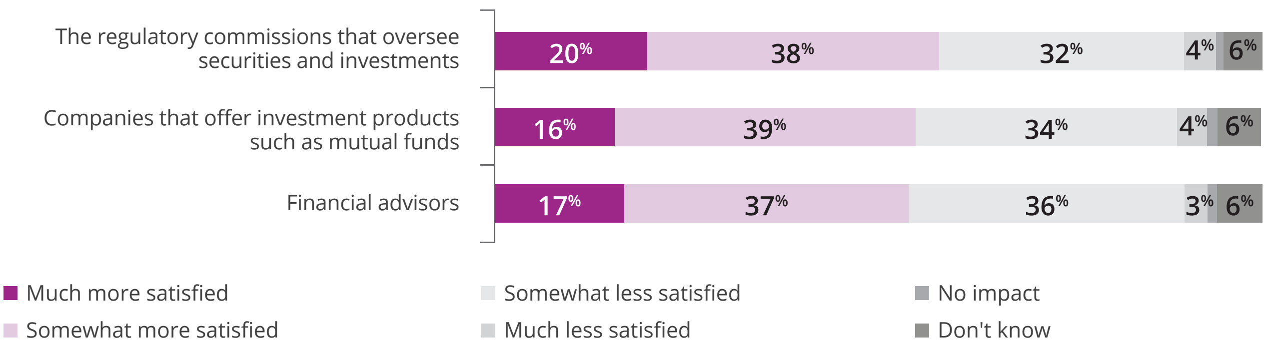
Third Party Compensation	
DSC Commissions	$0.00
GIC Commissions	$0.00
New Issue Commissions	$0.00
Trailing Commissions	$0.00
Other	$0.00
Total Third Party Compensation	**$0.00**

Trailing Commissions

Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions for the services we provide you. The amount of the trailing commission depends on the sales charge option you chose when you purchased the fund. You are not directly charged the trailing commission or the management fee. But, these fees affect you because they reduce the amount of the fund's return to you. Information about management fees and other charges to your investment funds is included in the prospectus or fund facts document for each fund.

Familiarity with these new requirements was low: 14% said they had heard a great deal about these requirements after being provided with this description and example and an additional 44% said they had heard something about them. After being told of these new rules, most said this had at least a somewhat positive impact on their view of the advisory services and fund management industry as well as regulatory bodies *(see table 15)*.

Table 15



"How do these new disclosure and reporting procedures concerning investment performance and compensation of advisors and firms impact your satisfaction with each of the following? Do they make you…" (All investors, n=1299)

Assessments of Trailing Commissions

Most investors have at best a moderate level of knowledge about the fees and commissions they are charged. When it comes to mutual funds (owned by 82% of investors):

- roughly four in ten investors who own them said they felt relatively knowledgeable about the amount and type of fees they pay on those funds (i.e. 38% of mutual fund owners rating their knowledge a 7, 8 or 9 on a 9-point scale where 9 means they know a great deal);
- another 38% rated their knowledge at about the mid-level;
- and 16% admitted they know little or very little about the fees they pay through their mutual funds.

The overall awareness of investors about fees they pay is important to the discussion of investors' preferences and concerns when it comes to commissions and advisory services. Many investors surveyed have not heard much about trailing commissions. For the purposes of the survey, investors were provided with the following description of trailing commissions:

"Trailing commissions are paid by most mutual funds and other investment products to financial advisors for ongoing service and advice they provide to clients. Trailing commissions paid to advisors tend to be between 0.5% and 1% of the value of the mutual fund or investment product the advisor purchased with their client, meaning the commission paid each year will be higher or lower based on the value of the investments. The fee is one part of the Management Expense Ratio or overall cost charged to investors for most mutual funds and some other investment products."

After that description was presented:

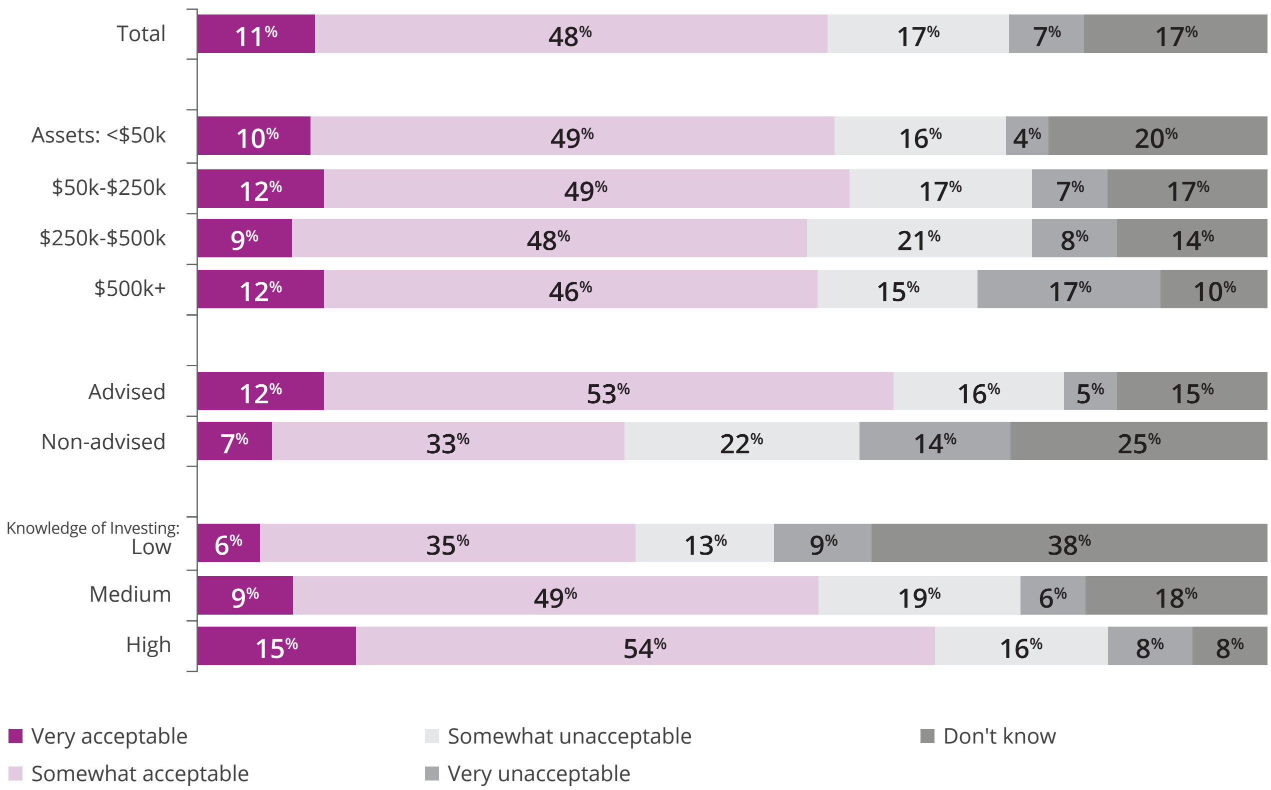
- 13% said they had heard a great deal about these commissions prior to the survey
- 31% said they had heard something about them
- 28% had heard very little about them
- 29% had heard nothing or were unsure if they had heard of them before.

Those who own mutual funds were not significantly more or less likely to say they had heard a great deal about these commissions. Advised investors were not significantly more likely to have heard a great deal or something about these (44% compared to 40% among non-advised investors).

Based on what they know, including the explanation provided, most investors said trailing commissions were an acceptable means of compensating advisors for the service and sales they provide. Advised investors were significantly more likely to say these were very or somewhat acceptable. Nearly one in four said these were unacceptable, but only 7% said these were very unacceptable (see table 16). High-net worth investors (at least $500,000 invested) were more likely than others to say these were very unacceptable (17%) although most in this group still said these were at least somewhat acceptable. Conversely, those with less invested tended to be unsure of how acceptable these commissions were.

What is especially noteworthy is that those investors who said they had a high-level of knowledge about investing (roughly 4 out of every 10 investors), were significantly more likely to say trailing commissions. So, while most investors know only a moderate amount about the fees they pay or about trailing commissions, those who claim to know more are no more likely to be concerned or consider these commissions to be unacceptable.

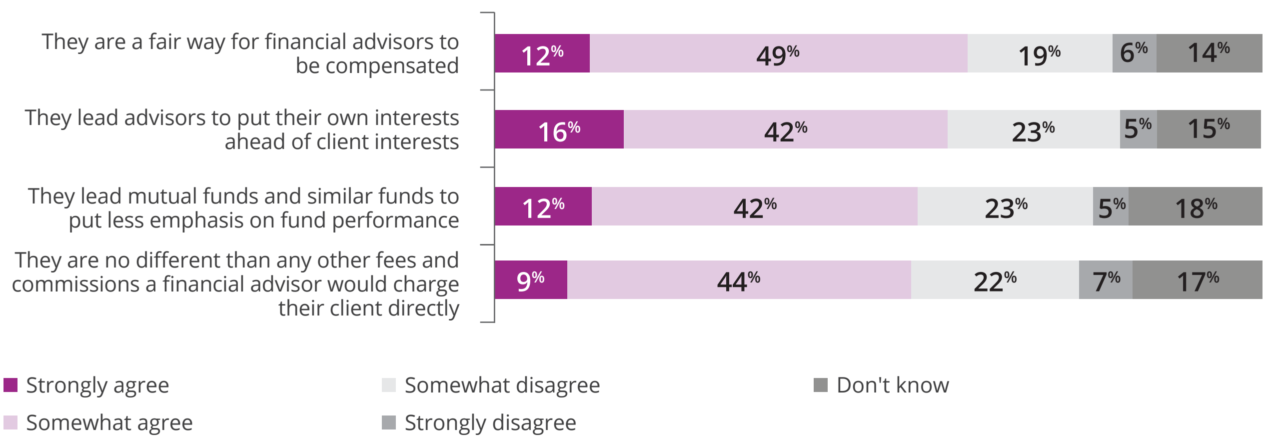
Table 16



"Based on what you know, how acceptable do you think trailing commissions are as a means of compensating financial advisors for the service and sales they provide to investors?" (Among all investors, n=1299)

We tested several propositions or statements in relation to trailing commissions. There is a recognition by at least half of investors that these commissions lead advisors to put their interest ahead of their clients or lead funds to put less emphasis on performance *(see table 17)*. However, there was little strong agreement about these concerns and investors were somewhat ambivalent in their feelings towards these types of commissions. Most agreed trailing commissions were no different than any other fees and commissions a financial advisor would charge their client directly.

Table 17

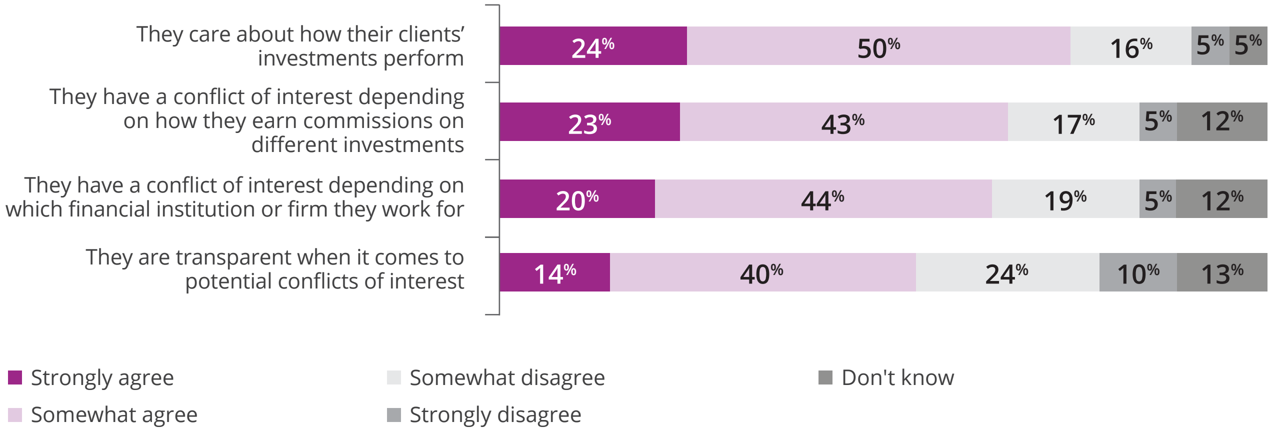


"To what extent do you agree or disagree with the following statements about trailer commissions?"
(Among advised investors, n=1041)

And while most agreed advisors have a conflict of interest, that was offset by the fact that investors are more likely to believe advisors are motivated to ensure their clients' investments perform well and are transparent *(see table 18)*:

- While 66% of all investors agreed advisors have a conflict of interest based on how they earn commissions, a larger majority (74%) agreed that advisors care about the performance of their clients' portfolios.
- Among advised investors per se, an even larger proportion (82%) agreed that advisors care about clients' portfolio performance.
- 54% of all investors (including 61% of advised investors) agreed advisors are transparent about potential conflicts.

Table 18

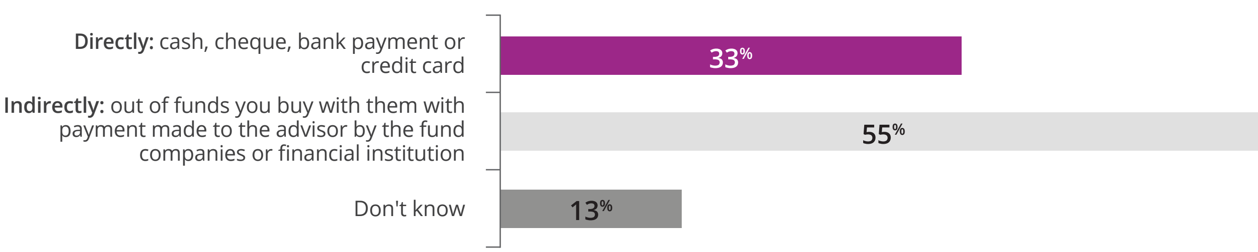


"How much do you agree or disagree with each of the following statements about financial advisors?" (Among all investors, advised and non-advised, n=1299)

Advisor Compensation Options

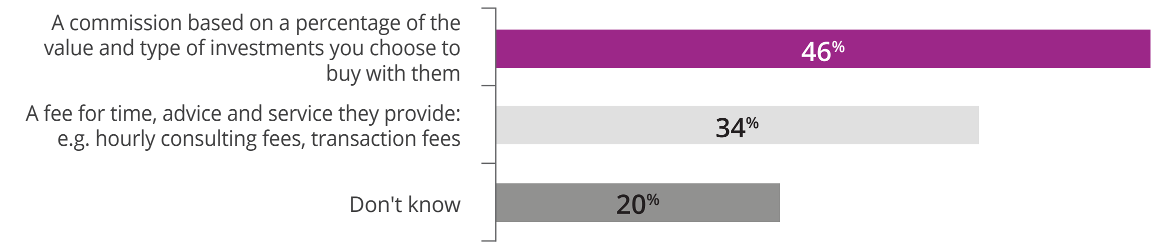
An important reason for investors' preferences in respect of commissions relates to how they prefer to calculate and pay for their advisors' compensation. In a forced choice, advised investors (and those who said they were likely to seek out an advisor) expressed a clear preference to pay for the service offered by advisors indirectly: i.e. out of the funds they buy with that advisor and with the payment made by the fund provider or financial institution. Far fewer would prefer to pay directly by way of a payment.

Table 19



"And between the following two options how would you prefer to pay a financial advisor for advice and services they offer?" (Among those with an advisor or likely to seek one out, n=1158)

Table 20

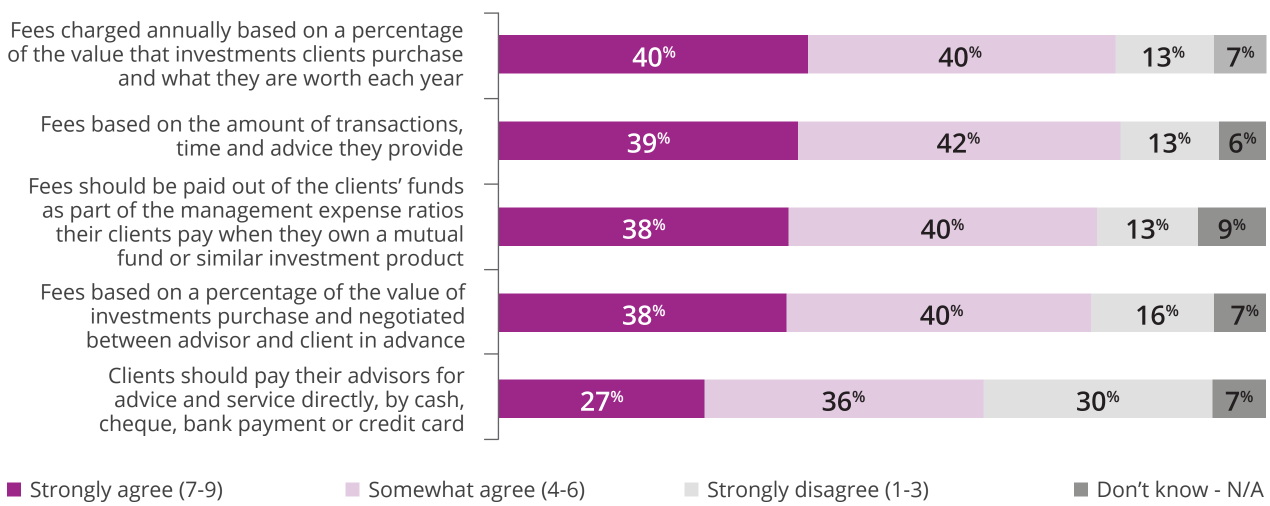


"How would you prefer to determine your financial advisors' compensation for advice and services if you had to choose between the following two options?" (Among those with an advisor or likely to seek one out, n=1158)

Even when asking all investors (both the advised and non-advised) to rate their agreement with each approach per se (rather than in a forced choice) there was little disagreement with a model that emphasizes annual commissions for advisors based on the value of investments clients purchase with them *(see table 21)*.

There was agreement with the idea that fees should be negotiated and reflective of the amount of service advisors provide. But somewhat more disagreed with the idea of charging advisors directly, i.e. delivering them a bill that they would be separately by means of payment outside of a deduction from their portfolio – 30% disagreed strongly with that approach to compensating advisors *(see table 21)*.

Table 21

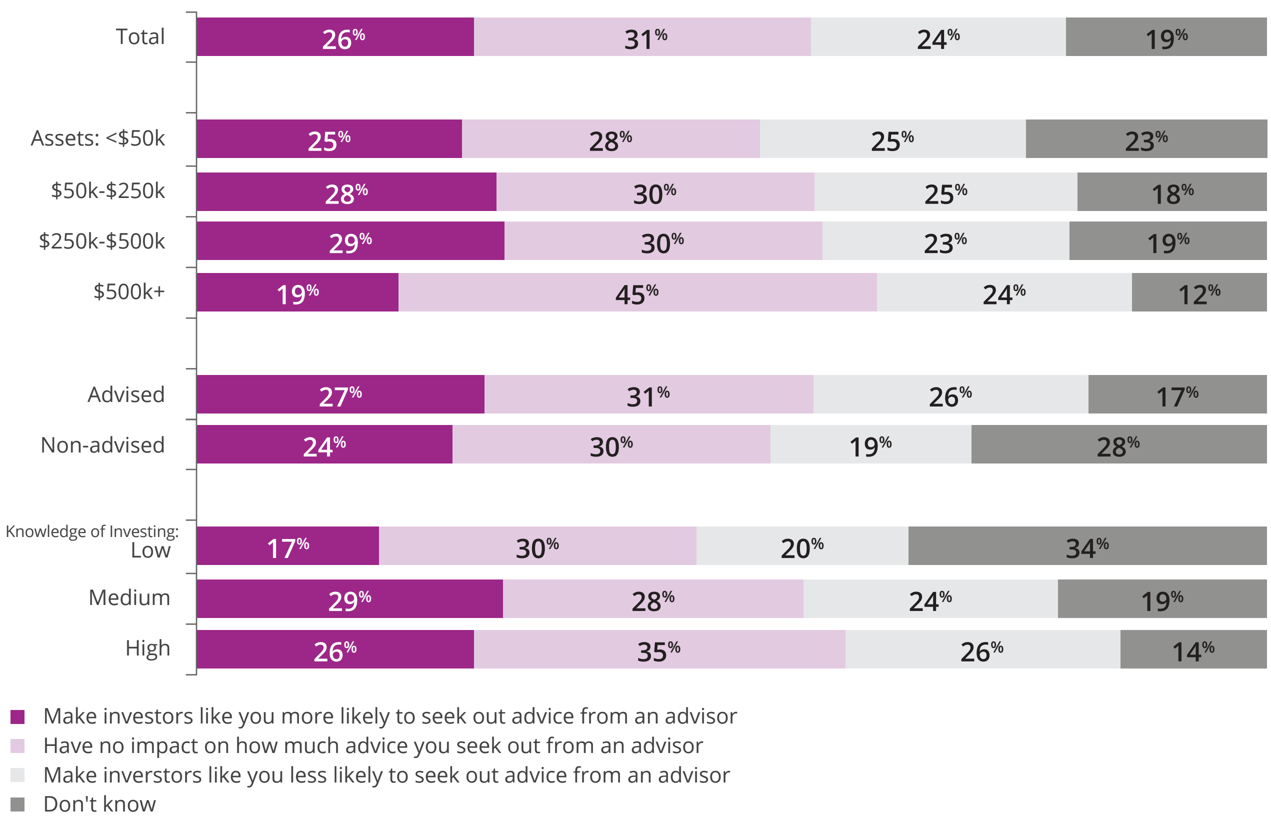


"Using a 1 to 9 scale where 1 means strongly disagree and 9 means strongly agree, please tell us how much you disagree or agree with the following approaches to compensating a financial advisor for their advice and service to a client?" (Among all investors, n=1299)

Investors were divided when asked what the potential impact would be of any possible move to phase out trailing commissions and the way they are paid to advisors and calculated.

Roughly three in ten investors said phasing out trailing commissions paid out of a clients' portfolio and moving to a system where advisors charged clients for advice and service would have no change in their likelihood to seek out advice; 19% were unsure. For 26% of investors, such a move would make them more likely to seek out assistance from an advisor whereas 24% of investors said such a move would make them less likely to seek out advice.

Table 22



"If mutual funds ended the practice of paying advisors trailing commissions based on and paid out of the funds or investment products their clients own, and advisors instead charged clients for advice and service directly, would this:" (Among all investors, n=1299)

Conclusions

In sum, there is limited dissatisfaction with the current system of financial advice in Canada and the way advisor compensation is calculated. While there may be some dissatisfaction about fees, generally, there is relatively higher satisfaction when it comes to advisors' transparency around fees.

It could be argued that the lack of concern around current approaches to advisor compensation is due to the low level of knowledge investors have about different fee structures and all the implications of them. But this is not the case for more knowledgeable investors who were more likely to say trailing commissions were acceptable.

The acceptability about current fee models relates partly to investors' preference for a commission-based approach to advisor compensation based on portfolio value instead of a fee-for-service approach that would see investors invoiced with a bill they would have to pay out of pocket. While investors see value to fees geared to the amount and level of service provided, and generally agree that fees should be negotiated, investors see strengths in both approaches. In a forced choice, more opted for a system of commissions paid by fund providers and financial institutions to advisors from the capital of the investments purchased with the advisor.

Fundamentally, the degree to which investors perceive a potential or real conflict of interest when it comes to advisors' fees is offset by the fact a larger proportion of advised investors is satisfied with their advisors and think they have their clients' interests at heart. Most believe their advisors are concerned about the performance of their portfolio and a preference for a commission-based approach to advisor compensation (drawn from and based on the value of the portfolio) may be rooted in that.

INCLUDES COMMENT LETTERS

CSA CONSULTATION PAPER 81-408- CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

January 10, 2017

Comments

To:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

1. *Do you agree with the issues described in this Part? Why or why not?*

   Yes. The potential conflicts of interest could misalign reps and investors.

2. *Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.*

   No comment.

3. *Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.*

   Not in our view.

4. *For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:*

   - *mutual fund*

   Yes.

   - *non-redeemable investment fund*

   No comment.

   - *structured note*

   No comment.

   Should the product be subject to the discontinuation of embedded commissions?

see answers above)

If not:

a. *What would be the policy rationale for excluding it?*

No comment.

b. *What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?*

Significant arbitrage risk could be an influence.

5. *Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?*

No – in order to ensure no arbitrage of the system.

6. *Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?*

We believe it should apply to all.

7. *Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?*

Yes.

8. *Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:*
   a. *the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;*
   b. *referral fees; and*
   c. *underwriting commissions.*

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

We believe that the existing rules should be diligently enforced, and that there needs to be a safe whistle blower system.

9. *If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?*

   We feel it is too early to say.

10. *With respect to internal transfer payments:*

    a. *How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?*

    We have seen improvement in this regard.

    b. *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*

    Yes.

    c. *Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?*

    No comment.

11. *If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.*

    No comment.

Where possible, we strongly encourage commenters to provide data to support responses.
Addressing the issues

12. *Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?*

    We believe it is a great initial step.

13. *Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?*

No comment.

14. *Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?*

This is very possible. Issuers evolve and adapt, so further revisions may be required at some point.

Change in investor experience and outcomes

15. *What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:*

- *Will investors receive advice and financial services that are more aligned with the fees they pay?*

Yes.

- *What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?*

No comment.

- *Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?*
-

Yes. That is what we would expect.

- *What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*

We expect it to be beneficial to investors.

- *What effect will the proposal have on the cost and scope of advice provided to specific investor segments?*

We expect the effect to be positive.

16. *What types of payment arrangements are likely to result if this proposal is adopted? In particular:*

- *Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?*

We would hope not.

17. *Do you think this proposal will lead to an advice gap?*

We do not think this will occur.

In particular:

- *Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.*
  - *Do you agree with our definition of an advice gap?*

We agree with your definition.

- *Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?*

No opinion.

- *What types of advice or services currently provided today would be most affected by the proposal?*

No comment.

- *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*

No comment.

- *How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?*

No comment.

- *Do you think that online advice could mitigate an advice gap? If so, how?*

We believe that online advice could mitigate an advice gap to some degree.

- *Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?*

Yes.

Industry change independent of regulatory response to discontinue embedded commissions

18. *Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action?*

    We do not believe this would occur.

    In particular:

    - *Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?*

    No. If it did, it would be very slow to do so.

19. *How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type?*

    We concur that it is accurate.

    In particular:

    - *Do you see payment options and business models evolving at present?*

    No comment.

    - *How are they likely to change over time if the CSA were to choose not to move forward with the proposal?*

    No comment.

20. *We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?*

    The continued availability of embedded commissions.

    Potential impact on competition and market structure

21. *Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:*

    - *Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?*

    No comment.

    - *What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?*

We would expect the efficiency to remain.

- *What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?*
  - *Independent dealers?*
  - *Independent fund manufacturers?*
  - *Integrated financial service providers?*
  - *Mutual fund dealers?*
  - *IIROC dealers?*
  - *Online/discount brokers?*

No comment.

- *What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?*

There could be an increase in regulatory arbitrage.

- *What would be the impact on dually-licensed mutual fund dealers and insurance agents?*

Potentially more commission based products.

- *Will the proposal lead new, lower-cost entrants to the market? Why and how?*

Hopefully yes – and greater breadth of products.

- *Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?*

No.

- *Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?*

Yes.

- *Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?*

Yes.

- *What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?*

No comment.

22. *What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:*

    No comment.

    - *Is there any specific operational or technological impact that we should take into consideration?*

    No comment.

23. *The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.*

    - *Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?*
    - *To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?*

    No comment.

24. *Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?*

    No comment.

25. *Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?*

    No comment.

26. *What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:*
    - *career path;*
    - *attractiveness of the job;*
    - *typical profile of individuals attracted to the career;*
    - *recruitment; and*
    - *relative attractiveness of careers in competing financial service business lines?*

    No comment.

27. *How practicable are the mitigation measures discussed and how effective would these measures be at assuring:*
    - *access to advice for investors,*
    - *choice of payment arrangements for all investor segments, and*

- *a level playing field amongst competing investment products?*

No comment

28. *What other measures should the CSA consider to mitigate the above unintended consequences?*

No comment.

29. *Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:*

a. Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.

b. To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?

c. What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

No comment.

30. *With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,*

a. to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;

b. does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and

c. what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?

No comment.

31. *What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded*

commissions?

No comment.

32. *Which transition option would you prefer? Why? Are there alternative transition options that we should consider?*

    No comment.

33. *As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?*

    No comment

34. *Please explain whether you think each of the initiatives discussed above will, either alone or in combination:*

    - *address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and*
    - *address or not address any additional harms or issues that you have identified.*

    No comment.

35. *Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.*

    No comment.

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June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
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Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

I am pleased to be able to share my input (and that of our firm) on the above-referenced proposals. For background, HighView Financial Group is the brand under which we operate our business. HighView Asset Management Ltd. ("HighView") is registered in the category of Portfolio Manager in Ontario, Alberta, British Columbia, Manitoba and Saskatchewan. HighView designs portfolios for affluent families and institutions; embracing our status as a fiduciary and operating with diligent processes, transparency and robust – and clear – reporting.

GENERAL COMMENTS

I doubt that there is anyone in the industry that can justifiably deny the conflict of interest inherent in the structure of embedded compensation. While many dealing representatives conduct themselves professionally and like fiduciaries; I have seen first-hand how the conflicts of embedded compensation play out in advisor-client interactions and recommendations. This conflict was first highlighted in an Ontario Securities Commission research paper by Glorianne Stromberg[1]; succinctly captured in the following excerpt.

> *If a manager does not agree to increase the amount that it will pay by way of trailer or service fees to what a competitor is prepared to pay, the manager can expect that the sales representative will cause his or her clients to switch their investments to an investment fund group that will pay the higher amount regardless of whether this benefits the client or has tax consequences for the client. The payment of high trailer or service fees by an investment fund manager may also be a factor in a sales representative not recommending a change in the client's portfolio when it would be in the client's interests to make such change. This is why some people have referred to trailer or service fees as being "bribes" and why there is a high level of concern about the conflicts of interest that exist between the sales representatives and their clients.*

Remarkably, regulators and industry continue to discuss and debate this issue more than 22 years after it was first researched and documented. I note that I was part of a team that created an online suite of portfolio analytics in 1997 that created a level of transparency that is still beyond what CRM2 requires today. So I comment on this paper with a passionate interest in treating investors the way I would want to be treated – and with a history of taking action to achieve transparency for investors during my 23-year career.

While I have long thought that embedded compensation should not preclude full transparency for investors; the industry (product manufacturers and distributors) has done too little for too long in this respect. Now that it faces a full-blown ban on embedded compensation, the industry is responding with potential solutions. But I believe that it missed an opportunity. Accordingly, I agree that eliminating embedded commissions may be the only way to better align the interests of dealers and their clients.

[1] Recommendations For Regulating Investment Funds in Canada, Glorianne Stromberg, January 17, 1995.

What follows are my responses to the consultation questions, within which I've included my detailed comments on various aspects of this proposal.

CONSULTATION QUESTIONS

Part 2 (Investor Protection & Market Efficiency)

1. Do you agree with the issues described in this Part? Why or why not?

   Generally yes. The notion that embedded compensation create a conflict is intuitive; and supported by my anecdotal experiences. I note, however, that the paper authored by Dr. Douglas Cumming left me with many unanswered questions – even after directing many detailed questions to the lead author[2]. While I agree with the paper's conclusions I struggle to see how the data pointed strongly to this conclusion.

   For example, I am puzzled as to why the authors calculated flow-performance sensitivity using a series of stand-alone one-month periods. Intuitively, the impact of a material jump in trailing or deferred sales commissions would have to be measured over a period of at least several months – not a single monthly data point. Also, the paper's measures of flow-performance sensitivity used 'gross performance'. Given that fund distributors and sellers only 'see' net-of-fee returns I fail to grasp how they can be influenced by gross returns[3]. That said, I believe in the paper's conclusions because they are intuitive; I've seen this dynamic play out first hand over my 23-year career; and Glorianne Stromberg reached similar conclusions more than two decades ago after extensive research.

[2] I sent two emails to Dr. Douglas Cummings. The first was acknowledged but contained no replies to my questions. As of the date of this submission, I've received no response to my second email.

[3] I concede that strong gross performance is likely linked to strong net-of-fee performance but that depends entirely on the robustness of a fund's performance and the level of fees. It is seemingly more sensible to measure each fund series' performance directly – net of fees – since that is what distributors, salespeople and investors see.

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

   None that come to mind.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

   I agree partly with the industry comment that eliminating embedded commissions is likely to result in advice becoming inaccessible to many people. But I have two related concerns that contrast with the broader industry's views.

   While I believe that eliminating embedded commissions will widen the so-called advice gap, I believe such a gap already exists. In my column for the mid-November issue of Investment Executive[4] I noted that IE's advisor survey figures suggest that even those that are already on the books as clients are unlikely getting the level of advice and service that they want and need. Still, I believe that eliminating embedded commissions will widen this gap materially. Online investment managers will fill some of this gap – but not all of it.

   An additional problem arises in the form of regulatory arbitrage.

[4] See http://www.investmentexecutive.com/-/advice-gap-exists-now

Advocis reports that the number of insurance-only licensed advisors grew from 19,460 in 2008 to 24,070 in 2011 – by far the fastest growing segment tracked by Advocis[5]. In a follow-up report, Advocis reported that insurance-based advisors grew 12% between 2010 and 2013 while the numbers of non-insurance licensed advisors fell slightly during the same period. These statistics support the suggestion in my March 17, 2015 article in the Globe and Mail[6] that some advisors are moving to the insurance platform to avoid tougher investor-friendly CSA regulatory changes.

Part 3 (Potential Scope of eliminating embedded commissions)

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption – mutual fund; non-redeemable investment fund; and/or structured note – should the product be subject to the discontinuation of embedded commissions? If not:

    a. What would be the policy rationale for excluding it?

    These products are often sold alongside prospectus-sold mutual funds – by the same dealers and dealing representatives. So to the extent possible, any regulation that applies to mutual funds, should equally apply to these other exempt market products sold through retail distributors. There is one scenario in which I can see a strong argument to continuing to allow embedded compensation.

    Typically, all retail investment funds – i.e. mutual funds, ETFs, closed-end funds – see their management expense ratios rise with the addition or existence of a trailing commission. There are some instances, however, whereby a trailing commission effectively exists but it is paid by the product manufacturer – not the end investor or out of fund assets.

[5] See http://www.advocis.ca/pdf/Financial-Advice-Industry-Economic-Profile.pdf

[6] See http://www.theglobeandmail.com/globe-investor/funds-and-etfs/some-advisers-behaving-badly-with-crm2-on-the-horizon/article23511604/

For example, consider a fund with three series of units:

- Series A offers all of the traditional commissions to retail distributors. These units charge a 2% annual management fee, which includes a trailing commission of 1% per annum when sold on a front-end load basis.
- Series F has zero embedded compensation so its management fee is 1% per year.
- Series X also has a 1% management fee (like the F series). The fund's sponsor directly pays the dealer selling these units 0.5% per year as a trailing commission.
    - But in this case embedded commissions don't increase the management fee because the trailing commission is paid directly by the sponsor not out of fund assets. The sponsoring company effectively earns half of the management fee on this series in exchange for the dealer bringing it a large group of clients.

So in this case Series X units technically pay a trailing commission but it is not increasing the costs of the end investor (i.e. they're paying the F series fee rate). So I'd suggest writing definitions such that this kind of structure can survive even if this proposal is implemented.

b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?

As it stands now, there will be some amount of regulatory arbitrage because none of the CSA regulations apply to distributors of insurance products – some of which look and sound similar to investment funds to end investors.

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

None that come to mind.

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

   None that come to mind.

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

   In theory, I don't fundamentally oppose the use of embedded commissions or third-party payments to compensate product distributors or dealers – as long as this is paired with meaningful transparency. Product manufacturers and distributors have proven that this has not been a high priority. As a result, they've not done enough to voluntarily create meaningful transparency. It's not hard to do. I've done it in a few different employment situations – starting as far back as two decades ago.

   While CRM2 can be evolved in a way that provides total cost disclosure – i.e. CRM3 – that is not enough. Investors not only need and deserve total cost disclosure through post-investment reporting; but it's also critical to provide accurate total cost estimates prior to investing so that investors can be fully informed prior to engaging a firm's services. And that is most efficiently accomplished in a regime where compensation is explicit – not embedded. Moreover, the industry has proven that true transparency will only materialize through new regulation – not voluntary innovations to create similar transparency.

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

   a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;

      I wouldn't lose any sleep if such payments are eliminated. Again the industry has been its own worst enemy by sometimes twisting NI 81-105 rules or breaching them altogether.

b. referral fees; and

There is no reason to eliminate referral fees so long as the relationship and the fees are clearly disclosed and explained – verbally and in writing – so that the end investor is paying the fee and is clear about what they're paying; to whom they're paying it; and what services is each party providing for the fees being paid.

c. underwriting commissions

These are key payments to facilitate capital raising – a vital function – so I'd recommend not banning these commissions.

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

Yes. While I don't have any specific recommendations in this respect, I urge the CSA members to review NI 81-105 with an eye toward aligning its provisions with the spirit of the final decisions that emerge out of this consultation process.

Product manufacturers have long had the flexibility to push the limits of such payments. And a recent Ontario Securities Commission settlement agreement[7] exposed how, despite the regulation, abuses can and will occur.

[7] See http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20170331_sentry.pdf

10. With respect to internal transfer payments:

a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?

   Given that so few 81-105 enforcement actions have been undertaken – and none that I know of with respect to integrated firms – I don't have sufficient information to adequately answer this question.

b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

   Similar to my comments on potential changes to NI 81-105 I would take a similar view of internal transfer payments of organizations with affiliated product manufacturer and dealer subsidiaries. This consultation proposes to strip dealer compensation out of the product and make it transparent. Moreover, it proposes to end all payments to dealers from any party other than the dealer's clients.

   In fairness and in keeping with the intent and spirit of the 81-408 proposals, it seems clear that internal transfer payments between affiliates of integrated firms cannot be tied to any product sale. Failure to take this measure would allow all integrated firms – particularly the big banks and insurers that already dominate Canadian wealth management – to have a product manufacturer compensate a related or affiliated dealer for product sales. And if the CSA moves forward to eliminate embedded commissions on investment funds and other products; it must similarly eliminate internal transfer payments for sales of the same products.

c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

None that I'm aware of.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

As long as the dealer in question has an account that it administers for its clients; this is a good interim step. Ultimately, however, the end goal should be to put this obligation onto dealers since they are the firm with the direct client relationship. And an interim step may be necessary given that dealers – particularly MFDA dealers – operate on thin margins.

Ultimately, however, I fully support a payment method whereby dealers can charge fees to clients' investment accounts. Allowing product manufacturers to facilitate the deduction and remittance of client fees opens up the potential for manufacturers to provide benefits to firms placing clients in their products.

In this case, manufacturers would not be paying a monetary benefit to dealers. But allowing them to facilitate fee payments – and remitting them to dealers – equates to providing a non-monetary benefit by saving distributors from the costs of setting up, maintaining and processing administrative and accounting systems for fee billing and HST remittance purposes.

However, allowing a product sponsor to facilitate fee payment and remittance for instances where a dealer is being compensated but does not administer a client account makes a great deal of sense. That said, full, true and plain disclosure is mandatory in this instance. Admittedly these instances are not the norm but they exist and should be considered by any implementation of this part of the proposal.

Part 4 (Potential Impact of eliminating embedded commissions on Stakeholders & Market Structure)

Addressing the issues

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

    Yes.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

    None that I'm aware of that are as simple and transparent.

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

    There is no such thing as a conflict-free method of advisory compensation. As I explained in a June 16, 2010 article[8] commission, asset-based, hourly and project fee models each have their own unique conflicts. There is no escaping the potential for conflicts of interest.

[8] See https://www.highviewfin.com/blog/advisor-compensation-no-fee-model-is-free-from-potential-conflicts/

Change in investor experience and outcomes

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:
    a. Will investors receive advice and financial services that are more aligned with the fees they pay?

       I think this outcome is more likely but by no means assured.

    b. What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?

       If you are referring to online investment managers (i.e. 'robo-advisors') then I expect that the proposal will spur growth of automated advice.

    c. Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?

       This shift was already underway without a ban on embedded commissions. IIROC dealers have been seeing a gradual shift toward managed accounts with individual registrants registering as advising representatives. Others have left the dealer world behind to join or launch firms registered in the Portfolio Manager (PM) category.

       And the newest entrant – so called 'robo-advisors' – are registered PM firms. There are business and efficiency reasons explaining why this shift was already in motion. Moving away from embedded compensation may well accelerate this trend. That said, the shift won't be brisk given the differences in credentials and compliance.

    d. What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?

       See my answers to 15 (b) and (c) above.

e. What effect will the proposal have on the cost and scope of advice provided to specific investor segments?

Given that a significant percentage of financial advice providers are licensed as dealing representatives (for securities purposes) and licensed to sell life and health insurance; clients with modest investment portfolios could still represent significant revenue.

To the extent that a ban on embedded commissions on securities would not preclude being able to still generate commission income from insurance sales, servicing clients with smaller investment portfolios can continue to be very economical. Most households have $100,000 or less in investable assets[9]. Some part of this majority – it's uncertain how much – will continue to be served by their existing (dual-licensed) representatives.

While the advice gap may widen, it's unclear to what extent and whether there will be shifts within this segment. For example, most households with assets of $100k or less do not currently use an advisor[10]. Some of those may be encouraged by the emergence of robo-advisors and make use of those services. Others who are currently receiving advice may opt out of the system after the dust settles post-implementation of this proposal (should that occur).

Also, it is my impression that there are more providers of pure financial planning advice compared to 10-15 years ago. Many are quite affordable and could also contribute to filling some of the advice gap.

[9] Table 1, page 26, CSA Consultation Paper 81-408 – consultation on the option of discontinuing embedded commissions.

[10] Table 4, page 29, CSA Consultation Paper 81-408 – consultation on the option of discontinuing embedded commissions.

High Net Worth investors – generally those with $500,000 or more of investable assets – already have access to higher level services, discretionary management, and advisers that are legal fiduciaries. I don't anticipate this to materially change under a regime without embedded compensation.

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

    a. Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?

    No. The payment arrangement that strikes the best balance between efficiency and transparency is for advisory firms to charge the fee directly to each client's investment account. It's transparent because each statement will show fees paid in dollars; an aggregate amount of which will be disclosed at least once annually. And client directly pay fees to the firm from which they seek and receive advice. I cannot think of a reason to use different payment methods for different segments; other than the scenarios described in my responses to questions #4 and #11.

17. Do you think this proposal will lead to an advice gap? In particular:

    a. Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.

    See my response to 15 (e).

    b. Do you agree with our definition of an advice gap?

    Yes.

c. Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?

Not unless that is a component of advice with which investors are unhappy. If that is the case, you could expand the definition of "advice gap" – e.g., investors who cannot obtain the amount of advice they desire at the price they are willing to pay and delivered through the desired mechanism (i.e. face-to-face, virtually).

d. What types of advice or services currently provided today would be most affected by the proposal?

I don't expect that this will change significantly. Higher net worth investors are more likely to receive more financial planning services; which I expect to continue. Most others are not receiving much financial planning; and I expect that to continue under a direct-pay regime.

e. Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?

It would be quite reasonable – if not recommended – for the CSA to consider and measure the impact of CRM2 prior to making a final decision on other pending initiatives, such as this proposal.

f. How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?

Most likely through full service firms adopting and implementing online platforms to service smaller accounts. Also with changing circumstances, I expect that dealers and other advice-providers will – out of necessity – innovate more efficient solutions for bridging this gap. The very existence and success of robo-advisors around the world is proof of just such an innovation. There are fixed costs to servicing and maintaining client accounts. Robo-advisory firms created a platform to make that much more efficient; though this efficiency only kicks in once sufficient scale is realized.

g. Do you think that online advice could mitigate an advice gap? If so, how?

   Partially yes. Given that regulators have begun to work with online advisers to streamline profiling and onboarding for smaller accounts; the technological efficiencies will be an appealing option for many. But some advice gap will continue to exist – as it does today and has for some time.

h. Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

   No.

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

    a. Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

       Some of the shifts toward lower fee series – such as the measures in question #18 – resulted from regulatory pressures as issues like Client Relationship Model, Best Interest Standard and this proposal were in various stages of discussion, proposal or implementation. The growth of exchange traded funds – and the participation in this segment by traditional mutual fund companies – resulted from a combination of competitive pressures and regulatory pressures.

While there have been pockets of price competition between investment funds, it was rarely widespread. Retail mutual fund companies were more likely – over the past two decades – to compete on commission rates than on fees. Indeed I witnessed this much more often than the few isolated examples of price competition. And price competition goes hand-in-hand with moving away from embedded commissions.

Most of the shift away from sales of deferred sales charge funds has been organic. CRM2 has likely all but killed what remained of DSC sales volumes. The uses of trailing commissions and, to a lesser extent, low load would continue without the implementation of this proposal.

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

    a. Do you see payment options and business models evolving at present?

       Figure 8 appears accurate to me with one small exception. It is my impression that insurer-owned IIROC dealers serve a wider range of household account sizes than their bank-owned peers. As for payment options and business models; they are always evolving in response to and in anticipation of regulatory and competitive forces.

    b. How are they likely to change over time if the CSA were to choose not to move forward with the proposal?

       CRM2 would keep sales of DSC funds very low while trailing-commission-paying front end load sales option would remain prominent. But competitive forces and heightened standards – e.g., CSA proposed targeted reforms – would continue to nudge the industry away from embedded compensation. Also, discretionary platforms would likely become more prominent over time – thereby also raising the legal standard of care owed by most advice providers.

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

    I can only speculate on these obstacles. One may be that many smaller or less sophisticated clients may be resistant to more explicit advisory fees. Another may be the limitations of back office and accounting systems required to support direct billing and the slow adoption of such systems due to the significant costs to acquire, set-up and maintain such systems. But these obstacles have been slowly abating over the past decade.

Potential impact on competition and market structure

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

    a. Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?

       Consolidation of small-to-mid sized dealers has been occurring for many years – largely because thin margins and rising costs have necessitated greater operational scale. This proposal may exacerbate dealers' challenges and, in turn, accelerate or heighten this consolidation trend. Dealers may require even greater scale to offset the increased costs of complying with the Proposal and other new regulations (e.g., targeted reforms). Rising costs and increased need for scale will likely favour larger integrated firms and stifle competition to a degree. However, this proposal must be applied with fairness; in a way that treats independent and integrated firms equally.

b. What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?

As noted fewer dealers equates to less competition; which generally does not bode well for investor outcomes. One example may be that less competition leaves less negotiating power in the hands of investors and more homogeneous pricing and services. Competitive forces will naturally offset this to some extent.

c. What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?

i. Independent dealers?
ii. Independent fund manufacturers?
iii. Integrated financial service providers?
iv. Mutual fund dealers?
v. IIROC dealers?
vi. Online/discount brokers?

Small and medium sized dealers of all types (i.e. independent dealers, MFDA & IIROC dealers) will be challenged by a combination of increased costs and reduced revenue (from some client/asset attrition). These dealers are already challenged and this proposal will toughen their operating environment.

Independent fund manufacturers have been challenged to generate consistent inflows for some time due to increased competition – and dominance of banks – greater fee sensitivity (by advisors and investors) and disappointing performance. The long-term isolated impact of this proposal should be neutral; but shorter-term it will be a negative as both distributors and investors adjust to a new regime. There is a good likelihood that mutual fund assets will fall at discount brokerage firms, thereby adding to manufacturers' challenges.

Discount brokers will be hurt slightly as a result of lost trailing commission revenue. As of the end of 2011, discount brokerage client accounts held about 4% of total Canadian mutual fund assets[11]. At that time, this equated to mutual fund assets of about $33 billion. Assuming an average trailing commission rate of 30 basis points, that's nearly $100 million of discount brokerage commission revenue.

If this was spread across 100 or more brokerage firms, it would be a relatively small amount of revenue. But this amount is largely attributed to a handful of bank-owned discount brokers. So that is a significant revenue loss. I expect that discount brokers who continue to offer mutual funds trading on FundSERV will add their own fees to either make up the lost trailing commission revenue or to direct investors to securities with lower trading and custody costs.

Integrated firms like banks and insurers are the best positioned for a ban on embedded commissions. They have greater flexibility to modify compensation of client-facing representatives without technically tying it directly to product purchases; but where it can still reflect aggregate sales volumes.

d. What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?

This is going to be a problem. Insurance-only licensees is the fastest growing segment of advice providers in Canada. I am convinced that the implementation of this proposal will foster more growth of insurance licensees; thereby exacerbating regulatory arbitrage.

[11] See pie chart on page 7 of http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_2012123_81-407_rfc-mutual-fund-fees.pdf

e. What would be the impact on dually-licensed mutual fund dealers and insurance agents?

Dually-licensed dealers[12] (and individual registrants thereof) tend to use CSA regulated securities for client investments while using their insurance licenses primarily to sell life and health insurance policies. In these cases there will be practical limitations to arbitrage different rules between securities and insurance registrations.

f. Will the proposal lead new, lower-cost entrants to the market? Why and how?

I do not see how this proposal will foster lower cost entrants. CRM2's disclosure of performance, compensation and charges – and the eventual evolution to total cost disclosure – is doing more to encourage lower cost products than a proposal to ban embedded commissions. As noted, the growth of the ETF segment has been accelerating for several years; unrelated to this particular proposal.

g. Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?

No.

h. Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?

Yes. A lack of embedded compensation will eliminate the need for many of funds' series of units. It won't eliminate all series, as tiered pricing is still implemented via separate series of units. Also, I expect different series of units with a range of distributions policies will continue to exist. But this proposal will significantly reduce the number of series and FundSERV trading codes – which should reduce the operating expense component of product expense ratios.

[12] Many dealers have affiliated entities that are Managing General Agencies licensed to sell insurance policies.

i. Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?

Yes. While tied selling is no longer employed, large integrated firms have made persuasive use of cross selling strategies. An example is granting more favourable terms on loans where investment accounts are transferred to the affiliated dealer.

j. What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

Online investment advisers tend to have much smaller average account sizes compared to MFDA and IIROC dealers and other advisers. And despite early claims to disrupt bank and other dealer business models; it seems more likely that online platforms will partner with incumbents and leverage their physical reach to achieve growth targets. Overall these effects will be positive but online advisers may not be the competitive disrupters that many are expecting.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

a. Is there any specific operational or technological impact that we should take into consideration?

No comment.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

a. Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?

Banning embedded commissions will not eliminate conflicts of interest; but they will reduce the number and extent of conflicts.

b. To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?

While a direct pay arrangement may alleviating some controls and oversight; it can also give rise to new ones. For example, auditing fee billing accuracy; having a process for flagging and correcting errors may result from dealers facilitating the payment of fees.

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

Yes. While it will require some client education efforts, reduced embedded product fees can be offset with direct charge percentage-of-asset fees roughly equal to the embedded commission. But this will be an administrative adjustment for dealers; a psychological adjustment for clients; and will require efforts by client-facing representatives to explain the change in – and comparison between – compensation structures.

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

I don't expect significant changes in compensation structure. Commissions will be replaced with asset based fees if this proposal is implemented; and salaries and grids will be a function of the fee generation of client-facing representatives.

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:

a. career path;

b. attractiveness of the job;

c. typical profile of individuals attracted to the career;

d. recruitment; and

e. relative attractiveness of careers in competing financial service business lines?

The industry has already undergone significant changes over my 23-year career. While it is more challenging today to start as a client-facing counsellor the industry, change is gradual. And this relatively slow speed of change allows industry, recruiters and potential candidates to adjust accordingly. I don't know how exactly this will change. But I know that if the right changes are made for the right reasons, all stakeholders will adjust and there will continue to be a need for the financial advice industry – hence jobs for hopeful candidates.

Part 5 (Measured to Mitigate Potential Impacts & Unintended Consequences)

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

a. access to advice for investors,

As your own research highlights, most with investable assets of $100,000 or less are not getting advice (be it due to lack of acceptable options or to choice). I don't expect that to improve materially on a net basis under the proposal. Nor do I expect the noted mitigation measures to help materially in this regard.

b. choice of payment arrangements for all investor segments, and

Choosing among a variety of payment arrangements is ideal but I no longer believe this to be feasible. Clients have technically had this choice for as long as I can recall. Yet the vast majority 'chose' commissions. But this was more of a passive choice than an active one. While some dealing representatives present a choice of compensation methods to clients; most do not. The vast majority of advice providers are compensated by commissions; the prevailing payment arrangement. This was not explicitly chosen by most clients. It was accepted when presented and explained. But survey after survey suggests that this was either not explained well or not well understood from the outset. So it's a stretch to call this a choice.

Since investors in fee-based accounts aren't actually writing a cheque for the fee – i.e. it is charged directly to the account – directly charged asset based fees can be considered somewhat passive. But greater transparency allows prospective clients to make a more informed choice; thereby injecting more accountability to the relationship between clients and their dealers and individual representatives.

The consultation paper makes a couple of references to hourly fees and flat fees as possible alternative direct pay arrangements. While this is theoretically true, these fee models are not feasible given the current industry structure, regulator and business environment. Unlike the legal and accounting professions there is no embedded demand for investment and financial advice. Quite the contrary, over the past two decades efforts have continued toward empowering individuals to take charge of their own investments.

Moreover, hourly fees are problematic in that it discourages contact between clients and advisor – or has the advisor doing a lot of work for free. Each outcome is far from optimal; but again does not align with the costs and legal responsibilities of administering and managing client accounts. Much of the same can be said of flat fees. The only fee model other than asset based fees that might work is a monthly retainer model. But any firm that adopts this model will likely have a tiered pricing model that is tied either to specific services or to household asset levels. In either case, prices will be set at levels that equate to asset based fees being charged today.

c. a level playing field amongst competing investment products?

Other than trying to convince other regulators to get onside, there isn't much that can be done to level the playing field across products falling under different rules.

28. What other measures should the CSA consider to mitigate the above unintended consequences?

I don't have specific suggestions at this time but always welcome the opportunity to discuss this issue in more detail.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

a. Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.

Yes it would. Direct pay fee arrangements – where fees are charged to client accounts – need not trigger negative tax consequences (e.g. taxes payable; additional reporting; higher tax filing fees). This is easily mitigated by holding small amounts of residual cash in each client account; having distributions paid in cash (to replenish cash); and periodically investing excess cash.

While this introduces some cash drag, it's minimal given the cash required. Charging fees by debiting each client's cash balance has no tax consequences. And the combination of cash distributions and periodic reinvestment keeps cash balances fairly steady. While this is easier to implement for discretionary accounts, a similar solution can be designed for non-discretionary accounts.

b. To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?

   Yes, if funds are simply wound-up, liquidated and proceeds paid out. But I expect that the more common outcome would see investors in one series simply switched to another series within the same legal entity (i.e. mutual fund trust or mutual fund corporation). For tax purposes this is known as a reclassification of shares or units; and occurs on a tax-deferred basis.

c. What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

   See my answer to 29 (a) above.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

a. to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;

   It's not a given that this loss would occur. Higher net worth investors are generally paying lower percentage fees (albeit higher in dollar terms) as a result of client demand for lower costs and competitive pressures. As I noted in my response to question #27 (b) even a retainer model would be tiered to reflect the additional work required for higher net worth households.

b. does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and

Every business prices its products and services above the cost of providing said products and services. This is the profit margin. Various regulatory measures and changes in the operating environment will see margins ebb and flow. And some client segments will be more profitable than others (though this depends on each firm's or representative's target market and services provided). But it is essential to the sustainability of every business to price its products and services at a level that allows for some profit margin.

c. what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?

The continuation and evolution of tiered fee schedules will address dealers' revenue and profit needs while charging higher net worth clients lower percentage fees.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

The industry has already been acting in this regard by lowering fees across the board, providing better pricing for large investments and by offering lower fee products for fee-based and discretionary platforms. In addition, launching ETFs has added to the lower fee products they now offer.

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

    a. Are there unique costs or challenges to specific businesses?

       No transition necessary since our firm manages discretionary managed accounts on client's behalf; with fees charged directly to client accounts; and reporting with full transparency that is well ahead of regulatory minimum standards.

    b. What transition period would be appropriate?

       None; see answer to 32 (a) above.

    c. Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

       Allowing existing schedules run their course seems reasonable.

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

    No comment.

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

    When commissions are embedded and are neither transparent nor negotiated, it can make sense to implement caps. But where fees are transparent and explicitly charged directly to clients; the industry should be free to let competitive forces decide organically fee levels that are acceptable to clients.

It is my hope that the CSA can find a way to engage the end investor in consultations like this – e.g., town hall and community outreach programs – particularly on an issue like this that so directly and significantly impacts them.

Otherwise I hope that you find my input somewhat helpful and informative. I remain, as always, eager to further discuss this issue with you as you review comments and consider next steps.

Sincerely,

Dan Hallett, CFA, CFP
Vice-President & Principal
HighView Financial Group
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VIA E-MAIL:

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June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territories
Registrar of Securities, Nunavut

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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Montréal, Québec
H4Z 1G3

Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions

We are writing on behalf of ATB Investor Services with respect to the CSA consultation paper published on January 10, 2017 seeking input on potential impacts of discontinuing embedded commissions.

Background on ATB Investor Services

ATB Investor Services (ATBIS) is a trade name under which three legal entities wholly-owned by ATB Financial operate: ATB Investment Management Inc.(ATBIM), ATB Securities Inc.(ATBS) and ATB Insurance Advisors Inc. ATB Financial is a Crown corporation owned by the Province of Alberta.

ATBIS had approximately $16.7 billion in assets under administration as of March 31, 2017. ATBIM is registered as a portfolio manager and investment fund manager; in addition to its private counsel business, ATBIM acts as portfolio advisor and manager of ten mutual funds. Those funds are primarily distributed through ATBS, an IIROC Dealer Member.

General Comments

We believe that investors deserve access to advice regardless of invested dollars and investment fund managers and advisors deserve to charge a fair price for the advice provided. Investors should also receive – from investment fund managers and dealers – sufficient information to understand what they are paying for advice so that they may assess the value of it.

Recent regulatory changes, like implementation of new fee and compensation reporting under CRM2, has improved the information available to investors. It is, however, too early to tell whether better information – and potentially more questioning of fees – will result in investors really challenging their advisors to demonstrate that they are getting value for fees paid.

While we understand the CSA's desire to treat the past CRM work, best interest / targeted reforms and this consultation as somewhat separate initiatives, we believe they share a common goal of accelerating the evolution of investment firms to a less conflict of interest-ridden, more client-focused model. We have some concerns that treating these initiatives separately may have unintended consequences for investors, so would find it highly desirable for the CSA to consider and implement any future initiatives as part of a coordinated roadmap.

Key Investor Protection and Market Efficiency Issues Raised by Mutual Fund Fees and Related Evidence

We agree that the issues identified in the consultation do exist, although perhaps not universally across all investment fund managers and dealers. Of acute concern are fee or compensation practices that influence advisor or investor behaviour in selecting or retaining an investment product for reasons other than the investment thesis. We also agree that embedded fees, and particularly the proliferation of complicated fee structures, contribute to the uncertainty investors may have regarding what they pay for investment advice and ultimately the value of that advice.

However, we question whether the issues identified arise not because of the inherent nature of embedded fees, but because investment industry participants are choosing to implement embedded fees in a manner contrary to the interests of investors.

An embedded trailer fee, for example, should be (but is not always) conceptually easy for an investor to understand if the disclosure practices of a dealer exceed the regulatory minimums. Use of an investment product with an embedded trailer fee is operationally efficient, requires less paperwork to initiate and maintain, and allows a wide-variety of securities to be held in a single account. If embedded trailer fees were the same across all investment funds, many of the issues highlighted in the consultation would not be nearly as significant particularly since growth in assets means a growth in the trailer fee collected (on a dollar basis) thus creating some alignment in interests between investor and advisor.

We note that one of the issues identified is misalignment between fees paid and value received. The CSA has presented evidence in this consultation and previously to suggest that the value of advice may exceed the benefit to investors, much of this predicated on the inability of advisors to consistently "beat the market". The consultation briefly notes that there may be other benefits of advice that, being chiefly behavioural, are intangible in nature.

We would argue that the consultation does not give the behavioural impact of good advice its full due. Good advice helps investors understand their goals and marry those objectives to an investment strategy that is expected to deliver the risk-adjusted returns that enable meeting of those goals. Good advice helps manage investor expectations, exhilaration, and fear under all market conditions. Good advice is not just selecting a security that returns more than the market over the short-term.

Most importantly, good advice is not tied to executing a transaction. Fee-based arrangements – whether direct-pay or embedded trailer fees – differ from commission-based compensation arrangements in their ability to remind investors that advice is being paid for and available even if an investor is not contemplating a trade.

Overview of the Proposed Option to Discontinue Embedded Compensation

We believe that it is in the best interest of investors to have access to good advice and have a clear understanding of the cost of that advice so they can assess whether there is alignment with the value received. We also have observed that the industry has only begun to evolve, with regulatory prodding, towards achieving this so we understand why the CSA would propose something as far-reaching as prohibiting embedded fees to accelerate this evolution. If the CSA lacks faith in the investment industry that it will make the necessary improvements on its own, we accept – grudgingly – that prohibiting trailer fees may be a necessary step to effect change even though we feel there is a less-radical approach that would still enable the CSA to meet its regulatory goals.

We are of the view that any prohibition against embedded fees should have as wide an application as possible. Coordination in respect of insurance products is particularly important so as to avoid regulatory arbitrage. We would be very concerned if dually-licensed individuals are permitted to offer segregated funds with and embedded fee component while at the same time maintaining a full securities registration. We feel this is particularly important given recent industry anecdotes suggesting that dual-licensed individuals elected to sell insurance products to avoid CRM and POS disclosure requirements.

We do not believe that investment fund managers should be able to facilitate payment of dealer compensation if embedded fees are discontinued. The complexity of this activity (assigning a particular fee rate to each client account in the investment fund manager book of record) favours organizations which are able to manage this activity internally (or with a related-party). Accordingly, investment fund managers who rely upon a third-party service provider currently to collect embedded fees may not be able to offer a similar service to dealers. This may provide an incentive to dealers to offer funds from certain investment fund managers, which we believe creates a new conflict of interest to consider.

Depending on the exact mechanism in which fees would be collected, we would note that allowing an investment fund manager to collect fees on behalf of a dealer may result in an investor experience not materially different from existing embedded trailer fee arrangements because fee transactions may still be "hidden" from dealer account statements. That may result in an unfortunate circumstance where significant work is done to make this process operationally effective, but the actual benefit to investors is no greater than keeping the existing trailer fee approach.

Regulatory Impact & Mitigation Measures

We would agree that discontinuing embedded fees will address many of the key investor protection and market efficiency issues identified in the consultation, at least to some extent. Embedded fees are most likely to be replaced by fee-based accounts, commission-based (front load), or fee-for-service arrangements. Each of those arrangements addresses the issues somewhat differently are discussed below.

Fee-based Account Arrangements

Fee-based accounts holding investment funds closely parallel the existing embedded trailer fee regime with two notable exceptions: visibility of fee transactions in dealer account statements and (potentially) the ability to influence the level of fees.

With respect to the latter, larger clients will have access to tiered fee structures and possibly the ability to negotiate even lower fees. We believe, however, that the CSA may be overestimating the ability to extend this power to investors with fewer investable assets. Smaller investors are unlikely to obtain a level of control over fees similar to that afforded to larger investors, and may end up with fees equivalent to existing trailer fees. As a result, the only gain for smaller investors might be greater clarity on fees.

We would note that many investors, particularly smaller investors, have expressed a reluctance to enter into fee-based arrangements in order to avoid the periodic redemption of investment fund units to raise cash for fees. Fee-based accounts can also be problematic if an investor wants to hold securities other than investment funds. In that instance, unless a firm has the technological capability to assign a fee code to an asset or asset type instead of at an account level, a client could end up with two accounts (fee-based and transactional) or all assets subject to fees. This means that clients may have a choice between accepting a change in performance reporting (especially since the new performance reports are mandated at an account level) and paying more fees. We are concerned that this added complexity may make it much more difficult for an investor to understand his or her progress towards investment goals.

Commission-based Account Arrangements

Employing front-end load funds in a commission-based account will avoid problems described above with fee-based accounts. However, we feel that a turn to commission-based accounts simply migrates the nature of the conflict of interest to the potential for more frequent trading (or outright churning) for revenue purposes with no real benefit to the investor other than the simplicity and visibility of the fee structure. Perhaps more importantly, commission-based accounts (perhaps unconsciously) promote the idea that advice is needed and given only when a transaction is necessary. We do not see this as a positive development in the client-advisor relationship, nor is it setting the conditions for the provision of "good advice".

Fee-for-service Arrangements

Fee-for-service on an hourly basis is certainly well-entrenched in the legal and accounting professions but rarely seen in the investment industry, at least with retail investors. As a true "pay for what you use" model, fee-for-service arrangements would result in very good alignment with the amount of advice given and the fees paid; as the quality of advice given cannot be known as quickly as legal and accounting advice might be, there may be less of an immediate connection made to fees paid. However, dealers implementing this model would need to develop an entirely new technological and operational infrastructure to bill clients, so we would expect very little adoption of this approach except perhaps in the high net worth area.

We would also note that under a fee-for-service model an investor is most likely to obtain advice when he or she is unsure of a course of action (much like legal and accounting services). That may lead to the unfortunate consequence of investors avoiding getting advice about investment actions they have a high degree of conviction about, even if not in their best interest i.e., not when coaching and counselling not to take a potential action would be most helpful.

"Advice Gap" Issue & Transitional Matters

The consultation asks whether it is likely that an "advice gap" could arise if embedded fees are discontinued. Some have been expressed the view that elimination of embedded fees (or the potentially more impactful targeted reforms as initially presented) could result in a vast campaign of client de-marketing from firms as it is effectively business model-destroying. We believe, however, that impact will be more subtle. If there is fee compression (as anticipated), we believe that dealers may be forced to further rationalize their service models and this will likely impact the structure of the market available to service investors over the long term.

Lower advisory fees will impact smaller dealers the most as they lack the scale to absorb reduced revenues. We see the large, integrated bank-owned firms benefiting the most from discontinuing embedded fees as they have the operational and technological scale to adapt and, most importantly, employ a large number of registrants whose role may be to offer banking products in addition to investment products. Should smaller firms need to adjust their service focus, the integrated bank-owned firms have an existing cost effective platform to receive clients who can no longer be serviced by smaller dealers. We do not see this as a win for most investors, as the quality of advice may drop in parallel to the reduction in fees, further exacerbating the gap in advice available to smaller investors versus larger investors.

It is important to remember that while much of the discussion around fees centres on percentages and basis points, each dealer can ascribe a cost on a dollar basis to a client account that is not contingent on account size. In that regard, advisory fee compression is most likely to favour larger investors, particularly if cross-subsidization (to the extent it exists) is reduced or eliminated and fees for larger investors drop. Fees for smaller investors may rise as pressure from potentially reduced advisory fees in the middle to upper client tiers causes dealers to consider ways to recover higher fees – on a dollar basis – from smaller investors.

One circumstance in which we can envision this occurring would be if firms instituted a minimum fee amount for all clients for fee-based accounts. It is highly likely that the minimum amount will be above that which would typically be collected through an embedded trailer fee arrangement. While a smaller investor would not be de-marketed in that instance, we are concerned that small investors may elect to opt-out of firms that offer advice and choose to maintain accounts at discount brokerages in order to minimize costs

Most of the comments in the foregoing come from the dealer perspective. As an investment fund manager, we welcome any action which inhibits fund managers from motivating dealers and advisors through means other than their investment philosophy and investment track record. We also support initiatives that simplify and rationalize fee structures. There may be an operational impact on investment fund managers in addressing increased transaction levels as unitholders redeem units to raise cash for fees, but this is likely to lead to increased costs without additional operational complexity.

However, we reiterate our general opposition to allowing investment fund managers to collect advisory fees on behalf of dealers, however. Yes, this mitigates some operational challenges that could be faced by dealers (especially smaller ones) but it potentially puts the operational burden and increased liability onto investment fund managers.

While the CSA appears to have pre-emptively dismissed this idea, we believe there is an argument for allowing investment fund managers and dealers to continue to make use of an embedded trailer, on the condition that investors can determine whether the trailer fee could influence advisor behaviour. We believe this could be accomplished through disclosure by the investment fund manager of not just the quantum of the trailer fee, but how that trailer fee compares to industry averages. Alternatively, there may be an opportunity to use regulation to standardize the trailer fee that may be charged to eliminate the ability of an investment fund manager to use the magnitude of the fee as a differentiator.

With improved disclosure to investors, we feel that an embedded trailer fee that is conflict-mitigated offers an efficient and effective mechanism for smaller dealers without the risk transfer envisioned in the proposal to allow investment fund managers to collect fees on behalf of dealers.

We agree that the 36 month timeframe post the Effective Date should be enough time to complete the transition. However, we would look for guidance to be issued by the CSA and/or the self-regulatory organizations on how to address any instance where, despite best efforts, a client does not complete the requisite documentation to set up an account to support a new fee structure. In those instances, we would expect to be able to complete the transition steps without client consent.

Related Regulatory Initiatives and Existing Tools

We believe that regulatory initiatives to date (CRM and POS) and prudent further changes planned (target reforms) would address most of the investor protection and market efficiency issues...if firms would go beyond meeting only the minimum compliance requirements and put their clients' interests ahead of that of the firm. As noted above, we believe that regulation addressing certain fee structures to mitigate the likelihood of investment fund managers influencing advisor recommendations through compensation, when combined with other regulatory initiatives, would address the issues without an outright prohibition of embedded fees.

The consultation points out that certain issues – particularly lack of investor control over fees and misalignment of fees paid to perceived value – would not be well addressed by other regulatory initiatives underway, necessitating discontinuation of embedded fees. We do not disagree with this assertion, but we also suggest that these two issues are also the least likely to be fixed through prohibition of embedded fees. Removal of embedded fees may be very effective in mitigating potential conflicts of interest and result in an incremental gain in understanding of fees, but we believe that these two issues (that most closely align with smaller investors) will only be fully addressed by firms actively engaging with clients to explain the nature of the client-advisor relationship and its relationship to fees paid.

Summary

To conclude our comments, we would like to consider the debate regarding embedded commissions by drawing a loose parallel with the healthcare industry.

As Canadians, we pay income tax to fund the medical system in each province. Rarely do we pay for specific services; what our taxes really give us is access to medical services. Some pay more in income tax than the actual value of medical services received, and some pay far less. Either way, cost is rarely an issue in Canada when an individual decides to make use of medical services.

However, when it comes to dental services we – for the most part – only pay for what we receive. As a result, many only go to a dentist when absolutely necessary in order to minimize expense, even if ongoing expenses associated with preventative care would save money in the long run.

If the securities industry did a better than (the admittedly poor) job it does today in explaining to investors that the existence of embedded trailer fees should equate to ongoing access to advice, more investors might elect to reach out for that advice on a more regular basis. Much like many Canadians visit a doctor for check-ups instead of when medical intervention is critically needed.

We are concerned that eliminating embedded fees in their entirety could prey on the price sensitivity of investors and cause them to avoid obtaining advice even more than they do now. In particular, we anticipate that investors faced with only a direct pay model could react by moving to no-advice platforms, or fee structures that perpetuate the belief that advice matters only when there is a transaction imminent i.e., when there is a "toothache".

Through recent regulatory initiatives and internal industry pressures, there has been a steady but slow evolution towards better practices regarding fees. We can appreciate the CSA's desire to accelerate this through regulatory change, but we would encourage the CSA to consider whether there is a regulatory step before blanket prohibition of embedded fees that may mitigate the issue of conflicts of interest between investment fund managers, dealers and investors without further reducing the likelihood that investors seek out good investment advice.

We appreciate the opportunity to provide you with our comments on the CSA Notice and Request for Comment. We look forward to our continued participation in any further consultation on this topic and would be pleased to discuss our input in greater detail with you. Should you have any questions or wish to discuss these comments, please contact me directly by telephone at (780) 977-8812 or by email at bkimak@atb.com.

Yours very truly,

ATB Investor Services

(signed) “Brett Kimak”

Brett Kimak
Chief Risk Officer & Head of Compliance

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June 9, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Dept. of Justice and Public Safety, PEI
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut
Superintendent of Securities, Yukon

Submitted via email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

Dear Sirs and Mesdames,

Canadian Imperial Bank of Commerce ("**CIBC**" or "**we**") is pleased to provide comments on the Canadian Securities Administrators' ("**CSA**") Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the "**Paper**") which consults with stakeholders on the potential option of discontinuing embedded commissions and transitioning to direct pay arrangements in Canada. CIBC directly, and through its subsidiary, CIBC Asset Management Inc., manages several families of mutual funds. In addition, several CIBC subsidiaries provide dealer services to clients through which mutual funds are sold.

We support the CSA's goals of increasing transparency, reducing the complexity of fund fee structures and achieving investor awareness, understanding and control of dealer compensation costs. We are also supportive of the CSA's desire to ensure fair, efficient and competitive capital markets. However, we believe that the CSA should carefully consider the impact of regulatory initiatives that have been recently implemented to address many of the same objectives as the Paper and consider the potential unintended consequences of discontinuing embedded commissions before making any broad regulatory changes.
Our response will not address all of the specific questions posed by the CSA, but rather will highlight what we view as important considerations, including the potential impact on investor choice and access to advice. In addition, CIBC has participated in working groups established by the Investment Fund Industry of Canada ("**IFIC**"), the Investment Industry Association of Canada ("**IIAC**") and the Portfolio Management Association of Canada ("**PMAC**"), to study the Paper, and we share many of the concerns raised in the IFIC, IIAC and PMAC response letters.

Discussion

Assess the Impact of Recent Regulatory Changes and Proposals

The CSA has recently implemented new rules which are aimed at improving investor awareness and understanding of fees and performance under point of sale disclosure ("**POS**") and the client relationship model phase 2 ("**CRM2**"). The CSA has also consulted on a proposal to enhance the relationship between clients and their advisors and dealers through CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* ("**CSA CP 33-404**"). POS and CRM2 have had an impact on the disclosure of mutual fund fee information, including information related to trailing commissions. These initiatives are expected to increase investor awareness of the costs of investing in mutual funds and address many of the CSA's concerns discussed in the Paper. We are of the view that Canada has a regulatory framework that is aimed at addressing many of the investor interest concerns highlighted in the Paper and that a thorough assessment of the impact of POS and CRM2 and any potential impact of the proposals outlined in CSA CP 33-404, if implemented, should be made prior to any discontinuation of embedded commissions. Consequently, we encourage the CSA to ensure that, before it proceeds with any further regulatory action, it gives adequate time to allow for a meaningful assessment of the impact of any such action.

Unintended Consequences

We are concerned that proceeding with a discontinuation of embedded commissions without carefully exploring the impact of this change could have unintended consequences. We believe that eliminating embedded commissions may disproportionately impact less affluent Canadian investors and, in particular, those investors that deal with smaller independent dealers. Such investors may be unwilling to pay for, or appreciate the value of, advice in a direct pay model. Nor is it clear that such investors would be inclined to obtain advice from robo-advisors as is suggested by the CSA. This and other unintended consequences need to be properly addressed in the consultation and should be reflected in any possible final proposed implementation timelines to allow market participants sufficient time to structure their operations, educate their clients and refine their offers.

Conclusion

CIBC supports the CSA's efforts to increase investors' awareness and understanding of the costs of owning mutual funds so that they can make informed investment decisions. We are of the view that many of the potential regulatory actions outlined in the Paper could have significant unintended negative consequences for investors and market participants. In addition, CIBC encourages the CSA to carefully monitor and assess the impact of current regulatory initiatives in Canada and internationally before taking steps to propose further changes in Canada.

We thank the CSA for this opportunity to provide comments on the Paper and look forward to participating in further discussions.

Yours truly,

Steve Geist
Senior Executive Vice-President and Group Head
Wealth Management

Marc-Etienne L Salvail, B.A.A. Finance
Planificateur financier, représentant en épargne collective, conseiller en sécurité financière
Associé principal chez Financetoimieux.com et GestionFTM

LETTRE CONSULTATION AMF

PRÉAMBULE

Lorsqu'on m'a proposé d'écrire une lettre afin de donner suite à la consultation effectuée par l'AMF, j'ai pensé qu'il était de mon devoir de vous offrir mon opinion sur la question, car je crois être en mesure de bien représenter la relève de l'industrie. Mon cabinet a accueilli plus de douze stagiaires en assurance de personne au cours de la dernière année, dont plusieurs sont également représentants en épargne collective. Je suis donc très bien placé pour comprendre les enjeux importants de la relève et de l'amorce d'une carrière dans le domaine. J'ai également vécu les différents enjeux auxquels nous devons faire face lors du démarrage d'un cabinet en services financiers, puisque nous en avons démarré deux en 2016-2017. Avec tous les conseillers que nous avons initiés à la carrière, nous sommes fiers de dire que notre taux de rétention est de 100 % à ce jour. C'est donc signe que nous avons su réunir les éléments de succès importants pour une entrée en carrière réussie.

La question des commissions intégrées est plus large qu'une simple divulgation et une banale transparence face à la rémunération de l'industrie. Lorsque nous achetons un meuble dans un magasin, le manufacturier a-t-il à divulguer son prix (coût) coûtant ou affiche-t-il seulement son prix de vente? De par cette analogie, je cherche à démontrer une logique. Il est important d'afficher un prix, certes, mais il serait impensable, lorsque vous achetez une table de cuisine, de payer une première facture directement au fabriquant de meubles et ensuite en payer une deuxième, pour sa quote-part, au magasin de meubles qui vous a vendu l'item. Demandons-nous aux vendeurs de voitures de soumettre à leur client leur commission sur une facture à part? Déjà que notre industrie nous demande de dévoiler notre commission depuis MRCC2. Ce faisant, nous démontrons davantage de transparence que beaucoup d'autres travailleurs, tous marchés confondus. Certains magasins de meubles établissent leurs campagnes de marketing sur le prix, d'autres sur le service. Tout dépend de leur stratégie, même que certaines bannières réussissent à faire payer leur client, pour un même produit, beaucoup plus cher qu'un concurrent. Dans le cas présent, nous parlons d'un simple meuble, mais qu'en est-il des finances des Québécois? Maintenant, voulons-nous vraiment ouvrir cette porte? La population est-elle assez éduquée financièrement pour prendre une décision éclairée par rapport au prix et aux produits financiers qu'elle achètera et ainsi ne pas se laisser berner par le marketing imposant axé sur les frais? Poser la question, c'est y répondre, selon moi. Quantité de consommateurs, principalement les moins bien nantis, feront leurs achats de placements en se basant uniquement sur le coût, mais beaucoup se feront berner par une campagne de marketing réussie, alors que des milliards de dollars y sont investis chaque année.

Dans le contexte d'une population bien éduquée financièrement, le consommateur serait en mesure de comprendre la valeur ajoutée du conseil. Malheureusement, ce n'est pas le cas. Donc, qui sera réellement en mesure de jauger la valeur du conseil afin de payer le juste prix? Autant certains pourraient facturer des prix faramineux pour des conseils médiocres, autant des épargnants ne voudraient pas avoir à payer pour des conseils à forte valeur ajoutée, car à première vue, ils ne seraient pas en mesure de comprendre pourquoi ils paient. Qui sera en mesure de définir la valeur d'un conseil au sein d'une population aussi pauvre en connaissances financières et où l'analphabétisme financier bat son plein? Je vois déjà les publicités et le lobbying des grandes institutions montrant comment leurs conseils sont excellents et à quel point ils ne sont pas coûteux, alors qu'en réalité, ça ne vaudrait pas cher, car il est impossible de recevoir un service de qualité sans devoir payer le juste le prix, une expertise, ça se paie. Mais qui pourra en juger réellement? Maintenant, comment les petits cabinets indépendants peuvent-ils rivaliser avec des budgets de marketing de plusieurs milliards de dollars?

Ensuite, la disparité sur le plan de la rémunération fait en sorte que par moments, la pratique de l'industrie est axée davantage sur la rémunération du produit que sur le produit en soi et ses caractéristiques. La preuve est la suivante, et je la vis au quotidien : souvent, les représentants de compagnie de placements en fonds mutuel nous parleront davantage de la structure de la rémunération que du produit lui-même. Lorsqu'on demande conseil au représentant d'une compagnie de fonds, le portefeuille alors conseillé est bâti d'abord en fonction de la rémunération. Ainsi, les fonds d'obligation sont souvent boudés au détriment des fonds équilibrés ou des fonds d'actions, étant donné la meilleure rémunération octroyée pour ces types de fonds. Sont-ils à blâmer ? Si les représentants de compagnies de fonds agissent de la sorte, c'est que cette stratégie fonctionne, que plusieurs conseillers en placement adhèrent à cette pratique et que les compagnies de fonds mutuels obtiennent du succès avec cette approche. Cependant, et au risque de se répéter, est-ce à l'avantage du client? Certainement pas. Le conflit d'intérêt est omniprésent. Comment régler ce conflit d'intérêt au chapitre des incitatifs? En nivelant les commissions, peu importe qu'il s'agisse d'un fonds d'obligations ou d'un fonds d'actions. La rémunération devrait être la même, puisque dans les faits, l'épargnant paie pour du conseil et ce dernier est tout aussi important, qu'il s'agisse d'un fonds d'actions ou de fonds obligataires. Une réelle manière de diminuer de beaucoup les conflits d'intérêt consiste, selon moi, à uniformiser les commissions d'une compagnie à l'autre et d'une série à l'autre. Ainsi, lorsque les fonds paieront tous de la même manière, cela ne viendra pas influencer la recommandation du conseiller à son client.

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QUESTION 2 – Systèmes et opérations

- **Quelles répercussions la proposition aurait-elle sur vos systèmes et processus opérationnels et de conformité?**

Cela viendrait embourber davantage les conseillers sur le plan administratif. Ceci dit, ils passeraient plus de temps dans les papiers et moins avec le client. C'est donc bien évident que cela aurait pour effet de diminuer l'offre de service en première ligne, ou alors les conseillers devront assumer une baisse importante de revenus. Selon le sondage réalisé par la CDPSF auprès des représentants en épargne collective, c'est sans surprise que près de 72 % pensent que cela augmentera la gestion administrative.

Lorsque des clients traversent des périodes difficiles, dans quel secteur coupent-ils en premier? Le premier frais qui sera négligé à cause d'un budget serré sera les honoraires payés au conseiller. Est-ce vraiment une bonne chose alors que justement, c'est dans ces moments précis que nous avons probablement le plus besoin de conseils. Aussi, qu'adviendrait-il de l'administration des comptes sous gestion dans le cas où un client ne paierait pas sa facture? Faudra-t-il envisager une gestion supplémentaire pour les mauvais payeurs? Encore de l'administration en surplus! Et que ferons-nous avec le compte du client qui ne paie plus? On lui verse l'argent dans son compte bancaire? Je n'ai pas toutes les réponses, mais j'entrevois un fardeau supplémentaire pour le conseiller, et ce, combiné à une rémunération probablement moins importante, car il reste difficile de faire valoir le prix de nos conseils auprès des clients peu éduqués financièrement. Ainsi, pour avoir des clients, il faudra baisser nos honoraires, sans quoi il sera très difficile de développer une clientèle.

Finalement, un autre point qu'il ne faut pas négliger est l'émotion des marchés. Nous sommes tous au courant que le pire ennemi de l'investisseur, ce sont les émotions. Ainsi, pour un client, de voir chaque mois son compte débité d'un frais par son conseiller alors que les marchés sont en baisse n'aura d'autre effet que d'amplifier ses décisions irréfléchies de retirer son argent, et ce, probablement au pire moment alors que son portefeuille a subi une baisse significative.

QUESTION 3 – Interfinancement

- **En ce qui a trait à la perte d'une forme d'interfinancement provenant des investisseurs fortunés au profit des investisseurs moins aisés à la suite d'un passage à des mécanismes de rémunération directe :**
    - **Dans quelle mesure cette perte augmenterait-elle le coût de la prestation de conseils et de services aux investisseurs moins aisés dans le cadre des mécanismes de rémunération directe?**

Il est bien évident que les clients plus fortunés permettent au conseiller de proposer des services aux clients possédant de plus petits portefeuilles. Mais encore faut-il avoir des clients plus fortunés et en début de carrière, nous commençons tous avec de plus petits clients. Ainsi, dans ce cas, l'interfinancement n'est pas une option.

Pour le client, le conseiller a besoin d'une rémunération s'il veut être en mesure de poursuivre son travail demain et être encore présent dans 5, 10 ou 15 ans. Il est bien évident qu'une structure de rémunération à honoraires aurait pour effet de diminuer de façon importante la rémunération globale. Or, qui dit baisse de rémunération dit baisse de services et d'interfinancement. Conséquemment, qui sera intéressé à servir et à conseiller les jeunes professionnels arrivant sur le marché du travail alors qu'ils en auront le plus besoin? Qui s'occupera des comptes de 10 000 $, 20 000 $ ou 50 000 $? Pourtant, ces clients ont aussi besoin de conseils, et avant d'avoir 200 000 $ ou 500 000 $ sous gestion, majoritairement, ils ont commencé avec de plus petits montants. Ainsi, la majorité des petits épargnants seront redirigés vers les grandes institutions car personne ne voudra s'occuper d'eux, et s'ils entament leur processus d'épargne avec une grande institution, bien souvent, ils y demeureront à long terme. Encore une fois, les grandes institutions en sortiront gagnantes. Les commissions intégrées permettent aux plus petits épargnants d'avoir droit à un service de qualité. Quant au conseiller, ça lui permet de générer un revenu intéressant afin de rester motivé et d'être encore là lorsque son client aura des sommes plus importantes à investir à moyen et long termes. Malheureusement, sans la commission intégrée, peu nombreux seront ceux encore dans la course après quelques années.

QUESTION 4 – Carrière

- **Quelles répercussions la proposition aura-t-elle sur les représentants du secteur, en particulier sur ce qui suit?**
  - **Le cheminement de carrière**
  - **L'attrait de la profession**
  - **Le profil type de la personne intéressée par la profession**
  - **Le recrutement**
  - **L'attrait relatif d'une carrière dans les services financiers**

Sur le terrain, l'impact d'une abolition des commissions intégrées serait catastrophique du point de vue de la relève dans l'industrie, et ce, à un moment où cette dernière a le plus besoin de relève, ses acteurs actuels accusant une moyenne d'âge de plus de 55 ans. L'amorce de cette carrière étant déjà particulièrement très difficile, les commissions intégrées permettent aux jeunes conseillers de générer un revenu acceptable durant leurs premières années de travail. C'est ce même jeune conseiller qui, un jour, prendra la relève des conseillers plus vieux, poussés vers la retraite. Cependant, s'ils ne sont pas en mesure de passer à travers ces premières années, qui restera pour prendre la relève ensuite?

Certes, les frais doivent être divulgués. Nous pouvons être d'accord sur ce point. Ceci est une question de transparence et d'intégrité face à nos clients et à l'industrie. Les conseillers doivent maintenant mieux justifier leur rémunération et apporter une valeur conseil à leurs services, ce qui était moins nécessaire avant MRCC2.

Maintenant, l'idée d'abolir les commissions intégrées est-elle une solution pour obtenir encore plus de transparence? Probablement que cela aiderait, en effet, mais créerait du même coup un nouveau problème, celui du manque de relève qualifiée. Depuis peu, les préalables en termes de scolarité ont été abaissés à un simple secondaire 5 pour devenir conseiller en sécurité financière. Pas très prestigieux pour la profession, et je peux vous confirmer que l'abolition des commissions intégrées aurait pour effet de décourager des candidats hautement éduqués à faire carrière en services financiers. Le fardeau de la conformité étant déjà très lourd à supporter pour un conseiller autonome, demandons-leur maintenant d'établir leurs tarifs et de gérer en plus un système de facturation à honoraires pour leurs placements sous gestion et nous venons de décourager de manière importante le peu de relève qui reste dans l'industrie en matière de conseillers indépendants. Il est normal qu'après quelques années, plusieurs passent à des comptes à honoraires. Ils connaissent alors mieux les enjeux et sont en mesure de bien faire

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valoir leur rémunération, mais demander à quelqu'un qui entre dans l'industrie d'avoir les mêmes aptitudes et les mêmes connaissances du marché sur le plan de la concurrence est illusoire. Les comptes à honoraires viennent avec une certaine expérience. Encore une fois, les grandes institutions financières en sortiront avec plus de pouvoir.

Il ne faut pas oublier que la valorisation d'une clientèle est basée principalement sur la valeur des renouvellements, et donc, des commissions de suivi. Il sera alors beaucoup plus difficile de faire financer l'achat d'une clientèle.

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QUESTION 5 – Représentant débutant

- **À quels autres modes de rémunération les représentants débutant dans le métier pourraient-ils avoir recours si les commissions intégrées étaient abandonnées?**

Est-ce que la méthode de rémunération doit rester inchangée? Je crois que non, et la majorité des principaux intéressés sont probablement d'accord que des modifications doivent être apportées. Menotter le client avec des pénalités à la sortie au profit du conseiller via une commission accélérée n'est en aucun cas à son avantage. Cependant, donner la charge au conseiller selon un prorata est, selon moi et plusieurs autres, une solution logique responsabilisant ce dernier. Tout comme en assurance de personne, où les commissions sont renversées au prorata advenant que la police d'assurance soit annulée à l'intérieur d'un certain délai.

La relève d'aujourd'hui se retrouve, d'une certaine manière, à payer le prix pour les lacunes des années passées. Le nombre de clients frustrés rencontrés qui écopaient de pénalités en cas de retrait à l'intérieur de sept ans est effroyable. Lorsque le client est insatisfait des services reçus, c'est lui qui doit payer le prix pour changer de conseiller. Est-ce logique de payer 5 % pour faire appel à un autre conseiller? Surtout que plusieurs conseillers sont excellents pour vendre leur offre de service, mais même dans ce contexte, quelle garantie a le client que son conseiller livrera la marchandise? Dans un premier temps, les pénalités devraient être chargées au conseiller et non au client. Cela aurait pour effet de responsabiliser le conseiller. Je peux témoigner de ce changement d'attitude auprès de nos conseillers envers leurs clients, puisque plusieurs conseillers utilisent cette structure de paye avec une rémunération accélérée, mais comportant un décommissionnement au prorata advenant un retrait du client à l'intérieur de cinq ans. Tous les conseillers de notre cabinet ont pris l'habitude d'expliquer leur rémunération, et tous les clients apprécient cette méthode de rémunération et se sentent libres de quitter advenant une insatisfaction. « Aujourd'hui, j'ai une rémunération, et si pour quelque raison que ce soit, tu n'es plus satisfait de mes services et désires changer de conseiller, c'est moi qui serai décommissionné. Ainsi, j'ai tout intérêt à faire de bons suivis et à m'assurer que je t'offre un placement qui répond réellement à tes besoins. »

Sans commission intégrée, il est difficile de voir comment un jeune pourrait tirer une rémunération décente des services conseils qu'il offre à son client. Surtout que les jeunes conseillers commencent habituellement avec des clients moins bien nantis. Une fois avec un certain actif sous gestion, 10 millions par exemple, l'impact serait moindre, car tu obtiens alors une base de revenus récurrente, et que la commission soit intégrée ou non, les 10 millions sous gestion te procureront une bonne base et ton mécanisme en vaudra la peine. Ce que l'on oublie, c'est qu'avant d'avoir 10, 20 ou 30 millions sous gestion, le conseiller a commencé avec 100 000 $, 500 000 $ et 1 million sous gestion. C'est après plusieurs années dans le milieu avec un actif important sous gestion que l'ensemble des conseillers commenceront à adopter les comptes à honoraires. Ce n'est pas avec leurs premiers 50 000 $ de placement qu'ils l'ont fait, et c'est normal.

Déjà que la rémunération des nouveaux conseillers dans le milieu est relativement faible, une telle mesure viendrait diminuer davantage celle-ci, et cela s'en refléterait par une baisse corrélée de la relève qualifiée.

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Conclusion

En conclusion, je crois effectivement que des changements s'imposent. Voici comment je vois l'avenir de la réglementation face à la rémunération des fonds commun de placement. D'abord, niveler les commissions, qu'ils s'agissent de fonds mutuels, fonds distincts, d'actions, équilibrés, d'obligations, auto-géré, etc. La commission au conseiller devrait être la même, car le conseiller doit être rémunéré pour la valeur conseil. Ensuite, laisser en place les commissions accélérées afin d'encourager la relève qualifiée à faire carrière en service financier, mais abolir les frais de sorti aux clients et transférer cette pénalité au conseiller sous forme de décommissionnement, et limité le délai à maximum 5 ans. Comme cela se fait déjà en assurance de personne. Ensuite dans un autre ordre d'idée, je crois qu'il est du devoir de l'AMF d'obliger le conseiller en sécurité financière à détenir également son permis en fonds commun de placement pour offrir des fonds distincts, et non seulement son permis en assurance de personne. Aussi, je crois que les représentants en épargne collective devraient également être soumis à une période de stage probatoire pour obtenir leur permis comme c'est le cas en assurance de personne. Selon mon expérience, il se doit d'être superviser pendant un minimum de temps avant de pouvoir prodiguer des conseils en placement, cela est une question de protection des épargnants avant tout. Enfin, je crois que le dévoilement des commissions via MRCC2 fera son œuvre à travers les années et la concurrence du secteur fera en sorte que les conseillers n'auront d'autres choix que de se tourner vers des comptes à honoraire pour les portefeuilles de plus de 250 000 $.

J'espères que mon opinion vous aidera à faire votre conclusion pour la consultation en cours. Je demeure disponible si vous avez des questions et il me fera un plaisir d'argumenter davantage si vous avez des questions sur mes propos.

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June 9, 2017

VIA E-MAIL

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:
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comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
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800, square Victoria, 22e étage
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consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 81-408: *Consultation on Banning Embedded Commissions* (the "Consultation Paper")

We are writing in respect of the request for comments dated January 10, 2017 on the Consultation Paper. We appreciate the opportunity to comment on these important matters.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco, Ltd. Invesco is an independent investment management firm dedicated to delivering an investment experience that helps people get more out of life. As of April 30, 2017, Invesco and its operating subsidiaries had assets under management of approximately US$841 billion. Invesco operates in 20 countries in North America, Europe and Asia.

Invesco Canada is registered as an Investment Fund Manager ("IFM"), an Adviser and a Dealer in Ontario and certain other provinces. Our investment products are primarily bought by and sold to retail investors and institutional investors. As such, we take a great interest in regulatory discussions that impact those investors. Please note that we have responded to the consultation questions in an appendix to this letter.

For many years now in the debate over mutual fund and dealer fee structures, Invesco has championed the concept of investor choice. We believe this is important because not all investors are the same, and not all investors need, want or require the same fee structures. For some investors, subscribing for mutual funds on a front-end commission basis makes the most sense, for some fee-based accounts make sense, and for others purchasing under a deferred sales charge ("DSC") option makes the most sense. We do not believe the Canadian Securities Administrators (the "CSA") has exhibited any appreciation for the reasons for these different approaches nor does it seem interested in doing so, especially once it has determined that some of these options give rise to conflicts of interest. Most disturbingly, we find the conflict of interest analysis in the Consultation Paper very weak; rather than explaining how it views the conflict of interest under each purchase option or fee model, the CSA has taken the conflict of interest as "received wisdom". In our experience, adopting received wisdom rather than reasoning out a concept leads to serious errors in analysis and poor outcomes. Because of our championing of investor choice and the CSA's overreliance on received wisdom, we cannot support the CSA initiative to ban embedded commissions. We do not close the door to eventually banning embedded commissions, but, as discussed below, we believe that would be premature at this time.

Notwithstanding the foregoing, we acknowledge the regulatory concerns raised by the CSA in the Consultation Paper. While there are many statements contained in the Consultation Paper with which we disagree, especially those that appear to be mere speculation[1], there are also many valid points made that simply cannot be ignored. Having

[1] See, for example, Consultation Paper pages 51 (about declining fund costs due to fund size), page 52 (on the costs of simplifying fund series), page 52 (entry of lower-cost producers), page 53 (smaller emerging asset managers),

considered the issues raised in the Consultation Paper and other major initiatives over the last several years, we believe the specific regulatory concerns raised by the CSA can be addressed with the following:

1. Prohibit all DSC purchase options; and
2. Set (not cap) trailing commissions at 1%.

While we believe the DSC has its use, we believe it has been distorted over time so as to no longer be in the public interest. We believe setting trailing commissions eliminates the conflict of interest that arises when a mutual fund is recommended or sold based on the rate of trailing commission. While this does not address the conflict of interest that arises from dealing representatives recommending products that pay trailing commissions over those that do not, we believe market forces are well underway to address that issue, primarily through the move to fee-based accounts, the rise in exchange-traded funds (both active and passive), and the increase in discretionary managed accounts. As such, regulatory intervention is not necessary and threatens to disrupt market forces that are behaving in an appropriate manner.

<u>The Trailing Commission Conflict</u>

According to investor advocates and the CSA, trailing commissions are inherently bad because they create conflicts of interest. Unlike other conflicts of interest that the CSA believes can be mitigated, the essence of the Consultation Paper is that these conflicts cannot be mitigated and, therefore, a ban is required. When one considers the range of conflicts of interest inherent in the wealth management industry and the numerous ones that the CSA has decided not to ban (see CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to Their Representatives*) it is hard to comprehend the push behind the current consultation. As such, it is important to properly identify the conflicts of interest arising from trailing commissions.

In our view there are two types of conflicts that arise from trailing commissions:

1. A dealer may recommend one mutual fund over another not on the merits of the investment but on the basis that the recommended mutual fund pays a higher rate of trailing commission than the non-recommended fund, thus enriching the dealer.

2. A dealer may recommend a mutual fund over another investment product type because the mutual fund pays a trailing commission and the other product type does not.

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p.53 (reduction of fund management fees), page 53 (50 bps MER decline due to entry of low-cost providers), pp.54-55 (shift to passive), page 58 (15 bps for online advice), p.60 (lack of outperformance of fund-of-fund products), p.63 (that banks are indifferent to which product a client buys), pp.64-65 (UK cross-subsidization rule as limiting introduction of other delivery models), p.65 (no anticipated change in fund products being recommended by integrated dealers), p.66 and elsewhere (the entire notion that retail investors can negotiate fees)

The first type of conflict was the subject matter of the Cumming Report, commissioned by the CSA following the comment period for CSA Discussion Paper 81-407. Prof. Cumming collected data from a statistically significant portion of the fund industry and ran a series of regression analyses to determine the relationship between sales, performance and certain variables, such as commissions, fee-based accounts, proprietary funds distribution, etc. Prof. Cumming arrived at several conclusions the most important of which for present purposes is that the higher the rate of trailing commission, the greater the sales of the fund regardless of fund performance. In other words, Prof. Cumming found that a poor performing fund can mitigate the impact of performance on flows by paying a higher trailing commission. This conclusion is unassailable.

More controversially, Prof. Cumming sought to determine the cost to the investor as a result of this conflict by determining the "negative alpha effect" of trailing commissions in various scenarios. Whereas "alpha" is generally used to mean the value added by an investment professional relative to a pre-determined benchmark, the negative alpha effect shows what the cost is, in terms of performance, of the variables referred to in the preceding paragraph. In our view, it is this latter conclusion, which is less robust than the first conclusion noted above, that is driving the CSA's clear preference[2] that investors do not invest with active managers, using financial advisors. While individual CSA members are entitled to opinions, acting on this particular type of opinion is far beyond the scope of a securities regulator and there is no authority for this in the *Securities Act* (Ontario) or the equivalent statutes in other CSA-member jurisdictions.

The second conflict is based not on any purportedly scientific evidence and, thus, is dubious. While it is true that mutual funds pay trailing commissions, to suggest that is why they are recommended investments betrays an understanding of retail financial services, investment products and options, and investor needs. Mutual funds are simple to understand and, notwithstanding the myriad critics who have already submitted comment letters and, frankly, would like nothing more than to see the mutual fund industry disappear, they provide better disclosure to those who care about disclosure and/or want to know about their potential or actual investment, than any other investment product offered in the world. Most mutual fund investors have had positive experiences with mutual funds and that is an important aspect of their popularity.

For many years IIROC dealers have offered to their clients the opportunity to invest in separately managed accounts ("SMA") and unified managed accounts ("UMA"). This comes under several models but, on balance, an SMA is like a mutual fund with the primary differences being (a) the investor pays the management fee directly to the dealer, and (b) the investor holds the portfolio securities that an equivalent mutual fund would hold whereas for a mutual fund the investor does not have ownership of the portfolio securities. In contrast, a UMA may hold any type of investment product and is not limited to stocks and bonds. While the investor price for a SMA/UMA is controlled by the dealer, the price is often (though not always) lower than that for a mutual fund. Regardless, Canadian investors have not flocked to

[2] See Consultation Paper, pp. 54 and 55

SMAs/UMAs, although we acknowledge growth rates are high for SMAs/UMAs and this continues to be a focus for full service dealers.

When an IIROC client participates in a SMA/UMA program, the client pays an asset-based fee for the account. Put differently, the management fee paid to a mutual fund (inclusive of trailing commission) is replaced by the asset-based fee. In the case of the mutual fund, only the trailing commission goes on the dealer grid, but on the SMA/UMA, the full fee goes on the grid. Both fees are treated similarly on the grid so where an SMA/UMA might charge 1.75% and the mutual fund trailing commission is 1.00%, the advisor receives the same proportion of these fees. By the laws of mathematics, therefore, the advisor is always better off if the client invests through a SMA/UMA. Therefore, if trailing commission rates drive mutual fund sales, you would expect SMAs/UMAs to have eaten mutual funds for lunch long before the present day. However, that has not occurred. How does the CSA explain this phenomenon? The CSA theory, underpinning the notion that investors are in mutual funds because of trailing commissions, seems rather absurd because the CSA is effectively saying that the dealer is happy to take significantly less revenue in order to "deceive" the investor over fees. Note that the all-in fee for the SMA/UMA is typically lower than a Series A mutual fund management expense ratio ("MER") so this should be an easy sell to an investor.

With the foregoing understanding of the conflicts of interest raised in the Consultation Paper, we can now better consider the concepts set forth therein.

Consultation Paper Concerns

Upon our initial review of the Consultation Paper, we had very negative reactions. While the CSA included much data in the Consultation Paper, some of it surprised us and much of it was, in the context of the Canadian regulatory regime, irrelevant. Yet such "facts" formed the basis for the CSA's proposal. While we will not and cannot address every deficiency in the factual background included in the Consultation Paper, we will address several of significant concern and relevance.

What Advisors Sell And Why

The CSA believes that dealers and their representatives sell funds that compensate them the best or focus only on funds that pay a trailing commission.[3] We believe there is merit in the first part of this assertion – and we address that in our alternative proposal – but we do not believe there is merit in the second part of this assertion. It is our view that many dealers would prefer that their clients switch to fee-based accounts. The reason for this is twofold, yet simple: dealer compensation is generally higher in a fee-based account than for a commission-based account; fee-based accounts provide dealers with a steady, predictable revenue stream whereas commission-based accounts do not.

[3] Consultation Paper, p.3

➢*Higher Compensation In Fee-Based*

The reality is that mutual funds that pay trailing commissions and are sold on a sales charge (or front-end) basis generally pay 1% for equity funds and 0.5% for fixed income funds. Dealers are typically permitted to also charge an upfront commission to their clients for these purchases but our experience is that this is quite rare. According to our internal records, over 94% of Invesco Canada-managed funds sold on a front-end basis are sold without the dealer charging an upfront commission.[4] Therefore, in those cases, the dealer compensation is the trailing commission only. This must be compared with the fee charged on fee-based accounts. In the Consultation Paper, the CSA notes the dominance of Canadian bank-owned dealers in the distribution of mutual funds, all of whom offer fee-based accounts so it is appropriate to look to these institutions for comparative purposes. Our research indicates that the biggest dealers in Canada typically charge a fee of 1.50% for accounts that are less than $500,000 and in many cases the charge is 1.75% for such accounts. It seems rather obvious, therefore, that these dealers would prefer that clients be in fee-based accounts and if dealers are focused solely on higher compensation, as the CSA asserts, it would be irrational for dealers to offer any fee option other than asset-based fees. This fee discrepancy also raises the question of the extent to which we should be concerned with the conflicts of interest that arise from embedded commissions: is eliminating that conflict worth a 50-75% increase in the cost of advice for investors? While it is difficult to quantify relative value propositions such as this, we do not believe that such a price increase is warranted in the circumstances. While we understand the CSA may not agree that this increase will occur[5], there is no basis for this belief. It is not clear to us how an increase of 50-75% in fees is good for investors, even if it eliminates underlying conflicts.

Under the DSC option, the dealer typically does receive greater compensation over the life of the investment as compared to what it would receive from a fee-based account. As explained further below, in our opinion, the concept and economics of the DSC have been eroded over time such that the initial premises no longer apply. We are also aware of real abuses with DSC and we would agree that eliminating the DSC is an appropriate regulatory response. As such, in the balance of our comments, we assume away the DSC and further assume that the only commission-based option is a front-end option.

➢ *Fee-Based Provides More Predictable and Stable Revenue Stream*

We do not intend to dwell on the second reason asserted above as to why dealers prefer fee-based accounts other than to note that, as a simple matter of good business, any business prefers a predictable revenue stream to an irregular one and part of the dealer revenue in commission-based accounts is variable and unpredictable. We note that dealers may have other reasons for preferring fee-based accounts, including oversight and compliance.

[4] See comment letter dated April 12, 2013 of Invesco Canada Ltd., responding to CSA Discussion Paper 81-407, p.3.
[5] Consultation Paper, p.58 and p.89

Lack of Understanding By Investors and Resulting Impacts

The CSA states that "due to their embedded nature and complexity, [trailing commissions] inhibit the ability of investors to assess and manage the impact of dealer compensation costs on their investment returns."[6] In our opinion there is much wrong with this statement. At best, this statement is mistimed.

We do not agree that the mere fact that a fee is embedded means investors do not understand the fee. While this is certainly possible, there has been tremendous publicity around trailing commissions for several years due to CSA publications, investor advocacy, and media attention. To the extent investors do not understand the fee, the CSA has sought to remedy this in two ways: Fund Facts document disclosure; and the CRM2 report on charges and other compensation. The Fund Facts documents are now given at the point of sale and investors receive detailed information about trailing commissions in the report on charges and other compensation. These are new initiatives that will take time to achieve the desired results, although a recent report published by the British Columbia Securities Commission demonstrates that despite investors receiving CRM2 reports for the first time only this year, all key metrics around understanding fees, discussing fees with their advisor, and the ability to evaluate the service received in relation to the fees paid, have significantly improved.[7] While the CSA states that the proposal contained in the Consultation Paper is complementary to these earlier proposals which are now regulation, it is not clear why that is so. While trailing commissions remain embedded, the CSA statement implies that makes them opaque, but these earlier initiatives directly address that issue. The purpose of the Fund Facts document, regardless of when delivered, is to make the disclosures less complex. When the report on charged and other compensation and the Fund Facts document are read together, the trailing commission is not complex.

As a result of CRM2, the trailing commission paid on behalf of the investor is laid bare for the investor. As a result of that initiative, there is no difference in clarity for an investor between asset-based fees paid to the dealer directly by the investor and trailing commissions paid indirectly to the dealer on behalf of the investor through the IFM. Therefore, if investors cannot assess and manage the impact of trailing commissions on their investment returns in a CRM2 environment, it follows that they cannot do so with a fee-based account, which receives the same reporting under the regulations, and the CSA argument falls short.

We note further that investment performance for mutual funds must be presented on an after-fees basis to the extent the fees are charged by the IFM. This implies that a Series A return is an all-in number, whereas a Series F (or any fee-based series') return is misleading since it does not include the asset-based fee paid by the client directly to the dealer. In other words, the client return in Series F is overstated since it does not account for the fee, whereas the Series A return is correct since it does. The CSA has actually acknowledged the validity of this point through the investment performance report mandated under CRM2, which

[6] Consultation Paper, pp.3-4

[7] Innovate Research Group, commissioned by the British Columbia Securities Commission, "Investor Readiness for Better Investing, 2016-2017 Panel Study: Part 2", April 26, 2017.

requires investment performance to be reported at the account level which has the effect of taking into account the asset-based fee.

That the lack of understanding and confusion cited by the CSA exists is not at all surprising. The CSA could have avoided this when it mandated preparation by IFMs of the Fund Facts document but chose not to. In our comments at the time, we requested that Fund Facts documents not be separated by series in order for investors to be able to compare fees and compensation among different series of the same fund. This would show investors – or at minimum give them the ability to determine – which fee structure makes most sense for them. Instead, the CSA chose to obscure this information by requiring a separate document for each series with the full knowledge that investors will most likely receive a Fund Facts document of the same series for multiple funds but not for multiple series of the same fund. The solution to this is not to eliminate compensation options but rather to ensure proper and appropriate information is provided to investors.

Investment Fund Managers Rely More On Trail Than Performance to Preserve Assets

The CSA states that "Investment fund managers who pay embedded commissions to dealers may be incented to rely more on those payments than on generating performance to attract and preserve assets under management."[8] This statement is insulting because it ignores the realities of the marketplace. Most IFMs that pay trailing commission pay the same rate, accordingly, there is no incentive to rely on those payments to preserve assets. Assets are preserved by performance. It is true that some IFMs pay trailing commissions above the standard 1% and those IFMs do tend to attract a disproportionate amount of assets regardless of performance. We agree that is wrong and that it gives rise to a regulatory issue. Our proposed solution to these issues addresses this problem fully.

We note that this problem is of the CSA's own doing. For many years, mutual funds that paid trailing commissions paid up to 1%. At some point, some companies started paying a higher rate. The CSA takes the position – with which we disagree, as discussed below – that the trailing commission is compensation for service. Yet, the CSA issued receipts for all of these prospectuses without ever asking how the higher trailing commission is justified. While securities regulations do not have a line item to address this issue, regulators do have a public interest power and it seems that such would be apt for use in this instance. We question why the CSA has not done so and continues to issue receipts for prospectuses with above market trailing commissions.

Commission Conflicts Diminish Focus on Risk-Adjusted Performance

The CSA states that "the research that we have gathered and reviewed suggests that this inherent conflict of interest diminishes the investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns."[9]

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[8] Consultation Paper, p.9
[9] Consultation Paper, p.10

This assertion is provided with no basis whatsoever. While the report prepared by Prof. Cumming shows correlative effects between trailing commissions and performance (which is obvious through the application of simple math), the CSA statement above is a statement about causation. This demonstrates an important misunderstanding by the CSA on how portfolio managers ply their trade.

At our firm, the value of assets managed by a portfolio manager has no bearing on their compensation. Rather, each portfolio manager has a base salary, which is designed to constitute a smaller portion of their compensation. The vast majority of compensation is based on a bonus structure, which can be as high as several times base salary, that is tied primarily to fund performance compared to peers in the category. That is, the portfolio manager has no incentive under this structure to retain assets and has strong incentive to outperform. The quoted statement is also nonsensical because the IFM *per se* has no ability to influence the investment decisions of the portfolio manager. The further reality is that poor performing funds do not, over time, attract assets.

We also note that the investment management market is intensely competitive already due to the number of firms and products available. The competitive drive to achieve superior performance is enhanced by the fact that most IFMs pay the same rate for trailing commissions, so competition based on dealer compensation does not, for most firms, exist. As dealers prepare for the reforms discussed in CSA Consultation Paper 33-404, this competition will intensify as dealers reduce their product lists. The nature of the Targeted Reforms discussed in that paper is such that third-party products will likely not be considered for dealer product lists without superior risk-adjusted performance and the failure of a product to be included on a dealer product list will make it impossible for such products to generate new client subscriptions, which in many cases will lead to the demise of the product. Note that one major Canadian integrated bank-owned dealer recently announced a reduction in its recommended list by 1/3 (from 49 third party funds to 33). Under the Targeted Reforms, it is unlikely that funds not on that list will be sold within that dealer's network.

Investor Ability to Negotiate Fees

The CSA states that "since the cost of dealer compensation is embedded in the fund's ongoing management fees, investors have no ability to directly negotiate this cost and consequently have no control over the amount they ultimately pay their dealer and their representative."[10] The assertion that investors in trailing commission-paying accounts have no ability to negotiate fees is littered throughout the Consultation Paper and seems to be an important factor in CSA deliberations. While it is true that such an investor cannot negotiate fees, the CSA implies that if the client were in a fee-based account, it could. This is preposterous. While we cannot say it never occurs, there is very little evidence that fee-based clients that are not considered to be high net worth investors have a real ability to negotiate fees. We do believe this happens but that such occurrences are rare and subject to exigent circumstances. Most retail investors have no ability to negotiate fees. Dealers will simply not do

[10] Consultation Paper, p.13

that. We encourage the CSA to engage specifically on this point with the heads of bank-owned IIROC dealers.

Cross-Subsidization

The CSA states "because trailing commissions are deducted at the fund level rather than the account level, some investors indirectly subsidize certain dealer compensation costs that are not attributable to their investment fund."[11] As a basic premise, any collective investment scheme involves some degree of cross-subsidization. The reason for this is that if each investor paid "a la carte" for services used, it would cost more for all and there would be a net social welfare loss. By pooling expenses, the individual pays less. For firms that charge operating expenses on a cost recovery model, there is no question that investors are better off in a pooled vehicle with cross-subsidization than investing in the identical portfolio on their own.

Notwithstanding our statement above, the CSA assertion in this instance is simply wrong. In a multiple series mutual fund, there are common expenses charged to all series and there are series specific expenses charged only to that series. The management fee is an example of the latter. The trailing commission is directly tied to the management fee. That is, the IFM determines a stripped down management fee separately from a trailing commission and then simply adds the two for the stated management fee for series that pay trailing commissions. An investor in a series designed for fee-based accounts typically pays a 1% management fee and does not at all subsidize the investor in a trailer commission-paying series that pays a 2% management fee, since the difference in the two, the dealer compensation, is only paid by the investor who pays the higher fee.

Internal Dealer Transfer Payments

The CSA states that it will specifically permit internal transfer payments from affiliates to dealers in integrated models where the payments are not directly tied to an investor's purchase or continued ownership of mutual funds.[12] We are astonished by this.

While we understand the theoretical basis for this position, we note that there is no practical way to ensure compliance with it. That is, there is no means to police the level of internal transfer payments and to demonstrate that it does not relate to distribution costs. We urge the CSA to re-think this issue. There is no reason for these payments and these payments are simply prone to abuse.

Entry of Lower Cost Providers

The CSA states that "some lower-cost mutual fund providers have expressed to the CSA the view that embedded commissions function as a barrier to market entry."[13] We are disappointed that the CSA has not provided more particulars on this point because it sounds

[11] Consultation Paper, p.13
[12] Consultation Paper, p.22
[13] Consultation Paper, p.52

like a bunch of whining and sour grapes to us. Our understanding is that Vanguard has raised this issue prior to entering the Canadian market yet their entry into the Canadian market is a success by any measure. The other unnamed companies may feel that because of the numerous competitors in our small market that it is simply not viable to compete and seek assistance from government to make it easier for them. What will the CSA say if these competitors do not come to Canada even after a ban on embedded commissions and what will the CSA say when these competitors do not have the success they envision? This is a spurious argument to be put forward by the CSA.

The CSA continues in that part of the Consultation Paper to talk about other niche providers entering the market and having success based on their performance in their home market. The CSA must be aware that these providers would be prohibited from marketing their products in Canada based on track records abroad and the CSA must be aware that Canadian dealers will not put a product on their shelf unless they know the IFM very well or until there is proven performance by way of at least a 3-year track record for the current mandate. As a result of these facts, it is not clear how the CSA concludes that niche providers will have the impact imagined as it is difficult for them to promote new products based on success outside of Canada.

Clarifications of Historical Items

Before discussing our proposed solution to the issues raised in the Consultation Paper, we believe it is important to provide historical context to the two forms of embedded commissions most under attack in the Consultation Paper: deferred sales charges and trailing commissions.

Clarifying Misconceptions: Deferred Sales Charges

The CSA has declared that the embedded commissions with which it is concerned are trailing commissions and DSC, both of which are paid by the IFM to the dealer. Interestingly (and inexplicably) the CSA is not concerned with other payments from the IFM to the dealer, including referral fees or internal transfer payments. In our opinion, the DSC historically served an important purpose, although we acknowledge that the original noble purpose has been so distorted that, at this time, there is more harm from permitting the DSC option than there is good. We would not object to a simple ban on the DSC.

That said, we believe it is important to recount the history of the DSC and clarify the mythology around it so that others may consider whether there is merit in continuing with the DSC.

From the IFM’s perspective, the DSC was established to facilitate investment in mutual funds by small investors who, by definition, could not afford to pay much for advice yet still wanted access to professional investment advice and portfolio management. The DSC was originally designed to ensure the IFM would be indifferent between a sale under the front-end purchase option and the DSC option. At the time the DSC option was introduced, dealers were charging 5% or more for the front-end option and also receiving a 1% trailing commission from the IFM. For DSC to be viable, therefore, it was necessary to include a 5% upfront commission. In other words, instead of the client paying a 5% up front commission out of pocket, the IFM effectively loaned the 5% to the client to pay the dealer so that the client could invest all of their money, and the client agreed to repay the loan. Given the financing fees for DSC, if the IFM paid the full trailing commission for the period of the loan, then it would lose money unless the fund significantly outperformed. As such, trailing commissions were cut by half to 0.50% and the calculation went from there. The IFM also had to make an assumption about the holding period and assumed 12 years. Like any lender, they had to make some assumptions so it was assumed the fund would simply have a 0% return. This was important since there is an expected revenue stream from a loan and if the client repays the loan early, the lender does not meet revenue expectation. In a bank loan, this is called a prepayment penalty. In a DSC loan, it is called a redemption charge schedule. In both cases, the design intent is to make the lender indifferent between prepayment and a full term loan. So with the combination of the management fee growth, the half trail and the time, the loan (and IFM financing costs) are repaid over time.

This all worked nicely when commissions for sales under the front-end purchase option were regularly charged at 5% but that has not been the case for some time. As such, the declining front-end commission distorted incentives and led dealers to promote DSC over the front-end purchase option because they would get paid more. They took the view that the client does not pay for DSC, so they have more invested and are better off and they assumed that if the fund performed poorly, the investor could switch to another fund in the complex during the term of the DSC schedule. The reality is that dealers are now paid a higher commission for a purchase under the DSC option (relative to commission rates for front-end purchase option sales today). The industry has shown little inclination to modify the DSC to address this point, with newer DSC options having exacerbated the problem. Given that most sales under the front-end purchase option are done at 0%[14], there is no longer a need for DSC and, therefore, we recommend it be abolished. These considerations do not apply to trailing commissions.

Clarifying Misconceptions: Trailing Commissions

Over the last 20 years, the industry has created a fiction around trailing commissions that, unfortunately, the CSA has chosen to accept as gospel and, more recently, the Investment Funds Institute of Canada ("IFIC") has chosen to perpetuate. The fiction is that trailing commissions were designed to compensate dealers for the service and advice they provide to their clients. This is not the case. On its face, this explanation is inherently illogical as why would an IFM pay a dealer to serve the dealer's own client? In other words, why would an IFM pay a dealer to run the dealer's business?

The CSA (and now IFIC) use this fiction to then determine whether an investor is getting a "good deal" from the dealer in exchange for the trailing commission. In other words,

[14] See comment letter dated April 12, 2013 of Invesco Canada Ltd., responding to CSA Discussion Paper 81-407, p.3.

the CSA uses this fiction to determine if there is value for service and to then determine that there is not sufficient value for service.

We have previously explained in our comment letter on CSA Discussion Paper 81-407 that this is flat out incorrect. Our comment in that regard was ignored by the CSA. We were surprised that the CSA did not inquire further on this point but that requires us to largely reiterate our discussion herein.

Trailing commissions did not exist until the late 1980s and their adoption became widespread by the end of the decade or early in the 1990s. Prior to the initiation of trailing commissions, there were serious concerns relating to churning client accounts, since the dealer only was compensated on a sale of a mutual fund. At the time, dealers received as compensation for mutual fund sales, from their clients, a front-end commission of up to 10%. If the dealer chose a "good" fund for the client, the client would be expected to hold the fund for the long term and the dealer would receive no ongoing revenue stream. From a business perspective, then, the dealer would have a business with a high level of assets on its books but no way to realize revenue on those assets. That left a rather large incentive for the dealer to churn accounts (or to pick "bad funds").

Most mutual funds are intended to be long-term investments and constant client entries and exits into and out of a fund can be detrimental to the fund and other investors therein. As such, the fund has an inherent right – some would say responsibility – to minimize the occurrence of shorter term investments. One need look no further than the 2003 market timing actions for evidence that the CSA believes that IFMs have a responsibility to ensure that their funds are not being used as short-term trading vehicles.

From the IFM's perspective, however, it normally has assets on its books from which it derives almost all of its revenue. It is clearly detrimental to the business interests of the IFM for there to be a constant churning of investor money as that might negatively impact other investors in the fund and, ultimately, the IFM's predictable revenue stream.

The industry thus faced a conundrum. Dealers were getting paid just for transactional activity and at a high rate (compared to today) so there was motivation to generate more revenue through more transactions. Clients paid a high rate of commission and the dealers' solution was to find ways to pay the high rate with greater frequency. The IFMs were facing disruption to their funds, thus potentially impacting performance, but also impacting their bottom line. The common solution to this problem was trailing commissions:

> -Through a trailing commission, the dealer is able to receive a recurring and predictable revenue stream. This reduces the incentive to generate more transactions which may or may not be in the interests of their clients.
>
> -Through a trailing commission, the client gained a greater likelihood that their dealer was looking after their interests without the threat of regularly paying a large up front commission. This allowed the client to get better advice for a better price.

-Through a trailing commission, the IFM was able to prevent churning of its funds. Clients were still free to come and go based on fund performance and their own needs.

Prior to the advent of trailing commissions, therefore, the primary conflict of interest concern was churning of client accounts. While we would not anticipate churning to be an issue with the elimination of trailing commissions, we would be concerned about the flip side of that, being reverse-churning.[15] Any proposal to eliminate trailing commissions must take into account and seek to prevent such behavior or similar behaviors that market participants might devise.

<u>Our Proposed Solution</u>

As stated at the outset, Invesco Canada proposes a two-part solution to the regulatory concerns raised in the Consultation Paper: (1) prohibit the use of DSC; and (2) set (not cap) trailing commissions at 1%. We will discuss each aspect of this solution in this part.

Prohibit the Use of Deferred Sales Charges

As discussed above, the much-maligned DSC actually was conceived with the best of intentions. However, as commission structures and rates have changed over time, the DSC has not kept up. Invesco Canada currently offers the standard DSC (6-year redemption schedule, 4.9% commission paid to the dealer on purchase), Low Load 4 (4-year redemption schedule, 4% commission paid to the dealer on purchase), and Lower Load (2-year redemption schedule, 1% commission paid to the dealer on purchase). In our comment letter on Discussion Paper 81-407, we stated that 94% of our sales under the sales charge option (i.e. front-end commission paid by the client) are at 0% commission. To the extent a dealer might offer the DSC option, there is a conflict of interest that possibly, but unlikely, could be overcome with improved disclosure. However, we are skeptical of disclosure as a remedy for conflicts of interest, as demonstrated by the CSA in the Consultation Paper and in Consultation Paper 33-404, and we believe abolishment is the better approach.

We note that the most important legitimate use of DSC today is for new, small investors. Given the amounts these investors have to invest it would appear to be in their interest to invest the full amount without deductions and it is difficult, if not impossible, to devise a direct payment model that meets their needs and the dealer's revenue and profit needs. We do not believe dealers will offer such clients 0% front-end option as the dealers would lose money on those accounts. But we are also troubled by the notion that such clients should pay, indirectly, 5% (in addition to trailer commissions) to have their money invested in a low interest rate, low return environment and also pay ongoing fees. Some of our competitors

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[15] This echoes the point made in The Brondesbury Report, commissioned by the CSA following CSA Discussion Paper 81-407. Therein, the point was that there has been insufficient research on fee-based payment models to understand what conflicts of interest arise under that model and it would be ill-advised, in their view, to move to such a model without examining the conflicts present under such model. See Weinstein, E. (the Brondesbury Group), *Mutual Fund Fee Research*, prepared for Ontario Securities Commission on behalf of the Canadian Securities Administrators, Spring 2015, p.21.

have already stopped offering DSC and we have heard of no ill effects as a result. We recommend, however, that prior to proceeding with such a ban, the CSA meet specifically with firms whose business models depend on DSC. Notwithstanding the CSA's data presented in the Consultation Paper, there are a number of MFDA-licensed firms who cater to the mass market by relying on DSC. Those businesses would not be viable without DSC given the size of the accounts and the client's ability, or willingness, to pay. The CSA solution appears to be that those clients can go to bank branches or robo-advisors. However, the CSA owes it to the registrants most impacted to truly understand the business model and why it may or may not be in the public interest. If the CSA finds that it is in the public interest to offer DSC after meeting with those firms, then the CSA should obviously not prohibit the use of DSC but should consider rules around its application including, without limitation, requiring the IFM to include DSC use in its business plan filed as part of its registration application and to only approve such aspect of the business plan if issues relating to abuse are properly addressed. To be clear, we are not calling for a roundtable discussion open to all, we believe that in these circumstances a group of CSA staff (including representation from multiple provinces) should meet separately with firms whose business model is built on DSC sales to better understand the issues. We believe that a solution where such clients can agree to a commission on the transaction (which would presumably be at least 5% as the dealer requires a certain amount of revenue to make an account profitable for it), whether or not that payment is funded by the IFM in exchange for a DSC schedule, would largely mitigate the potential problem a DSC ban creates for these investors. In this scenario, having an agreement between the client and dealer setting the commission rate would be vital. In that model, we would not be averse to a ban on trailing commissions.

Setting (Not Capping) Trailing Commission Rates at 1%

Invesco Canada has previously proposed, in writing to the CSA and in in-person meetings with the senior leadership of the OSC, a cap on trailing commissions in response to the conflict of interest concerns relating to trailing commissions. While this option has been dismissed by the CSA in the Consultation Paper, in our opinion the reasons provided by the CSA demonstrate a misunderstanding of trailing commissions as well as the essence and reasons for our proposal. As such, we reiterate that proposal here.

In the past we have suggested a cap on trail on the basis that IFMs that pay an above-standard rate of trailing commission do so to garner additional flows: in other words, the very essence of one of the conflicts of interest the Consultation Paper seeks to address. The CSA solution is to effectively require a 0% trailing commission, but the reason the 0% trailing commission works is that every IFM pays the same rate. Similarly, if every IFM that paid trailing commission paid 1%, there would be no conflict among funds. Accordingly, we recommend that the CSA enact or recommend to the provincial legislatures to enact a rule or law that only permits trailing commissions on specific series designated for that method of payment (i.e. Series A) and that such trailing commissions be in the amount of 1%. Under this proposal, trailing commissions on series of securities not designated in accordance with the rule would be prohibited as would trailing commissions of less than 1%. In addition, while not vital to this proposal but perhaps more important, we recommend that there be a positive obligation on dealers to enter into a specific agreement regarding fees with their clients while allowing for multiple methods of payment, in which case, it should not matter what rate of trailing commission is set by regulation. (Note that this is also an alternative proposal to address the issues raised in the Consultation Paper.) For example, there is no policy rationale that would prohibit a client and dealer from agreeing to an account level fee of 1.50% of assets with part of that fee collected in the form of trailing commissions; in other words, the trailing commission acts to reduce that direct payment. We believe it is important to separate the fee from the method of payment so as to eliminate the confusion or lack of clarity cited by the CSA. We select 1% for this purpose as this is the standard used by the vast majority of IFMs, which would ensure the most seamless transition for back offices.

Our recommendation addresses several issues. First, competition among mutual funds based on trailing commission rates would be eliminated. Second, standardized series designations would assist in reducing client confusion over the alphabet soup of series, which is a significant contributor to the complexity issue, and it would make it clear which series are associated with which fee options. Third, a standardized trailing commission would eliminate any bias in favour of higher trailer commission-paying products (i.e. equities) over lower trailing commission-paying products (i.e. fixed income).

In light of the foregoing, we turn to the shortcomings identified by the CSA in its discussion of capping trailing commissions on page 138 of the Consultation Paper and we comment specifically on each of those:

- *as the payment of embedded commissions will continue to be permitted, they may continue to create a barrier to entry that may reduce the likelihood of lower-cost providers entering the market;*

The CSA evidence of this is scant and not convincing. In the last several years Vanguard, among others, has entered the Canadian market and appears to have done so successfully. It is disappointing that the CSA makes this assertion with no evidence, anecdotal or otherwise. It is very easy for a non-Canadian firm to tell the CSA (presumably in response to a direct question) that they are not entering the Canadian market because of barriers caused by trailing commissions, but such an excuse rings hollow. First, there is no impediment to those firms offering one or both of a trailing commission and non-trailing commission paying series. As such, the cost of additional series (which is insignificant) cannot be a realistic barrier to entry. Second, the reason many do not enter the Canadian market is because the market is not all that large or, beyond the higher net worth segment, not very profitable. Canada’s population is 35 million people and is dominated by the banks. Of the 35 million people, maybe 10 million are potential mutual fund investors (and that is being generous). There are well over 100 firms offering mutual funds or ETFs (or both) to the investing public, including iShares and Vanguard, both of whom are known for ultra-low fees on their core products. No other low cost provider comes close in terms of name recognition to these two firms which leads one to conclude that the notion that other low cost providers can come into this market and have an impact is pure fantasy.

• the presence of embedded commissions may continue to make the fee structure more complex, which may continue to inhibit investors' understanding of such costs;

We find this concern confusing. In a fee-based series of units, the fee is pretty simple: management fee as disclosed in the prospectus is paid by the fund, operating expenses or fixed rate administration fee is charged to the fund, the client directly pays the dealer for advice. In other words, there are 3 components. In an embedded commission series of units, the fee is equally simple: management fee as disclosed in the prospectus is paid by the fund, operating expenses or fixed rate administration fee is charged to the fund, the IFM pays the dealer for advice to the client (notwithstanding our comments that the trailing commission was not created for the purposes of paying for advice). Again, there are only 3 components. If this is set out graphically for the client, it would be quite simple to see, for commission-based accounts, how much of the management fee is a true management fee and how much is trailing commission and compare that to a similar chart for fee-based (showing the management fee and the advice fee separately). It would actually be a simple matter to personalize this for the client based on their historical activity and come to a decision as to which model is better for that client. Such an analysis would show that some clients should not switch to fee-based accounts because, for them, it as a bad deal. The point, however, is that fee structures are not complex. What might make this more complex is the numerous purchase options including front-end, DSC with a 6-year schedule, DSC with a 4-year schedule, DSC with a 2-year schedule, and a US dollar option. This is confusing but has little to do with embedded commissions. The solution to this particular confusion is quite simple: prohibit the DSC model and then the only real option is to decide (a) commission-based versus fee-based and (b) U.S. dollars where offered versus Canadian dollars. This is pretty simple.

• embedded commissions will still remain a "one-size-fits-all" fee that may not align well with the services and advice actually provided to individual investors in accordance with their specific needs, expectations and preferences; and

We address this is in our earlier comments regarding the origination of trailing commissions. That said, there is no reason for embedded commissions to be a one-size-fits-all fee. As discussed earlier, the CSA is confusing the concept of the negotiated or agreed upon fee with the method of paying the fee. There is nothing in securities regulation that prevents dealers from adopting a hybrid model. That the CSA has not encouraged this is mildly surprising since there would be no better way to ensure transparency of trailing commissions if the dealer was required to enter into a fee agreement with clients in all circumstances, even if the full fee is satisfied by the trailer. Adopting such a requirement would also present the opportunity to properly characterize and clarify the relationship between and among the client, dealer and dealer representative.

• to the extent DSC options are reduced or eliminated, this approach would tend to place firms that rely on these options (e.g. independent investment fund managers and dealers) at a disadvantage relative to those that do not (e.g. integrated investment fund managers and dealers).

We do not understand this argument. The effect of the proposals contained in the Consultation Paper is to eliminate DSC options altogether which would have the effect cited in this bullet point. It is not clear how capping trailing commissions makes that worse.

The analysis above directly contradicts the CSA conclusions under the heading "Why the CSA is not pursuing a fee cap." The CSA notes a "non-traditional role" of setting fee caps. This is incorrect. The CSA already sets certain trading fees[16]. The real issue is whether the CSA has the authority to set trailing commission fee caps. We believe that Ontario, for example, has the authority do so under s.143(1)32.ix of the *Securities Act* (Ontario). In the alternative, implementation would require a legislative amendment. We note that much of NI 31-103 could only be implemented in Ontario with legislative amendments. We see the same in other provinces on a regular basis, and we do not believe that such is any impediment to reform. On the contrary, we believe this is an appropriate case for legislative involvement as the changes being proposed are radical and fundamental. Changes that have such an effect are not the purview of the administrative system but properly belong in the legislative system. The administrative system was designed to allow a specialized regulator with intimate knowledge of the issues to react rapidly to events under certain circumstances. Such conditions do not apply in the current context given that this debate has been ongoing for 20 years, i.e. there is no essential requirement for rapidity. Further, if a change such as that contemplated is going to be made, legislators answerable to their constituents should be the ones to make those decisions rather than faceless, nameless bureaucrats to whom the public has no recourse whatsoever.

Unintended Consequences

We will conclude this letter by addressing the consequences of the CSA proposal. There is no doubt that this proposal will be incredibly disruptive. That is clearly its intent. It will force some dealers and some IFMs out of business. We dispute that this will lead to new entrants to replace the firms who exit as there is simply no evidence that such will or is likely to occur. It is likely that this proposal will lead to dealer consolidation and we urge the CSA to consider the consequences of that. Where there are fewer dealers, does the CSA truly believe that will lead to an environment where individual investors have greater power to negotiate fees? The history of economics suggests the opposite result. Regardless, the CSA does seem to believe that the outcome of a ban on embedded commissions will be to reduce fees. These assertions are littered throughout the second half of the Consultation Paper and are the only major assertions not footnoted. Without substantiation, they appear to be merely Staff speculation dressed up as legitimate economic theory. If the CSA is wrong about these outcomes, the consequences will be devastating to some, yet for no purpose. We do not believe that regulators have an inherent moral right to do devise policy based on wild speculation. Regulators are allowed to be wrong in devising policy but only if there is a reasonable basis for their belief that the policy change will remedy a particular situation. The Consultation Paper aims to provide such a basis but it fails under the weight of its own (lack of) logic. The most important conclusions and predictions are made with no substantiation

[16] See National Instrument 23-101 *Trading Rules*, and Press Release dated January 26, 2017, "Canadian Securities Regulators to Lower Trading Fee Cap for Non-Inter-listed Securities" issued by the CSA.

whatsoever. If the CSA is incorrect, as we believe it is, and it proceeds with this reform, then the result of this proposal will be a deterioration of, rather than an improvement in, the status quo. In light of this, the CSA should have the courage to test the conclusions it reaches in the Consultation Paper. In that regard, the CSA should solicit feedback from independent reputable economists and think-tanks, including the C.D. Howe Institute, the Fraser Institute and others. Finding an obscure academic to support CSA conclusions will offer no comfort to the public and it will erode the CSA's reputation even further in the eyes of the public.

Others have commented extensively on the unintended consequences of the proposals contained in the Consultation Paper, including the potential for an "advice gap". We will not comment on those as we have little to add to that discussion and we are not convinced that the consequences are in fact unintended. We will, however, comment on two impacts.

First, it is clear from this Consultation Paper, CSA Consultation Paper 33-404, and public statements of senior leadership of the OSC that they disagree with the concept of active management for retail investors. With respect, there are many flaws with this view[17] and, obviously, a firm such as ours has no choice but to disagree with it. But that is not, in our view, a proper debate for a regulator to initiate or in which to engage. If the ultimate goal is to ban or dissuade investors from investing with active managers as the recent initiatives suggest, this is clearly outside the scope of a securities regulator and should be referred to the legislatures.

Second, and more important, there is little doubt that this and the other initiatives referred to above will benefit bank-owned wealth management firms at the expense of non-bank-owned firms and the CSA acknowledges this.[18] Aside from the fact that it is fundamentally wrong for a regulator to actively favor one group of registrants over another, the favored group of registrants – the banks – have been in the news lately for alleged unethical behavior toward their clients.[19] These alleged acts include placing clients in unsuitable mutual funds simply because that will help the bank meet earnings targets.[20] To date, there has been virtually no reaction to these stories from the CSA and the only governmental response has been through a federal parliamentary committee. These allegations have been levelled at some of these dealers by their own employees. The CSA acknowledges that an advice gap would be created by banning embedded commissions[21] and it believes that issue is mitigated through bank branches and digital offerings. That one of those mitigation strategies has now been called into question in a public manner, the CSA must re-think how it intends to deal with an advice gap.

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[17] We have discussed this privately with the OSC and do not believe a full discussion of this issue in this letter is helpful.

[18] Consultation Paper, p.70, "...we would anticipate that both the discontinuation of embedded commissions and the potential KYP reforms proposed in CP 33-404 would be unlikely to reverse, and may even increase, the trend toward retaining mid-market and affluent households within the branch network."

[19] http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575

[20] http://www.cbc.ca/news/business/td-bank-employees-admit-to-breaking-law-1.4016569

[21] Consultation Paper, pp.62-63.

Thank you for providing us with the opportunity to comment on this important initiative. We would be pleased to discuss our comments further should you so desire.

Yours very truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President and Head of Legal – Canada

APPENDIX

SUMMARY OF CONSULTATION QUESTIONS

<u>Part 2</u>

1. Do you agree with the issues described in this Part? Why or why not?

   No, for the reasons set forth in the main part of our letter.

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

   We are not aware of any issues or harms that were not raised in the Consultation Paper.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

   To respond to this question requires us to accept the premise regarding harms, which we do not. We have set forth the benefits of embedded commissions in our letter.

<u>Part 3</u>

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

   - mutual fund
   - non-redeemable investment fund
   - structured note

   should the product be subject to the discontinuation of embedded commissions? If not:

   a. What would be the policy rationale for excluding it?

   b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?

   In no cases should the ban apply. As we have set out in the letter, there are proper and improper uses of embedded commissions. We can see no rationale to ban for some products but not for others or based on method of distribution. If the CSA is not convinced that this initiative will not achieve the results it sets out to achieve, then being selective among products or distribution method would considerably worsen matters. If embedded commissions were permitted only in the exempt market, we

would expect a massive shift toward the exempt market. It is very easy to offer products at retail via offering memorandum in most provinces and that is simply what would occur.

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

   As stated in our previous responses, this should be an all or nothing proposition.

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

   As we have stated, if embedded commissions are discontinued for one product, they should be discontinued for all products.

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

   We do not, as set forth in our letter. However, the Consultation Paper is not proposing a discontinuation of all payments. If all possible payments were prohibited, including various payments permitted under NI 81-105, the proposal would be strengthened significantly and would be more likely achieve its intended outcomes.

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

   a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;

   b. referral fees; and

   c. underwriting commissions

   Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

   There is no good reason why (a) and (b) above should be permitted to continue if the concern with embedded commissions is that payments by IFMs to dealers causes conflicts. Underwriting commissions are a different category altogether and have nothing to do with investment products. For corporate finance offerings to work, there has to be independent due diligence and that must be paid for. That is the purpose of (c). Whether or not that is an effective model is a different issue and outside the scope of the issues raised in the Consultation Paper.

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

   Please see our previous answers on this topic.

10. With respect to internal transfer payments:

    a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?

    b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

    c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

    a. NI 81-105 has been completely ineffective in this regard. Please see our comment letter on CSA Consultation Paper 33-404 for a partial list of nefarious practices engaged in by integrated firms to promote their own product as well as CSA Staff Notice 33-318 on compensation practices. One need look no further than the proliferation of integrated firms over the past 10-15 years and the reduction in independent firms for evidence of the ineffectiveness of NI 81-105 in this regard.

    b. These payments should be subject to regulation. For multinational firms, there are legitimate transfer pricing issues that must be addressed for international tax purposes. However, for domestic firms, there is not. Typically results are consolidated at a parent entity and, as such, whether the IFM or the dealer receives the revenue should not be relevant.

    c. We are not aware of any. More importantly, if some payments are tied to distribution and some are not, and the former are banned but not the latter, we are highly confident that the quantum of the latter will increase significantly. In other words, internal transfer payments are highly capable of manipulation absent tough regulatory scrutiny and there is no evidence that the CSA is capable of such scrutiny in this particular circumstance.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors'

payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

In this scenario, the client would have to enter into an agreement with the dealer regarding compensation and method of payment. Allowing this is consistent with the proposed ban on embedded commissions and should be permitted.

Part 4

Addressing the issues

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

    Given how the CSA has chosen to phrase the three issues, the answer to this intellectually dishonest question is obviously 'yes'. However, for those who disagree with the phrasing used, the answer is 'no'.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

    In our letter, we have proposed an alternative that addresses all of these issues in a less disruptive manner.

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

    The primary issue that will emerge is reverse-churning or, put colloquially, the phenomenon of "set it and forget it." We are concerned that clients will be left in products for too long. A secondary issue arises if the mass market is stuck dealing with banks or digital offerings as their only options.

Change in investor experience and outcomes

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

    - Will investors receive advice and financial services that are more aligned with the fees they pay?
    - What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?

- Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?
- What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?
- What effect will the proposal have on the cost and scope of advice provided to specific investor segments?

We decline to respond as we believe we have answered these questions in our comment letter. In our view, this question makes obvious the regulatory intent and we remind the CSA that we do not think this type of change is appropriate for a regulatory body to make. This magnitude of change and the underlying goals – while laudable – are the proper purview of an elected legislature in a democracy. That the OSC, for example, is answerable to the Minister of Finance is little protection given the structures of government and how accountability works in practice.

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?

While the CSA believes that this proposal will lead to a wide range of payment arrangements, we believe that it is naïve to assume that anything other than asset-based fees will dominate. There is simply no evidence that dealers will be satisfied with other fee structures as a general matter.

17. Do you think this proposal will lead to an advice gap? In particular:

- Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.
- Do you agree with our definition of an advice gap?
- Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?
- What types of advice or services currently provided today would be most affected by the proposal?
- Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?

- How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?
- Do you think that online advice could mitigate an advice gap? If so, how?
- Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

It is clear that an advice gap will develop; the CSA confirms this in the Consultation Paper itself.

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

- Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

As set out in our letter, we believe that the industry will continue to transition toward fee-based accounts as it is in the economic interest of dealers to do so.

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

- Do you see payment options and business models evolving at present?
- How are they likely to change over time if the CSA were to choose not to move forward with the proposal?

We have no comment on Figure 8.

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

To respond to this question, we revert to our response to Q.18 and the contents of our letter in which we clearly explain why dealers prefer accounts to be fee-based rather than commission-based. Fee-based accounts are not new, yet dealers have had difficulty convincing clients to move to such accounts. In our view, this is for good reason. Not every client agrees with the CSA that there should be a full blown financial planning relationship, which is the best scenario for fee-based accounts. Some investors, especially those who do not trade frequently, rightly prefer commission-based accounts as it is a better financial deal for them. There is nothing in securities

regulations that permits dealers to serve those accounts less than fee-based accounts. Accordingly, clients tend to choose the option that results in the lowest fee to them.

Potential impact on competition and market structure

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?
- What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?
- What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?
  - Independent dealers?
  - Independent fund manufacturers?
  - Integrated financial service providers?
  - Mutual fund dealers?
  - IIROC dealers?
  - Online/discount brokers?
- What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?
- What would be the impact on dually-licensed mutual fund dealers and insurance agents?
- Will the proposal lead new, lower-cost entrants to the market? Why and how?
- Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?
- Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?
- Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?
- What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

The bullet points in this question assume outcomes that have no basis in reality or economics. Therefore, we cannot properly respond.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- Is there any specific operational or technological impact that we should take into consideration?

Eliminating embedded commissions should have no meaningful adverse impact to the back office of an IFM.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?
- To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?

It is certainly possible that an IFM would be able to eliminate some controls and oversight. For firms that operate with a cost recovery model, we would expect that to have an impact on chargeable fund expenses although we would not expect such impact to be material. For firms operating on a fixed rate administration fee, the elimination of these controls and oversight directly improves the IFM's bottom line. As such, a potential impact of this proposal is a financial benefit to firms that charge a fixed rate administration fee. In our view, firms that operate in this manner tend to derive profit from this activity and we question the validity of such. We note that securities regulators let this practice develop and did not impose necessary oversight conditions to ensure fixed rate administration fees do not become a profit centre. We are heartened that at least in a small number of cases, the independent review committee of funds that adopted fixed rate administration fees imposed conditions to ensure this does not become a profit centre but we note that very few IRCs have done so and we do question why it is that securities regulators do not apparently consider this to be an important conflict of interest.

24 Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

As we have shown in our letter, dealers are financially better off with direct pay arrangements.

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

CSA Staff Notice 33-318 sets out many practices that are not commission grids and salaries. While such notice was prepared by the OSC's Compliance and Registrant

Regulation Branch and the equivalent at other securities regulators and the Consultation Paper was prepared by the OSC's Investment Funds and Structured Products Branch and the equivalent at other securities regulators, we would expect the latter to be well informed on this matter and read the former's staff notices.

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:
    - career path;
    - attractiveness of the job;
    - typical profile of individuals attracted to the career;
    - recruitment; and
    - relative attractiveness of careers in competing financial service business lines?

    We defer to dealing representatives to respond to this question.

Part 5

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:
    - access to advice for investors,
    - choice of payment arrangements for all investor segments, and
    - a level playing field amongst competing investment products?

    We believe that elements of these measures are naïve. For example, one mitigation strategy is to let IFM's collect the fee for the investor and remit it to the dealer. That is, the dealer and investor enter into a fee agreement but instead of the investor remitting the fee directly, the IFM collects it from the investor's account and remits it to the dealer on the investor's behalf. Invesco Canada has offered this service for several years. Typically, IIROC firms have no interest in this service since they have invested in the infrastructure to offer fee-based accounts and have no need for this service. However, MFDA firms typically do not offer fee-based accounts due to lack of infrastructure, which is why we (and others) offered this service. We have not found there to be significant take up of this service and as such, we question how effective a mitigation strategy this might be. Note that not all IFMs offer this service and unless widely adopted, MFDA firms may feel they are only able to deal with IFMs who do offer the service, even if the product assessments they make as part of their shelf decisions might suggest different results.

28. What other measures should the CSA consider to mitigate the above unintended consequences?

    The CSA should try to open its mind and not pre-determine the outcome of consultations. The public statements of the Chair of the OSC, beginning with the CBC interview on January 10, 2017, make clear that the CSA has determined the outcome of this consultation.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

- Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.
- To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?
- What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

It is difficult to assess the tax impacts as the federal government has made tax changes affecting mutual fund investors in every budget under the current Prime Minister. None of these changes have been telegraphed and, in some cases, we would expect the transition to give rise to a taxable event.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

- to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;
- does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and
- what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?

We reject the premise of this question, as discussed in our letter.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

We do not wish to respond to this question as such response would necessarily divulge competitively sensitive information.

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- Are there unique costs or challenges to specific businesses?
- What transition period would be appropriate?
- Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

We do not wish to respond to this question as such response would necessarily divulge competitively sensitive information.

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

While we have no preference – neither option would benefit us as an IFM over the other option – our primary concern with any transition relates to DSC schedules still in force. Some have suggested that on transition, any redemption charge would be waived. We vigorously oppose that. Any DSC is subject to financing and is a multiparty arrangement. It would be commercially unfair to waive redemption charges where a DSC schedule is still in effect. This could cause immense hardship for IFMs based solely on the amount of DSC they have outstanding. We would expect that, overall, the hardship that this would impose would provide IFMs with an incredibly strong incentive to challenge this proposal in the courts and further delay implementation.

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

Please see the proposal in our letter for a full response to this question.

Part 6

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

- address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and
- address or not address any additional harms or issues that you have identified.

We decline to respond to this question.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

Please refer to our letter.

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RE: Canadian Securities Administrators ("CSA") Consultation on the Option of Discontinuing Embedded Commissions – Consultation Paper 81-408

FAIR Canada is pleased to offer comments on the CSA's Consultation Paper 81-408 regarding the option of discontinuing embedded commissions ("Consultation Document").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

<u>Executive Summary</u>

1. FAIR Canada, on behalf of Canadians, has pressed for the adoption of a statutory best interest standard and reforms that will prevent or avoid conflicts of interest including the removal of embedded commissions (especially trailing commissions and deferred sales charges ("DSCs")) paid by investment fund managers. These changes are needed so that Canadian investors can receive professional objective advice free from damaging conflicts of interest. Advice needs to be focused on what is best for investors, not what is best for the investment fund manufacturers, financial services representatives and their dealer firms.

2. FAIR Canada supports the elimination of embedded commissions. Embedded commissions in investment products produces a system of inherent conflicts of interest that subvert or subordinate

the interests of investors to the interests of dealers, individual registrants and investment fund manufacturers. The result is that investor outcomes and market efficiency are harmed. In other words, the current mutual fund fee structure results in millions of Canadians not receiving objective advice and being sold suboptimal products.[1] Canadians receive product recommendations driven more by payments their advisor and her firm will receive, instead of what would be best for the consumer. This must change.

3. Canadians simply cannot save what they otherwise would have, given the impact of embedded commissions. They are not provided with advice they need and expect to receive. At best, ordinary Canadians end up with significantly less available for their retirement or for their children's education and have less to contribute to the Canadian economy. At worst, Canadians lose their hard-earned capital through having accepted the "advice" of registrants, having been better off not seeking out the registrant's "advice". This is a concern to all Canadians as our economy and society suffers as a result.

4. It is estimated that Canadians are charged over $5 billion in trailing commissions annually[2], with Canada being amongst the highest mutual fund fee jurisdictions in the world. [3] It also has far more actively managed funds than in other jurisdictions (including the UK and USA) with 87% of investment fund managers offering actively managed funds that have products with negative alphas (i.e. poor performance), with only 1.5% of mutual fund assets held passively.[4]

5. FAIR Canada believes that banning embedded commissions (including DSCs) from all investments is an essential step to address the harms that have been identified, and to improve financial outcomes for Canadians. We define "embedded commissions" as used throughout this submission to mean remuneration by a third party (for example an investment fund manager) to dealers (which may or may not also be paid to their representatives) in respect of the sale of an investment (whether it be mutual funds, exchange traded funds, structured products, exempt market products or other types of securities) to an investor.

6. In addition, other forms of compensation arrangements that harm consumers should also be addressed. What is needed is the avoidance of conflicted compensation arrangements rather than the permissive world of "managing" conflicts that firms now inhabit, which allow for the creation of personnel and compensation policies and practices that create conflicts. A real focus on this area is urgently needed. Resources to implement rules, and guidance to ensure conflicts are avoided – as well as effective compliance oversight and enforcement – are needed.

7. FAIR Canada believes that a ban on embedded commissions should be undertaken with a ban on other

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[1] The MFDA channel alone has 8.9 million Canadian households (or 56% of Canadian households) and it is estimated that 12 million Canadians own mutual funds.

[2] Douglas Cumming, "Blowing smoke on trailer fees: Fees harm investors. Here are the facts" (5 October 2016), online: <http://www.moneysense.ca/save/investing/blowing-smoke-on-trailer-fees/>.

[3] As noted in the Consultation Paper, such studies include: B.N. Alpert and J. Rekenthaler, "*Morningstar Global Fund Investor Experience 2011* (March 2011), online: < https://corporate.morningstar.com/us/documents/ResearchPapers/GlobalFundInvestorExperience2011.pdf>; A. Khorana, H. Servaes, and P. Tufano, *Mutual Fund Fees Around the World* (July 23, 2007), online: < http://faculty.london.edu/hservaes/rfs2009.pdf> and more recently B. Alpert, P. Justice, A. Serhan, and C. West "Global Fund Investor Experience Study"(June 2015), online: <https: //corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf>.

[4] Consultation Document at 42. This number excludes ETFs.

forms of conflicted compensation structures that have been identified. Incentives that distort advice and subvert the interests of consumers should all be addressed.

8. FAIR Canada calls for the immediate elimination of embedded commissions from investment products sold at discount brokerages given that IIROC Dealer Member Rules do not permit discount brokerages to provide recommendations.[5] FAIR Canada recommends that all firms offering a particular mutual fund be required to offer the "F" class version of the fund at discount brokerages. FAIR Canada is astounded that the CSA has not done this to date.

9. The benefits of eliminating embedded commissions include:

(i) Reduction in fund series and in fund fee complexity - the fund fee structure will be simplified and made more transparent;

(ii) Increased price competition and decrease in fund management costs;

(iii) New lower-cost product providers may enter the market (reduce barriers to market entry and increase price competition);

(iv) Shift in product recommendations to lower-cost and passively managed products including exchange traded funds;

(v) The market will innovate including through offering different forms of direct payment arrangements and through the use of fintech and online advice (robo advice) so that various consumer segments are served (including those with less assets);

(vi) Increase in transparency to the consumer as to what they pay as product costs (management fees and operating expenses of the fund) as opposed to what they pay for "advice" and services of the dealer/representative, which will better allow consumers to assess value and control such costs;

(vii) Advisors and their firms will no longer be incented by higher trailing commissions and fund managers will have to compete based on performance rather than on the basis of paying higher trailing commissions;

(viii) Ability to comparison shop – greater transparency should allow consumers to know, before they speak with a firm/representative and certainly before they enter into a relationship, what the cost will be for advice and services (and what those services and advice include (and do not include)) so as to compare the costs and services/advice of different firms (and their representatives);

(ix) Consumers will be able to assess the value of any services and advice they pay for against the costs they incur, on an ongoing basis, rather than simply reviewing the amount of trailing commissions and other costs they currently incur annually as a result of the required cost

[5] See IIROC Dealer Member Rules 3100 and 3200 and, in particular, Dealer Member Rules 3200(3)(a).

reporting and performance reporting documents (CRM2 Statements);

(x) Quality of the advice provided should improve and given product bias should be reduced. Business models should be capable of focusing on advice such as creating and following a budget, prioritizing short and longer term goals, paying down debt, and saving in the most tax efficient manner in light of income etc., rather than simply focusing on product sales; and

(xi) Enhance the professionalism of the financial services industry and enhance public trust in the industry and financial markets, which would benefit both investors, dealers and representatives.

10. *Disclosure Not Effective to Protect Consumers or Ensure Well Functioning Market* - Regulators and stakeholders must come to grips with the reality that disclosure is not an adequate solution to ensure effective financial consumer protection and simply will not address the problems identified. CRM2 and Point of Sale are worthwhile initiatives but do not address the compensation structures that lead to biased and tainted advice.

11. The Proposed Targeted Reforms will also not address the concerns with the relationship between dealers, advisers, and their representatives vis a vis their clients because they take existing business models as "inevitable" or "normal", and blithely assuming them to be manageable (typically by disclosure). FAIR Canada is strongly of the view, in light of the independent evidence, that disclosure is insufficient to address the problems caused by conflicts of interest in the financial sector *even if* that disclosure is improved to so that it is "prominent, specific and clear" and tries to be "meaningful" to the client so that the client "fully understands the conflict including the implications and consequences of the conflict for the client"[6] and even if dealers and their representatives complied with the rules (which they often do not).[7] Avoidance of conflicts is the answer.

12. Industry has failed to address the problems associated with conflicted compensation on their own – it has failed to increase proficiency adequately or avoid biased compensation models.

13. Professor Cumming's report found that proprietary products also harmed investors and harmed market efficiency. The report explained that affiliated dealer flows result in material conflicts of interest that are detrimental to mutual fund investors over the long-term.[8] Therefore, FAIR Canada continues to recommend that a clear picture be provided to consumers. Firms that only sell affiliated dealers products should not be able to hold out that they provide advice in the best interests of

[6] Canadian Securities Administrators, Consultation Paper 33-404: *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards their Clients* (28 April 2016), 39 OSCB 3947 at 3957 [Consultation Paper 33-404].

[7] The OSC's Mystery Shopping Report demonstrated that representatives did not comply with their regulatory obligations in disclosing conflicts of interest. Verbal disclosure about conflicts of interest was provided in connection with the discussion of fees and charges in only 4% of cases (2 of 49 shops) and in connection with the discussion of advisor compensation, in only 9% of cases (2 of 22 shops). See OSC Staff Notice 31-715, Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario, at page 29, online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

[8] Professor Douglas Cumming, Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance Report (2016) at 7, online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf [Cumming Q&A].

consumers and their representatives should be restricted to the title "salesperson".

14. *Banks and Insurers Need An Open Shelf and Oversight of Compensation Arrangements* - FAIR Canada further recommends that if bank branches or affiliated dealers of insurers want to provide advice in the best interests of consumers they should be required to have an open shelf. This should be monitored on a comprehensive basis so that sales incentives, compensation grids, performance targets or reviews or internal transfer payments don't favour the sale of affiliated/proprietary products over others, to the detriment of clients. FAIR Canada also recommends that a cross-subsidization rule be examined in order to ensure a competitive landscape and not provide an undue advantage to vertically integrated firms.

15. *Borrowing to Invest and Harmful Incentives* - FAIR Canada continues to recommend that securities regulators prohibit dealers and their advisors from obtaining any types of fees or commissions in respect of investments made from borrowed funds so as to prevent unsuitable recommendations to borrow to invest in securities, such as mutual funds. This should be the case whether the account is fee based or otherwise. For fee based accounts, dealers should be precluded from charging asset based fees on monies that are borrowed for investment purposes, as in Australia.[9]

16. *Referral Fees Incent Harmful Leverage Strategies* - In addition, referral fees from lenders to dealers and their representatives that incent representatives to recommend leveraging strategies should be prohibited.

17. We recommend that the CSA require the types of advice options and the range of investments available at a dealer be disclosed in plain language on the main page of the dealer's website so that consumers can easily shop around and make comparisons.

Payment Options – FAIR Canada Agrees with Direct Pay Arrangements

18. Various studies suggest that the further removed a transaction is from cash, the less price-sensitive consumers are about the costs. FAIR Canada disagrees that payment for advice be permitted to be automatically deducted from the consumer's account by the investment fund manager. We believe that this arrangement could encourage the dealer and its representatives to continue their relationships with certain investment fund managers when this may not be in the best interest of the client. The dealer and its representative may continue to offer certain mutual funds rather than recommend lower cost ETFs for example. The separation of the relationship between advice and product recommendations may be impeded by such continued relationships. Adoption of this type of system may create problems of a similar nature to the one it is trying to solve.

19. FAIR Canada recommends that the CSA determine other alternative forms of payment such as keeping a portion of the client's funds in a high interest savings account or money market funds to pay for ongoing advice received. This would ease the "pain" associated with writing a cheque while not creating relationships that lead to conflicts that harm consumers.

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[9] Australian Securities and Investments Commission REP 28, "Response to submissions on CP 189 Future of Finance Advice: Conflicted remuneration" (4 March 2013), online: < http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-328-response-to-submissions-on-cp-189-future-of-financial-advice-conflicted-remuneration/> [ASIC Response}.

20. *Regulatory Arbitrage* - FAIR Canada continues to recommend that the risk of regulatory arbitrage with segregated funds, principal protected notes, index linked GICs or other investment products be addressed by: (i) determining that advice not to invest in a security (in favour of a non-security) is advice about securities and is subject to a best interest standard; (ii) amend the definition of "securities" so that segregated funds are no longer exempted from provincial securities acts; and (iii) preclude acceptance of third party commissions in respect of investment products regardless of whether a security or not. We also support the measure noted in the Consultation Document aimed at having insurance regulators harmonize their regulatory frameworks so that mutual funds, segregated funds and other investment products are subject to the same rules including a requirement to remove embedded commissions.

21. *Internal Transfer Payments* - FAIR Canada recommends that internal transfer payments between affiliated dealers not be allowed to circumvent the prohibition of embedded commissions through another means.

22. *Other Dealer Compensation Payments* - FAIR Canada recommends that the CSA not permit conflicted dealer compensation payments that lead to incentives and behaviours subverting the interests of consumers. All compensation arrangements (referral fees, underwriting commissions and other sales incentives, monetary and non-monetary payments in respect of marketing and educational practices related to NI 81-105) should be examined. We make specific recommendations regarding these issues below.

23. *Need for Unbiased, Professional Advice* - FAIR Canada notes that Canada already has an advice gap. Today, not all Canadians with investments "can obtain the amount of advice they desire at the price they are willing to pay".[10] Canadians who have embedded mutual funds and other embedded investments are either getting no advice (including those at discount brokerages), or getting sold products that are suboptimal through biased commission structures, which leads to market inefficiencies and harm to consumers. Public policy should remove structures that impede a properly functioning market. They should also facilitate transparency so that consumers can assess value. Canadians expect and deserve unbiased, professional advice, but the embedded commission structure undermines the ability of the financial services industry to provide what most would consider true, or objective, financial advice.

24. *Transition* - FAIR Canada believes that a Transition Date of two years is more than sufficient for all affected parties to ensure a successful transition and complete all necessary transition steps. We favour a defined transition period as this would provide more clarity for consumers who wish to explore alternatives and is also a more simple approach for all participants.

25. FAIR Canada makes recommendations in this submission to improve the CSA's reform proposal in order to improve the ability of Canadians to receive advice that it is in their interests and encourage effective competition for the benefit of the investing public. The ban on conflicted compensation (including embedded commissions) will foster fair and efficient markets and enhance investor protection.

[10] This is how the "advice gap" is defined at page 62 of the Consultation Document.

26. We urge the CSA to move forward with this expeditiously.

27. *Best Interest Standard* - FAIR Canada also urges all CSA jurisdictions to adopt a statutory best interest standard as set out in our submission on CSA 33-404 (Proposed Best Interest Standard and Proposed Targeted Reforms) along with the accompanying reforms we believe are needed (increasing proficiency and restricting the use of titles).[11] For those jurisdictions that have indicated they will move forward with a best interest standard, they should move forward quickly to prohibit embedded commissions - a best interest standard should include a prohibition against the acceptance of embedded commissions and other conflicted compensation..

1. **<u>Embedded Commissions Harm the Market and Harm Investors – Key Investor Protection and Market Efficiency Issues Raised by Mutual Fund Fees and Related Evidence</u>**

1.1. As a result of the CSA commissioned research, we now have undeniable empirical evidence based on *Canadian* investment fund data that embedded commissions impact investor outcomes and market efficiency negatively. The CSA initiated independent third party research in late 2013 to assess the impact of commissions and embedded fees on mutual fund flows in Canada. Professor Douglas J. Cumming, Professor of Finance and Entrepreneurship and the Ontario Research Chair at the Schulich School of Business, York University conducted the research and released his findings in October 2015.

1.2. As explained by CSA Consultation Paper 33-404 (and in the Consultation Document), Professor Cumming's "…paper found that conflicts of interest specifically sales commissions and trailing commissions paid by fund companies (embedded registrant compensation), dealer affiliation and the use of DSC arrangements materially affect representative/dealer behaviour to the detriment of investor outcomes and market efficiency. While generally, mutual fund flows should (and do) bear a relationship to the fund's past performance, the research found that:

- The payment of embedded registrant compensation and the use of DSC arrangements materially reduce the sensitivity of fund flows to past performance and increase the level of fund flows that have no relationship to performance;

- The converse is also true: fund flows for mutual fund series that do not pay embedded registrant compensation (fee-based series) are more sensitive to past performance;

- as embedded registrant compensation increases there is an associated reduction in future outperformance before fees; and

- fund flows from affiliated dealers of the investment fund manager show little to no sensitivity to past performance, and this lack of sensitivity is also associated with reduced future outperformance before fees."[12]

1.3. In other words, trailing commissions and DSCs charges warp investment flows by letting

[11] See FAIR Canada's submission on CSA 33-404, available online at http://faircanada.ca/wp-content/uploads/2016/10/160930-Final-FAIR-Canada-Submission-33-404-Best-Interest.pdf [FAIR Submission on 33-404].
[12] Consultation Paper 33-404, *supra* note 6 at 3951.

something other than what's best for the investor drive sales, and this channels many investors toward suboptimal funds. Trailing commissions and DSCs harm investors and market efficiency by facilitating deteriorations in fund performance. Professor Cumming findings were consistent with previous research conducted on non-Canadian fund data.

1.4. **FAIR Canada believes that banning embedded commissions (including DSCs) is an essential step to address the harms that have been identified and to improve financial outcomes for Canadians.** It is not simply a "potential option" as described in the Consultation Document and in CSA Staff Notice 81-327[13]. It is a necessary step given the information and data we have. Conflicted remuneration, including embedded commissions, must be avoided.

Understanding How DSCs Harm Consumers

1.5. We know that DSCs are harmful to financial consumers because:

(i) Prof Cumming's report demonstrates that investments under the DSC option have the least sensitivity to past performance out of all purchase options[14] but nonetheless $241 billion dollars of assets under management are held in DSC funds (back-end and low load funds) at the end of 2015.

(ii) Fund investors with little to invest are the most likely to be offered DSC purchase options and some firms primarily offer their clients DSC options. As stated by the CSA, "The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and representative's revenue requirements."[15]

Therefore, recommendations are not being made based on the best interests of the client (or what is most suitable or appropriate for the client) but on the revenue needs of the dealer and its representatives. This makes it clear that investors do not presently have a "choice" at their existing dealer as to whether to choose embedded commissions or pay some other way. Many investors are unaware that they pay trailing commission and if aware, they trust and rely on their dealer and its representatives, with most believing the "advisor" will recommend what is best for them even at the expense of their own commission. Certain "choices" (and not others) are presented or recommended to the client.

(iii) Investors are often unaware of the redemption fees that apply to DSC funds if sold before the end of the redemption schedule (normally 7 years and 3 years for low load funds). Until recently, there was no regulatory obligation to inform investors when they were sold the fund that if they redeemed before the end of the 7 year period, they would incur redemption fees! Investors do not understand that the dealer/representative gets an

[13] CSA Staff Notice 81-327 "Next Steps in the CSA's Examination of Mutual Fund Fees" (29 June 2016), online: < http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20150629_81-327_next-steps-mutual-fund-fees.htm>.
[14] CSA Consultation Document at 100.
[15] Ibid at 48.

upfront commission when they recommend a DSC fund.

(iv) *DSCs and Proprietary Mutual Funds* - Investors may be unaware that they cannot move certain proprietary mutual funds in kind from one dealer to another and will be forced to sell the funds if they wish to move dealers. If they are DSC funds, redemption charges will be incurred. This impacts investors negatively and deters effective competition.

(v) DSCs can incent unsuitable recommendations[16] and can incent dealers and their representatives to promote unsuitable leverage strategies or churning, as can be seen from several MFDA Bulletins[17], enforcement cases[18], and OBSI statistics.[19]

(vi) *DSCs and Seniors* - The MFDA's 2017 Client Research Report indicates it has identified seniors as a particular concern with respect to DSCs[20] and that representatives may be using DSC commissions to finance the cost of their operations to mass market clients.[21] DSCs appear to targeted to the most vulnerable consumers.

(vii) It is perhaps then, not surprising to read that Canada has a unique reliance on DSCs in its mutual fund market with 20% of mutual fund assets in Canada whereas these options are less than 1% of mutual fund assets in the United States and Europe.

1.6. ***In light of the foregoing, FAIR Canada recommends that DSCs are a form of embedded commission (paid at the point of sale) that needs to be prohibited. They are rife with conflicts of interest, target the most vulnerable investors and there is strong evidence of misselling, in addition to the funds themselves being suboptimal.***

Recommending Borrowing to Invest in Mutual Funds Harms Consumers

1.7. Embedded commissions prevent the provision of objective financial advice (including not purchasing an investment). They also encourage harmful activities such as leveraging or using margin to purchase mutual funds and relationships between financial institutions who are lenders and mutual fund manufacturers and dealer firms, so that recommendations are made to

[16] See Ibid, Appendix A, at 103 to 104.

[17] MFDA Bulletin #0670-C, DSC Sweep Report (18 December 2015), online: < http://mfda.ca/bulletin/bulletin0670-c/>; MFDA Bulletin #0705-C, Review of Compensation, Incentives and Conflicts of Interest (15 December 2016), online: <http://mfda.ca/bulletin/review-of-compensation-incentives-and-conflicts-of-interest/> [MFDA Bulletin #0705-C]. The 2016 MFDA Report states that the MFDA "…identified compensation structures that provided additional incentives to recommend deferred sales charge ("DSC") funds. We expect firms to properly manage these risks and consider amendments to their compensation structure and we will continue to review compensation structures in our examinations."[17] The MFDA noted compensation grids that could incent representatives to favour DSC Funds or compensation grids where the payout on sales commissions (such as DSCs) was higher than trailing commissions. Both of these structures would "strongly incent" behaviour to generate DSC commissions.

[18] See footnote 174 of the Consultation Document.

[19] OBSI Annual Report highlights persistent issues with DSC funds. See for example, the 2015 Annual Report where fee disclosure such as DSCs are in the top 3 issues that consumers complain about and it is the largest secondary issue they complaint about; online <https://www.obsi.ca/en/download/fm/500/filename/Annual-Report-2015-1459375786-099e4.pdf> at 50.].

[20] MFDA Bulletin #0721-C, at 19.

[21] Ibid at 15.

an investor to take out a loan to invest in mutual funds.[22]

1.8. ***FAIR Canada continues to recommend that securities regulators prohibit dealers and their advisors from obtaining any types of fees or commissions in respect of investments made from borrowed funds so as to prevent unsuitable recommendation to borrow to invest in securities, such as mutual funds.*** This should be the case whether the account is fee based or otherwise. For fee based accounts, the fee should be calculated based on net assets under management – dealers should be precluded from charging asset based fees on monies that are borrowed for investment purposes, as in Australia.[23]

1.9. ***Referral Arrangements Between Lenders, Dealers and Representatives Take Advantage of Consumers –*** The CSA Consultation Document states as follows:

> "Recommendations that clients borrow to invest in funds on a DSC basis enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction."[24]

1.10. ***FAIR Canada recommends that referral fees from lenders to dealers and their representatives should be prohibited as they incent borrowing to invest strategies that are not in a consumer's interests and can lead to devastating harm.***

1.11. FAIR Canada commends the CSA for having conducted the independent research of mutual fund fees and for the thoroughness of the background data and the regulatory impact analysis found in the Consultation Document. The Consultation Document does a very good job of going through the investor protection and market efficiency issues related to embedded commissions. For further explanation of investor protection concerns, please see our best interest submission at pages 4 through 18.

1.12. **However, FAIR Canada does believe that the CSA has been too tentative in its presentation of the research findings on the harms caused by embedded commissions, and its conclusions, given the independent research findings, data and stakeholder input.** It is not simply that embedded commissions "can" "incent investment fund managers to rely more on payments to dealers….and this incentive "can" in turn lead to underperformance; or that it "can encourage a push for higher commission generating funds…which can impair investor outcomes". The Cumming research demonstrates empirically and categorically that it "does". The harmful effect of these fees is beyond doubt.

1.13. Similarly, if embedded commissions are not banned, investment fund managers will continue to place greater emphasis on payments to dealers than on performance to gather and preserve

[22] See FAIR Canada's letter to CSA dated October 26, 2011, online: <http://faircanada.ca/wp-content/uploads/2015/12/111026-letter-to-CSA-re-Leverage.pdf>.
[23] ASIC Response *supra* note 9.
[24] Consultation Document at 104.

assets under management. The model likely will continue to encourage high fund fees and impair investor outcomes and market efficiency, including effective competition in our market. It is not simply that this *may* occur. Follow the money!

1.14. *Industry Misinformation and Biased Reports* **- FAIR Canada also believes that it is incumbent on the CSA to evaluate and assess the research studies and reports that it references.** Sometimes, industry lobbyist groups or others in the financial services industry will resort to misinformation or unfounded critiques of independent research, or put forth flawed empirical studies of their own in an attempt to prevent (or at least delay) change. **We urge the CSA and governments to critically assess industry sponsored research, reports and industry assessments of developments in other jurisdictions**.

1.15. For example, the Consultation Document includes a summary of the key academic research that has been conducted in its discussion of how embedded commissions reduce the investment fund manager's focus on fund performance, which can lead to underperformance (conducted by Professor Cumming as well as the study by Susan Christoffersen et al.). In addition, it cites an industry study conducted by Investor Economics (sponsored by the mutual fund lobby group, the Investment Funds Institute of Canada or "IFIC") to state "in contrast to the above research"[25].

1.16. The CSA should also include, or at least footnote, Cumming et al's FAQ that was published by the CSA. The FAQ includes a pointed evisceration of the Investor Economics report. The FAQ comments that the IFIC sponsored report "studies the wrong measure of returns with insufficiently detailed data, and completely incorrect econometric methods that ignore over half a century of econometrics and statistics and has qualitative arguments that only serve to highlight the mistakes with the econometric methods used. Without the necessary econometric underpinnings and data, Investor Economics can say absolutely nothing about the relationship between mutual fund performance and mutual fund flows or about other pertinent factors that may affect those flows."[26]

1.17. The reader of the Consultation Document should be made aware of this critique of the industry sponsored research, at a minimum. Ideally, the CSA should indicate its own assessment of the validity of industry led research. To do otherwise, is to suggest that Cumming and Christoffersen's research is not conclusive and that the industry study has some validity, which in our submission it does not.

No Significant Benefits from Embedded Commissions

1.18. The CSA specifically asks if there are any significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances.

1.19. **FAIR Canada can respond with an emphatic no**. There is no independent evidence that Canadians will not have "access" to advice if embedded commissions are prohibited and we

[25] Ibid at 100 and footnote 158.
[26] Professor Cumming Q&A, *supra* note 8 at 16.

move to direct pay arrangements. There is no independent evidence that Canadians are better off through any "advice" (really meaning "sales") received through embedded commissions. However, there is much evidence that the relationship is ridden with conflicts, which leads to harms to investors and the market. Conflicted advice is provided while the consumer is led to believe that the dealer and its representative are acting in the consumer's best interest. Consumers are not getting the advice that they need, deserve and expect.

1.20. In fact, the academic literature suggests that, there is a clear benefit of policy intervention that requires firms to make customers pay directly for advice.[27]

1.21. We see no support for the idea that in some circumstances embedded commissions have "benefits" that outweigh the "costs". Moreover, the question implies that the CSA imports some value to the efficiency and cost effectiveness of business models rather than the efficiency and effectiveness of the market vis a vis the investing public. **Securities regulators do not have as their mandate the protection of business models or the support of a particular level of profitability of the financial industry, especially business models which do not serve consumers and lead to poor outcomes.**

1.22. Finally, market efficiency and effective competition are hindered by embedded commissions as found by the independent research, so that part of the question is misguided.

1.23. We note that the Consultation Document is quite thorough in going through the studies as to whether people are better off from obtaining conflicted advice.[28] FAIR Canada is concerned that a positive correlation between "advice" (which is undefined in the reports prepared by the investment fund industry lobby groups such as the Investment Funds Industry of Canada ("IFIC")) and positive outcomes (which are vague in the reports, and consist primarily of increased savings levels) is interpreted to demonstrate that "advice positively and significantly affects the level of savings of individuals". We note that correlation does not prove cause and effect. **While increased savings may be a positive by-product of obtaining investment advice, it may be due to other factors entirely such as those people who choose to receive advice are already more inclined to save than those who do not seek out advice.[29]**

1.24. Any intangible benefits that may be obtained from having a relationship with a representative will not be removed with the removal of embedded commissions. Canadians will still be able to obtain advice and it will improve the quality of the advice received. Moreover, there are other policy alternatives to encourage savings discipline amongst Canadians, which could take advantage of behavioural economics and behavioural insights.

2. CSA, IIROC and MFDA Reports on Compensation Practices and Incentives – Need for Avoidance of

[27] Roman Inderst and Marco Ottaviani, "How (not)to pay for advice: A framework for consumer financial protection" (August 2011), online: <http://www.wiwi.uni-frankfurt.de/fileadmin/user_upload/dateien_abteilungen/abt_fin/Dokumente/PDFs/Allgemeine_Dokumente/Inderst_Downloads/Finance/How_not_to_pay_for_advice.pdf> at 4.

[28] See Consultation Document at 105 to 107 and 125 to 129.

[29] Jeremy Burke and Angela Hung, "Rand Study: Do Financial Advisors Influence Savings Behavior?" (2015) online: <http://www.rand.org/content/dam/rand/pubs/research_reports/RR1200/RR1289/RAND_RR1289.pdf>.

Conflicts of Interest

2.1. The CSA and SROs have been reviewing or researching the issue of conflicts of interest for several years. These are not "legal" or "technical" conflicts but are structures that create concrete motivations, set from the top of the organization, that encourage behaviours which do not meet existing regulatory requirements, or should not be permitted because they harm investors and confidence in our markets despite not being explicitly prohibited. Last December the CSA, IIROC and MFDA all issued notices[30] (and IIROC released another notice this April[31]) relating to compensation related arrangements and incentive practices. The notices listed a litany of methods that firms have to drive real life behaviours that may, and do, harm clients but that presumably increase profitability or meet the business goals of the firms. The reports document business models whose compensation and personnel arrangements and practices clearly and explicitly incentivize and reward registrant behaviour that benefits the firm at the expense of its clients.

2.2. ***FAIR Canada recommends that the CSA, IIROC and MFDA take immediate action to enforce existing rules and take disciplinary proceedings against those compensation arrangements that do not meet current regulatory requirements.*** We are extremely disappointed with the timeliness of compliance oversight and lack of enforcement activity. We fully agree with the letter from the Ontario Securities Commission's Investor Advisory Panel on this issue.[32]

2.3. We believe that all of the following should be a violation of existing conflict of interest rules and the duty to act "fairly, honestly and in good faith": non-neutral compensation grids that favour the sale of proprietary products, awarding professional titles based on achieving sales targets, higher payouts for selling DSC funds or placing people in fee-based accounts, double dipping wherein people are placed in fee-based accounts but have embedded commission funds within such accounts, and tying a branch manager's or compliance officer's compensation to the sales performance of the employees they are responsible for supervising.

2.4. ***FAIR Canada recommends that securities regulators make it clear as a matter of urgency what practices and incentives are not permissible in accordance with their statutory mandates. What is needed is the avoidance of conflicted compensation arrangements rather than the permissive world of "managing" conflicts that firms now inhabit, which allow for the creation of personnel and compensation policies and practices that create conflicts harming consumers***. A real focus on this area is urgently needed. Resources to implement rules, and guidance to ensure conflicts are avoided – as well as effective compliance oversight and enforcement – are

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[30] CSA Staff Notice 33-318, *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives* (15 December 2016), online: <http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20161215_33-318_incentives.pdf> [CSA Staff Notice 33-318]; IIROC Notice, *Managing Conflicts in the Best Interests of the Client* (15 December 2016), online: < http://www.iiroc.ca/Documents/2016/4dd98e70-f053-4980-bc75-10ceb6f3940d_en.pdf>; MFDA Bulletin #0705-C, *supra* note 17, online: <http://mfda.ca/bulletin/review-of-compensation-incentives-and-conflicts-of-interest/>.

[31] IIROC Notice, *Managing Conflicts in the Best Interest of the Client* (6 April 2017), online: <http://www.iiroc.ca/Documents/2016/F58C9465-AFC5-42F3-A5D1-6C5BFDF19CF3_en.pdf>.

[32] Letter from the Ontario Securities Commission's Investor Advisory Panel to the CSA, MFDA, and IIROC re CSA, IIROC, MFDA Reports on Firm Compensation Practices (12 April 2017), online: <http://osc.gov.on.ca/documents/en/Investors/iap_20170412_firm-compensation-practices.pdf>.

needed.

3. **Disclosure Will Not Address Harms – CRM2, POS and Proposed Targeted Reforms Won't Address the Problem**

3.1. **Regulators and stakeholders must come to grips with the reality that disclosure is not an adequate solution to ensure effective financial consumer protection and simply will not address the problems that have been identified**. CRM2 and Point of Sale are worthwhile initiatives but do not address the compensation structures that lead to biased and tainted advice.

3.2. It is simply unworkable to expect dealer firms and their representatives to prioritize the interests of the client ahead of the interests of the firm and/or representative while permitting the harmful conflicted compensation structures (including embedded commissions) to continue. This has not been and will not be effective. Compensation drives behaviour! Regulators and governments need to require that conflicts of interests be avoided wherever possible. We refer you to our thorough discussion of why disclosure of conflicts of interest is not an effective remedy in our submission on CSA Consultation 33-404. [33]

3.3. ***CRM2 -*** To be clear, FAIR Canada supports the provision of important information to investors (such as the type of services that the firm and its representatives will offer, the costs for those services, summary disclosure such as fund facts[34] and cost disclosure and performance reporting). However, this does not mean that such disclosure is effective as a mechanism to protect their interests. Disclosure does not work to adequately protect investors from conflicts of interest including the structural harms that have been identified.

3.4. As noted by a recent BCSC survey, knowledge of direct fees paid is higher than knowledge of payments made by third parties.[35] From what we know about consumers, their level of trust and reliance on the representative and given behavioural insights, they are not able to take into account the knowledge of the consequences of this disclosure of conflicts of interest from third party payments. FAIR Canada agrees with the analysis in Part 6 of the CSA Consultation Document (at pages 87 to 89) that explains why CRM2 will not make consumers informed decision-makers that will be able to adequately compensate for, and factor in their decision-making, the conflicts of interest inherent in mutual funds with embedded commissions.

3.5. Essentially CRM2 forced the industry to disclose to its clients what they are paying in costs and how much they made, but it did not force the industry to behave decently so that clients are not harmed. FAIR Canada itself is still learning the extent and nature of the conflicts present in our financial services industry as a result of the recent CSA and SRO reports on compensation

[33] FAIR Submission on 33-404, *supra* note 11 at ss. 2.26 to 2.48

[34] We continue to be of the view that the fund fact's risk disclosure is deficient and does not meet international standards.

[35] After receiving the CRM2 statements, 76% agreed with the statement that they knew the "Total amount of fees paid to my [firm type] to operate and administer my investment account in the last 12 months" whereas 59% agreed with the statement that they knew the "Total amount of fees and commissions paid to my [firm type] by other companies because of the investments that I purchased and/or held in the last 12 months". BCSC Investright Survey Report (conducted by Innovative Research Group), "Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2 (26 April 2017), at 19. We note that it is our understanding that the margin of error is such that inferences from the subgroup data is not possible or meaningful.

practices and incentives. How are consumers supported to grasp it all?

3.6. ***Proprietary Products and CRM2*** – Consumers who buy mutual funds from integrated financial institutions (such as a bank or Investors Group) will not know the exact amount of the trailing commission from the Fund Facts document[36] as that document lumps the trailing commission in with the management fee, fixed administrative fee and operating fees as part of the Management Expense Ratio or MER. The document only provides a range and does not disclose that the trailing commission reduces the investors' return, nor that it may lead the dealer to favour some funds over others given the amount of embedded commissions it will receive.

3.7. ***CRM2 Does Not Work for Integrated Firms*** - In addition, the CRM2 disclosure for those dealers who are regulated by the Mutual Fund Dealers Association of Canada (again the bank branch representatives will be MFDA registrants as will Investors Group representatives) does not require the dealer to disclose the trailing commission amount separately if they receive transfer payments instead of commission revenue and instead may "…disclose total costs paid by the client to the combined corporate entity, which includes revenue earned by the corporate group for both product management and dealer services. This approach would also meet the requirements of Rule 5.3.3.1(f)."[37] Therefore, if the total cost approach is taken, the consumer will not know the amount that it pays in trailing commission. This is an added reason why, especially for integrated financial institutions (and 95% of assets in the MFDA channel are administered by integrated dealers[38]), the CRM2 disclosure will not provide sufficient transparency as to what they are paying in embedded commissions.

3.8. ***Integrated Firms and Internal Transfer Payments*** - In FAIR Canada's view, if integrated firms are incapable of separating out the trailing commission from the other fees that make up the MER (because the dealer firm does not receive commissions and instead receives internal transfer payments from its affiliate based upon a "management agreement with the corporate group") then the trailing commission charged to the consumer is really a fiction. Such dealers can make up whatever amount they like as the distribution cost. This is another reason that such embedded commissions should be prohibited because for integrated firms, such commissions do not appear to bear any relationship to distribution costs.

3.9. At its most fundamental level, consumers who go to their trusted bank or other trusted dealer firm are not going to be able to be able to unpack all of this information and act rationally to compensate for the conflicts. Such an expectation would be wholly unrealistic.

3.10. ***The Proposed Targeted Reforms*** – The Proposed Targeted Reforms will also not address the concerns with the relationship between dealers, advisers, and their representatives vis a vis their clients because they take existing business models as "inevitable" or "normal", and blithely assuming them to be manageable (typically by disclosure). FAIR Canada is strongly of the view,

[36] See for example, BMO Mutual Funds Fund Facts (24 April 2017), online: <http://fundfacts.bmo.com/RetailEnglish/BMO_Canadian_Small_Cap_Equity_Fund-EN-Series_A.pdf> and I.G. Investment Management, Ltd. Investors Real Property Fund – Series A Fund Facts, online: <http://fundexpressweb.rrd.com/investorsgroup/files/en/F011_IRPFA.pdf>.
[37] MFDA Bulletin #0689-P, Implementation of Requirements under CRM2 Phase 2 Amendments to NI 31-103 – Frequently Asked Questions (FAQs) (13 May 2016), online: <http://mfda.ca/bulletin/bulletin0689-p/>.
[38] CSA Consultation Document at 34.

in light of the independent evidence, that disclosure is insufficient to address the problems caused by conflicts of interest in the financial sector *even if* that disclosure is improved to so that it is "prominent, specific and clear" and tries to be "meaningful" to the client so that the client "fully understands the conflict including the implications and consequences of the conflict for the client"[39] and even if dealers and their representatives complied with the rules (which they often do not).[40] Avoidance of conflicts is the answer. While the Proposed Targeted Reforms try to be helpful because much disclosure to financial consumers has obfuscated the nature of conflicts of interest, managing conflicts through disclosure as a solution will not work (see above and our submission on CSA Consultation 33-404 (Proposed Best Interest Standard and Proposed Targeted Reforms) for a detailed discussion).

3.11. Alternative solutions that may be suggested by industry stakeholders (who have a lot to gain by maintaining the status quo) such as retaining consumer choice as to whether to continue with an embedded commission compensation model, would necessarily rely on disclosure, which will not alleviate the harm to the market or to investors. Such suggestions have rightly been rejected by the CSA. Disclosure of conflicts of interest, even if the consequences are clearly articulated, will not work and the structural problems, which results in market inefficiency and investor harm, will remain. In addition, the huge benefits to be gained from banning embedded commissions will be lost.

3.12. Canadians deserve to receive objective, professional advice that is in their best interests and is not tied to the recommendation of a mutual fund product. Elimination of embedded commissions from mutual funds (and other investment products) is a critically important step to achieving a situation where Canadians are better off as a result of engaging with the financial services sector. It is also a key step in moving toward a best interest standard – a key reform that Canadians expect and deserve, and that is long overdue.

3.13. Banning embedded commissions is not a giant leap of faith. Other jurisdictions have successfully implemented a ban of embedded commissions (usually combined with other needed reforms) with positive outcomes for consumers. The United Kingdom (U.K.), Australia and the Netherlands have done so and Europe is set to do so as of January, 2018. The United States is proceeding with implementation of the DOL Rule. We fully agree with the CSA that: "[G]enerally, jurisdictions that have enhanced the advisor's standards and obligations have eliminated embedded commissions at the same time …. because they have recognized that these payments are one of the main obstacles preventing the advisor from working in the interests of their clients."

3.14. FAIR Canada believes that the proposal to ban embedded commissions is the best method to address the issues and concerns identified by the CSA in the Consultation Document. A best interest standard, with its accompanying ban on embedded commissions and other conflicted

[39] Canadian Securities Administrators, Consultation Paper 33-404: *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards their Clients* (28 April 2016), 39 OSCB 3947 at 3957 [Consultation Paper 33-404].

[40] The OSC's Mystery Shopping Report demonstrated that representatives did not comply with their regulatory obligations in disclosing conflicts of interest. Verbal disclosure about conflicts of interest was provided in connection with the discussion of fees and charges in only 4% of cases (2 of 49 shops) and in connection with the discussion of advisor compensation, in only 9% of cases (2 of 22 shops). See OSC Staff Notice 31-715, Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario, at page 29, online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

remuneration practices, would prevent sales practices and behaviours that are all too common today but are contrary to the protection of consumers and fail to place the interests of consumers ahead of the interests of the fund manufacturers and intermediaries who distribute their products.

Industry Won't Address Problems on their Own

3.15. The financial industry has failed to address the problems associated with conflicted compensation on their own and has failed to increase proficiency adequately or avoid biased compensation models. In fact, quite the opposite is happening. Dealers are creating conflicts of interest given how they incent and compensate their representatives. FAIR Canada believes that the time is long overdue for reform measures by securities regulators and governments so that a statutory best interest standard is implemented with its necessary accompanying rules on avoiding conflicts of interest, including the elimination of embedded commissions.

4. The CSA Proposal – Direct Pay Compensation

What Are Embedded Commissions - Definition

4.1. The CSA Consultation paper refers to "the prevailing practice of remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions, paid by investment fund managers" as what they mean by embedded commissions.

4.2. To the best of our knowledge, there has been no widely used and accepted definition of trailing commissions in Canadian securities law. Trailing commissions are defined in Appendix B to the June 14, 2012 CSA Notice and Request for Comments on Proposed Amendments to National Instrument 31-103 relating to cost and performance reporting requirements, as follows: "trailing commission" means any ongoing payment to a registered firm in respect of a security purchased for a client that is paid out of a management fee or other charge to the investment."

4.3. This definition makes it clear that the trailing commission comes out of the investment and that a third party, the investment fund manager, is providing a commission to the dealer as a result of the sale of the security to the investor.

4.4. **We therefore, define "embedded commissions" as used throughout this submission to mean remuneration by a third party (for example an investment fund manager) to dealers (which may or may not also be paid to their representatives) in respect of the sale of an investment (whether it be mutual funds, exchange traded funds, structured products, exempt market products or other types of securities) to an investor.** We note that our definition, like that used by the CSA, does not include any reference to this as being a payment for advice and services that the dealer and its representatives provide to investors. This is misleading as it is a form of compensation for sales.

Direct Pay Arrangements

4.5. The CSA would require direct pay arrangements – that is the investor would pay the firm directly for the advice and services provided. Such arrangements could include upfront commissions, flat fees, hourly fees, and fees based on a percentage of assets under administration. In all cases the arrangement would be negotiated and agreed to exclusively by the investor and the dealer through the representative, pursuant to an explicit agreement (we assume to be documented in writing); and the investor would exclusively pay the dealer for the services provided under the agreement.

4.6. The CSA explains that it wants to transition to direct pay arrangements that:

- Better align the interests of investment fund managers, dealers and representatives with those of investors (i.e. lessening or avoiding conflicts of interest);
- Deliver greater clarity on the services provided and their costs; and
- Empower investors by directly engaging them in the dealer and representative compensation process.[41]

4.7. The CSA should also enunciate that it wants to transition to direct pay arrangements in order to foster market efficiency (effective competition that will benefit the investing public) as the current market failure needs to be addressed.

4.8. When advice will be a separate and direct cost agreed to by the consumer with the firm, the dealer firm and its representatives will no longer be tied to high fee, actively managed mutual funds. They will be neutral with respect to the various investment products and will be able to consider low cost index funds. Much independent research has found that actively managed funds rarely deliver index beating returns.[42] FAIR Canada believes breaking the tie between selling products (or the "transaction") and advice is important. Such a step will be important to improving the quality of advice that Canadians receive.

4.9. The CSA expects dealers to offer investors a compensation arrangement that suits their particular investment needs and objectives and the level of service desired.[43] For example, the CSA states that ongoing fees should be charged for ongoing services.[44] Therefore, the converse should be true, if ongoing advice is not provided, then the investor should not incur ongoing advice charges. FAIR Canada concurs as direct pay arrangements will reflect the principle that

[41] CSA Consultation Document at 4.

[42] See, for example, the SPIVA Canada Scorecard, available online at http://us.spindices.com/documents/spiva/spiva-canada-scorecard-year-end-2016.pdf. See also J.B. Heaton, N.G. Polson and J.H. Witte, "Why indexing works?", (May 2017), online: <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2673262>. The paper explains why active management dramatically increases the chance of underperformance of the benchmark index. The relative likelihood of underperformance by investors choosing active management is likely much more important than the loss to those same investors from the higher fees for active management relative to passive index investing. Oliver Renick of Bloomberg discusses the research that shows that the reason for the underperformance is largely due to the impact of "skewness". "…a concentration of outsize gains in a minority of index members is tantamount to a death sentence for anyone who gets paid for beating a benchmark". See Oliver Renick, "Are active managers tilting at a statistical windmill" *Bloomberg* (11 April 2017), online: < http://www.wealthprofessional.ca/business-news/are-active-managers-tilting-at-a-statistical-windmill-224002.aspx>.

[43] CSA Consultation Document at 5 and 21.

[44] Ibid at 21.

consumers should not be paying substantial ongoing fees in perpetuity to a financial firm simply as a result of continuing to hold a mutual fund in an account.

4.10. ***FAIR Canada recommends that the CSA devise specific principles or rules which will provide for this outcome i.e. so that the dealer doesn't simply offer one direct pay arrangement that benefits the dealer the most.***

4.11. ***FAIR Canada recommends that the CSA require the dealers to monitor trading in upfront commission accounts so that churning of the account does not occur to obtain excess payments. FAIR Canada's understanding is that dealers have the ability to do this currently.***

4.12. ***FAIR Canada also recommends that the CSA require the types of advice options and the services and types of investments available at a dealer be disclosed in plain language on the main page of the dealer's website so that consumers can easily shop around and comparison shop.***

Types of Investments Subject to a Ban on Embedded Commissions

4.13. The CSA proposes that the ban on embedded commissions would apply to an "investment fund" (conventional mutual funds, ETFs and non-redeemable investment funds) and structured notes, whether sold under a prospectus or in the exempt market under a prospectus exemption. FAIR Canada supports having a broad based ban. ***Indeed, FAIR Canada recommends that the ban on embedded commissions go further and apply to any "security".***

Addressing Regulatory Arbitrage

4.14. FAIR Canada is well aware that given our product silo approach to regulation, some products that financial consumers would consider "investments" are not regulated as securities. ***FAIR Canada continues to recommend that the risk of regulatory arbitrage with segregated funds, principal protected notes, index linked GICs or other investment products should be addressed by: (i) determining that advice not to invest in a security (in favour of a non-security) is advice about securities and is subject to a best interest standard; (ii) amend the definition of "securities" so that segregated funds are no longer exempted from provincial securities acts; and (iii) preclude acceptance of third party commissions in respect of investment products regardless of whether a security or not.***[45] We also support the measure noted in the Consultation Document aimed at having insurance regulators harmonize their regulatory frameworks so that mutual funds, segregated funds and other investment products are subject to the same rules including a requirement to remove embedded commissions.

4.15. A recent report by the MFDA[46] highlights that its non-deposit taker and non-direct sales dealer members have a sales force that are almost all dually-licensed to sell insurance. The report also notes that 53% of these representatives (or 19,021 individual representatives aka "advisors") likely do not have a book of business large enough to currently support themselves on mutual

[45] See FAIR Canada submission to the CSA regarding CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees (12 April 2013), online: <http://faircanada.ca/wp-content/uploads/2013/04/FAIR-Canada-comments-re-Mutual-Fund-Fees.pdf>.

[46] MFDA Bulletin #0721-C, MFDA Client Research Report (23 May 2017).

fund sales alone and moreover, they likely finance their operations through DSC commissions. This MFDA Report confirms what we fear – that many investors in the MFDA channel are getting commission driven sales recommendations that are harmful, through embedded commissions, DSC arrangements and insurance product recommendations that are high fee and would not meet a suitability standard in most cases, let alone be in the best interest of the consumer.

4.16. The MFDA Report in FAIR Canada's view, highlights the need for reform of the mutual fund fee structure to remove embedded commissions including DSCs, and highlights for governments that harmonization of regulatory frameworks needs to occur so that like consumers receive advice in their best interest rather than product-driven sales recommendations. This should be the case regardless of the type of investment (banking product, insurance product, securities product).

Facilitation of the Investor's Payment of Dealer Compensation

4.17. Direct pay arrangements are beneficial as no longer will the investment fund manager determine the compensation paid to the dealer with no direct involvement of the client. This will break the perverse form of competition that exists whereby investment fund managers compete by offering to pay higher trailing commissions to dealers rather than on performance of their funds and their skill. FAIR Canada agrees with the analysis provided in Appendix A on how embedded commissions reduces investors' awareness and understanding and control of dealer compensation (so called "advice") costs.

4.18. FAIR Canada believes that direct payment for advice is essential to real price competition in the investment fund industry. Consumers should agree to the fees in advance and such fees should be freed from the product. We believe this is an essential step to foster healthier competition.

4.19. While the CSA proposal requires direct pay arrangements and would prohibit payments by third parties to dealers out of fund assets or revenue, the proposal does permit allowing investment fund managers and structured note issuers to "…facilitate the investor's payment of dealer compensation. Specifically, the investment fund manager would be permitted to collect the dealer's compensation, either through deductions from purchase amounts or through periodic withdrawals or redemptions from the investor's account, and remit it to the dealer on the investor's behalf, provided the investor consents to this method of payment."[47]

4.20. Various studies suggest that the further removed a transaction is from cash, the less price-sensitive consumers are about the costs**. FAIR Canada disagrees that payment for advice be should be permitted to be automatically deducted from the consumer's account by the investment fund manager. We believe that this arrangement could encourage the dealer and its representatives to continue their relationships with certain investment fund managers when this may not be in the best interest of the client.** The dealer and its representative may continue to offer certain mutual funds as a result, rather than recommend lower cost ETFs for example. The separation of the relationship between advice and product recommendations may be impeded by such continued relationships. Adoption of this type of system may create

[47] Consultation Document at 22.

problems of a similar nature to the one it is trying to solve.

4.21. FAIR Canada recommends that the CSA determine other alternative forms of payment such as keeping a portion of the client's funds in a high interest savings account or money market funds to pay for ongoing advice received. This would ease the "pain" associated with writing a cheque while not creating relationships that lead to conflicts that harm consumers.

Allowing Other Types of Dealer Compensation Payments

4.22. The Consultation Document states that the CSA jurisdictions would continue to permit the following types of dealer compensation payments:

- Referral fees paid for the referral of a client to or from a registrant in accordance with NI 31-103;
- Dealer commissions paid out of underwriting commissions on the distribution of securities of an investment fund or structured note that is not in continuous distribution under an initial public offering;
- Payments of money or the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; and
- Internal transfer payments from affiliates to dealers within integrated financial service providers which are not directly tied to an investor's purchase or continued ownership of an investment fund security or structured note.[48]

4.23. The CSA states that "at this time" it would permit the above-noted forms of dealer compensation payments even though it admits that they "…may give rise to conflicts of interest that may continue to incent registrant behavior that does not favour investor interests", but does ask whether they should consider discontinuing such payments.[49]

4.24. ***FAIR Canada recommends that the CSA not permit conflicted dealer compensation payments that lead to incentives and behaviours that subvert the interests of consumers, and that all compensation (referral fees, underwriting commissions and other sales incentives) should be examined.***

Referral Fees

4.25. **FAIR Canada continues to believe, as recommended in its submission on CSA Consultation 33-404 (Proposed Best Interest Standard and Proposed Targeted Reforms), that disclosure of referral fees for selling certain products is not adequate and such conflicted payments should**

[48] Ibid.
[49] CSA Staff Notice 33-318, *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives* (2016), 39 OSCB 10115 at 10116, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20161215_33-318_incentives.pdf>.

be prohibited.[50] We also recommended that the rules around referral fees be updated. ***FAIR Canada is of the view that a best interest standard is needed so that any referral arrangement only occur in the context of a client's best interest, and therefore when there is an absence of any conflict of interest as a result. In addition, there should be full transparency, and the fact of the fee, its amount and its impact should be disclosed in plain language before or at the time the payment is made.***

4.26. Referral fees are leading to behaviour that is detrimental to clients. The following types of referral arrangements have been highlighted by securities regulators:

(i) *Referrals to facilitate loans used to purchase mutual funds* - "Recommendations that clients borrow to invest in funds on a DSC basis enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction."[51]

(ii) *Referrals to sell additional products or services to clients not based on need or suitability* - "Some firms use one-time or ongoing payments as an incentive for representatives to pass on business to related and/or third party financial service providers. Practices among surveyed firms ranged widely and included receiving one-time and ongoing (in some cases perpetual) referral fees and receiving both securities and non-securities related referral fees, including referral fees on mortgages, investment loans and insurance.

This practice may encourage representatives to search through their existing books of business to find those clients that could be sold the targeted product or service whether they need it or not. In the case of related party referral arrangements, it may encourage representatives to send their clients to another arm of their firm, even when third party product and/or service options may be more suitable. It may also encourage representatives to shift clients to more profitable business lines within the firm with little or no benefit to the client."[52]

(iii) *Referrals between MFDA dealers and portfolio managers* – This can be comparable to a mutual fund trailing commission. Firms have the ability of firms to structure arrangements as referral arrangements rather than distribution agreements, in order to avoid regulatory requirements including National Instrument 81-105. [53]

4.27. FAIR Canada believes that securities regulators must prevent payments that are detrimental to consumer's interests and, if they do not, they will become even more pervasive. Firms should not be able to do indirectly what they are not able to do directly.

4.28. ***FAIR Canada believes that referral fees for facilitating loans so that clients borrow to invest in***

[50] MFDA Bulletin #0705-C, *supra* note 17.
[51] CSA Consultation Document at page 104.
[52] CSA Staff Notice 33-318, *supra* note 30.
[53] MFDA Bulletin #0705-C, *supra* note 17.

mutual funds should be prohibited immediately as this leads to unsuitable recommendations to borrow to invest, often with disastrous consequences for the consumer.

4.29. FAIR Canada also believes that consumers are not receiving adequate disclosure of referral arrangements in accordance with existing regulatory requirements.[54] And, even if they were, they would not appreciate the bias created by the conflicts and what that means for the advice and services to be provided.

4.30. ***Internal Transfer Payments between Affiliated Dealers*** – There are internal transfer payments from affiliates to dealers within integrated financial services providers, which may be directly tied to an investor's purchase or continued ownership of an investment fund security or structured note. Presumably such transfers are used to pay for bonuses and sales targets and other forms of compensation that skew the advice provided towards the firm's own product. There are also internal transfer payments that are not directly tied. The nature and form of these payments, and their relationship to the embedded commissions that are collected/received by these financial firms need to be better understood. The regulators need to better understand these payments and convey that information to the public. ***FAIR Canada recommends that internal transfer payments not be allowed to circumvent the prohibition of embedded commissions through another means***.

4.31. FAIR Canada notes that the U.K.'s RDR reforms introduced requirements on vertically integrated firms who sold their own products. They were required to ensure that the charges for their advice service covered the costs of providing that service and that the firm did not unreasonably cross-subsidize these costs from other areas of their "value chain", such as their products. The rules were intended to prevent these firms from subsidising the costs of advice through their product charges and thus offering advice as a "loss-leader" in order to sell investors their own products.[55] This rule was amended to address the development of new business models while still ensuring that over the long-term the charges for their advice services cover the costs of providing that service.[56] ***FAIR Canada recommends that a cross-subsidization rule be examined in order to ensure a competitive landscape and not provide an undue advantage to vertically integrated firms.***

4.32. ***Integrated Financial Services Firms and Proprietary Products*** - Professor Cumming's report found that affiliated dealer flows showed no flow-performance sensitivity at all. This was found to be relatively more detrimental to investors relative to all trailing commission paying purchase options for non-affiliated dealer flows. He explained that affiliated dealer flows also results in

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[54] A quick look at some referral disclosures available online highlights the benefit to the consumer of these arrangements ("The purpose of these referrals is to introduce you to experts within the [unnamed] bank group who are best suited to help you achieve your financial goals"). The only mention of conflicts of interest is that the bank has "policies and procedures" to assist in "identifying and addressing any conflicts of interest that may arise" and the consumer is directed yet to another brochure full of legalese. FAIR Canada believes that there is likely widespread non-disclosure to consumers of the specific conflict of interest that occurs when a representative refers a consumer to another affiliated entity or third-party.

[55] Financial Conduct Authority, Final Report on the *Financial Advice Market Review* (March 2016), online: < https://www.fca.org.uk/publication/corporate/famr-final-report.pdf> at 37 [FCA Final Report].

[56] Financial Conduct Authority, *Financial Advice Market Review Progress Report* (April 2017), online: < https://www.fca.org.uk/publication/corporate/famr-progress-report.pdf> [FCA Progress Report].

material conflicts of interest that are detrimental to mutual fund investors over the long term.[57]

4.33. **Therefore, *FAIR Canada continues to recommend that a clear picture be provided to consumers. Firms that only sell affiliated dealers products should not be able to hold out that they provide advice in the best interests of consumers and their representatives should be restricted to the title "salesperson".***

4.34. ***FAIR Canada further recommends that if bank branches or affiliated dealers of insurers want to provide advice in the best interests of consumers they should be required to have an open shelf and this should be monitored on a comprehensive basis so that sales incentives, compensation grids, performance targets or reviews or internal transfer payments don't favour the sale of proprietary products over others, to the detriment of clients. There should be annual disclosure of the extent to which proprietary versus third party products are sold.***

4.35. ***Payments of money or the provision of non-monetary benefits by investment funds managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105 – FAIR Canada recommends that these payments should be prohibited as they are riddled with conflicts of interest and do not serve consumers' interests.***

4.36. In light of the removal of embedded commissions and avoidance of conflicts of interest, ***FAIR Canada also recommends that National Instrument 81-105 Mutual Fund Sales Practices be completely reworked.*** We also note that to date, there has only been one enforcement action resulting from this rule. The Sentry case[58] demonstrates how entitled the financial services industry can become at the expense of its clients.

5. FAIR Canada's Comments on the Predicted Consequences of Banning Embedded Commissions

Benefits of banning embedded commissions

5.1. FAIR Canada believes that a ban on embedded commissions should be undertaken with a ban on other forms of conflicted compensation structures that have been identified. Incentives that distort advice and subvert the interests of consumers should be addressed at the same time. The benefits that will flow from banning embedded commissions include:

(i) Reduction in fund series and in fund fee complexity - the fund fee structure will be simplified and made more transparent;

(ii) Increased price competition and decrease in fund management costs;

(iii) New lower-cost product providers may enter the market (reduce barriers to market entry and increase price competition);

(iv) Shift in product recommendations to lower-cost and passively managed products

[57] Professor Cumming Q&A, *supra* note 8 at 7.
[58] *OSC Staff Statement of Allegations re Sentry Investments Inc*. (31 March 2017), online: <http://www.osc.gov.on.ca/documents/en/Proceedings-SET/set_20170331_sentry.pdf>.

including exchange traded funds;

(v) The market will innovate including through offering different forms of direct payment arrangements and through the use of fintech and online advice (robo advice) so that various consumer segments are served (including those with less assets);

(vi) Increase in transparency to the consumer as to what they pay as product costs (management fees and operating expenses of the fund) as opposed to what they pay for "advice" and services of the dealer/representative, which will better allow consumers to assess value and control such costs;

(vii) Advisors and their firms will no longer be incented by higher trailing commissions and fund managers will have to compete based on performance rather than on the basis of paying higher trailing commissions;

(viii) Ability to comparison shop – greater transparency should allow consumers to know, before they speak with a firm/representative and certainly before they enter into a relationship, what the cost will be for advice and services (and what those services and advice include (and do not include)) so as to compare the costs and services/advice of different firms (and their representatives);

(ix) Consumers will be able to assess the value of any services and advice they pay against the costs they incur, on an ongoing basis rather than simply reviewing the amount of trailing commissions and other costs they currently incur annually, as a result of the required cost reporting and performance reporting documents (CRM2 Statements);

(xii) Quality of the advice provided should improve and given product bias should be reduced. Business models should be capable of focusing on advice such as creating and following a budget, prioritizing short and longer term goals, paying down debt, and saving in the most tax efficient manner in light of income etc., rather than simply focusing on product sales;

(x) Enhance the professionalism of the financial services industry and enhance public trust in the industry and financial markets which would benefit both investors, dealers and representatives.

5.2. The Consultation Document makes an assessment of the possible market impacts of discontinuing embedded commissions, which appear reasonable based on the assumptions it has made.[59] FAIR Canada has made recommendations above to improve the impacts of

[59] The Consultation Document's listed benefits include: (i) reduction in fund series and fund fee complexity; (ii) new lower-cost product providers may enter the market; (iii) increased price competition/decrease in fund management costs; (iv) shift in product recommendations to lower-cost/passively managed products; (v) shift in assets across existing investment fund managers; (vi) market innovations in product distribution and advice.
The consequences to investors by segment are described as follows:
"Mass-Market Investors (investable assets below $100,000) – lower product costs and better performing products, eliminate incentive to engage in unsuitable leverage strategies; use of online/discount brokerage without having to pay a trailing commission; some independent fund dealers may choose not to continue to service these individuals. No significant change in fund products recommended at integrated firms although cost and performance may change due to new market entrants. Risk of reverse churning. Risk of churning if the account is transaction-based commissions (but no trailing commission).

discontinuing embedded commissions and by addressing other inherent conflicts that have been identified. We have also made recommendations with respect to integrated financial services firms so that critical dealer affiliation issues are addressed and it is made clear to consumers whether they are getting advice in their best interest (open product shelf) or sales advice (proprietary products only) when they go to an integrated financial services dealer. This, accompanied by the ban on embedded commissions, should help foster a competitive landscape. Our recommendations in this submission are consistent with our recommendations on best interest. The two proposals go hand in hand.

The Existing Advice Gap

5.3. FAIR Canada disagrees with the industry's weak argument that if the CSA implements a ban on embedded commissions, then some investors, especially those with smaller amounts, will be unable to obtain "access to advice". The argument is that these investors will not be able to afford advice. This argument is wrong for a number of reasons.

5.4. It should be made clear that "advice gap" is defined in the Consultation Document to mean a group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay.[60] Firstly, such a gap exists for many different types of services – accounting services, tax services or pension advisory services. A gap will always exist to some extent for financial or investment advice. Only 37% of Canadians own investment funds and amongst those who do, only 58.5% of them use an advisor. For those who have investable assets up to $100,000, only 45% currently use an advisor.[61]

5.5. Secondly, it is wrong because investors, especially those with smaller amounts to invest (in the Consultation Document referred to as mass-market investors), are already paying for advice. If

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Advice – No anticipated significant advice gap. It is possible that the cost of traditional advice may rise for this group – direct pay arrangements and other regulatory reforms may increase the cost of dealers' operations and compliance, which may lead to an increase in the cost of advice. Some investors may be pushed into online advice relationships, others more simplified forms of advice, or the online/discount brokerage channel, even through these services may not meet all their needs and even though they may prefer, but can no longer afford, face-to-face advice". It suggests some may be discouraged from seeking financial advice as they may not want to pay fees for "advice" when they are not receiving any outside of the required suitability assessment.

Mid-Market Investors (investable assets between $100,000 and $500,000) – lower product costs, more use of passively managed funds, improved investor outcomes. Could be switched into fee-based accounts when transaction-based fees may be better for their circumstances (shift already happening today). Possibility of reverse churning. They state that the CSA 33-404 proposals would limit this.

Advice - different types of services and advice options offered with resulting greater control and clarity over the advisor/client relationship, possibly offered discretionary advice over time.

Affluent Investors (investable assets above $500,000) – Least impacted because less use of embedded commissions. Reduced product costs and more use of passively managed funds. Usage of discretionary advice likely to increase substantially. Will be provided the most flexibility in terms of payment arrangements and the most number and scope of advice delivery and service offerings.

Do it yourself investors – Will lower costs as they would no longer pay the full trailing commission and should benefit from decline in fund management costs. It expects that DIY investors will be charged transaction-based or asset-based fees "to offset the revenue lost from trailing commissions at roughly but only at a quarter of what they pay today. See Consultation Document at 51 to 72.

[60] Consultation Document at 62.

[61] Ibid at 28-29.

you believe the industry's argument that trailing commissions pay for "services and advice" rather than commission payments to incent the sale of products, then investors can and already do "afford" to pay for advice. A ban on embedded commissions would simply put those dollars under the control of the consumer so that they could decide for themselves how much and what kind of advice they want, and how much they are willing to pay for it.

5.6. Thirdly, there is no legal obligation to provide advice to consumers beyond meeting suitability obligations at the time of the transaction and in accordance with certain triggering events under CRM obligations. Accordingly, many of those with smaller amounts to invest often get no "advice" beyond the sales product recommendation (or a phone call at RRSP deadline season). At discount brokerages, the dealer is not permitted to provide any recommendation or advice. Canadians have been paying dearly in embedded commissions despite not receiving advice or product recommendations of any kind.

5.7. Fourthly, Canadians who have bought mutual funds with embedded commissions are not getting objective advice, but instead product sales under the guise of advice and these funds underperform. Canadians need objective professional advice to help them pay down debt and accumulate savings, but all too many Canadian are not getting this.

5.8. Fifthly, there is no independent study that shows that Canadians will not pay directly for advice. Canadians will be able to understand more clearly what they pay for "advice" versus what they pay for the product, and will be able to assess value. The answer is not to charge Canadians and hide the costs and harms those commissions engender.

5.9. The financial service industry has an ability to innovate and develop new ways to serve those Canadians who have smaller amounts to invest. Robo-advice has already entered the Canadian market and further innovation will occur to provide cost effective advice that meets the needs of Canadians.

The UK Example

5.10. In the U.K., not only were embedded commissions banned, but the Retail Distribution Review ("RDR") also increased proficiency requirements for representatives. In addition, in 2015, pension reforms were introduced so that consumers had access to their defined contribution pensions at age 55. The 2015 pension reforms thus created a situation where a large number of consumers were to make a significant financial decision at a time of unprecedented control over their pensions. This increased the public policy need to ensure that consumers had access to advice – and could obtain the amount of advice they needed at a price they were willing to pay.

5.11. The U.K. embarked on a Financial Advice Market Review of their reforms. This Review was undertaken to ensure that affordable advice and guidance is available to everyone at an amount each is willing to pay. The Consultation Document notes that the amounts currently paid for advice under fee-based accounts, are as follows: initial charges of 1% (minimum) to 3% (maximum) and ongoing charges of 0.5% (minimum) to 1% (maximum).[62] With the introduction

[62] Ibid at 149.

of robo-advice, advice costs will face more competitive pressure.[63]

5.12. The Review noted that RDR brought about positive changes as it reduced product bias on recommendations and increased the sale of low cost products. It also increased professionalism and transparency. There was some drop in the number of advisors when the reforms came into place as older advisors chose to retire rather than meet the new proficiency requirements. This problem appears to have been overstated as it has been reported that there are now more advisors in the UK than there were pre-RDR Reforms.[64] The number of registrants is not foreseen to be a problem in Canada. In the UK pre-Retail Distribution Review, there was one advisor for every 1,553 whereas there is one representative for every 336 Canadians as of 2015.[65].

5.13. The UK has made significant strides forward resulting from its reforms and there is no appetite to returning to an embedded commission structure: "Given the strong arguments against a commission-based system, such as the lack of transparency and distortion of incentives, FAMR does not believe there is a case to consider this, and is therefore not recommending a return to commission-based financial advice."[66]

6. Transition Date

6.1. FAIR Canada believes that a Transition Date of two years (rather than three) is more than sufficient for all affected parties to ensure a successful transition and to complete all necessary transition steps. We favour a defined transition period as this would provide more clarity for consumers who wish to explore alternatives and is a more simple approach for all participants.

6.2. FAIR Canada does not support a move to fee cap as a transition measure. This would likely delay the effective transition date and would add unnecessary complexity while not addressing the harms caused by embedded commissions.

6.3. FAIR Canada wishes to express some frustration at the slow pace at which investor focussed initiatives proceed. These delays result in investors continuing to be inadequately protected, subject to a marketplace that is inefficient and results in unnecessary with significant costs being incurred by Canadians. In light of some industry stakeholders' arguments, the CSA has taken the time to obtain direct empirical evidence based on Canadian data that the conflicts impact investor outcomes negatively. However, that research was released in October 2015.

6.4. Careful consideration and assessment of the impacts on all stakeholders (most importantly the investing public i.e. ordinary Canadians) and consultation is important**. However, timely response to market failures and investor harm is also important so that those harms can be redressed. Delays only benefit the industry.**

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[63] https://www.fca.org.uk/publication/corporate/famr-progress-report.pdf.FCA Progress Report, *supra* note 60.
[64] Susan Yellin, "What Canada can learn from the Australian and U.K. Experience" (20 January 2014), *The Insurance & Investment Journal*, online:<http://insurance-journal.ca/article/banning-embedded-commissions-a-series-of-three-articles-by-susan-yellin/>.
[65] CSA Consultation Document at 38.
[66] https://www.fca.org.uk/publication/corporate/famr-final-report.pdf.FCA Final Report, *supra* note 59 at 46.

7. <u>Conclusion</u>

7.1. FAIR Canada is strongly of the view that a statutory best interest standard is urgently needed. One of the keys to a best interest standard is avoiding conflicted compensation structures, including embedded commissions. FAIR Canada supports the elimination of embedded commissions and strongly urges the CSA to move forward with this step and at the same time to address the other conflicted compensation structures and practices that subvert the interests of investors.

7.2. FAIR Canada has made recommendations in this submission to improve the CSA's reform proposal so as to improve the ability of Canadians to receive advice that it is in their interests, and to encourage effective competition for the benefit of the investing public. The ban on conflicted compensation will foster fair and efficient markets and investor protection.

7.3. We urge the CSA to move forward with this expeditiously. FAIR Canada also urges all CSA jurisdictions to adopt a statutory best interest standard as set out in our submission on CSA 33-404 along with the accompanying reforms we believe are needed (increasing proficiency and restricting the use of titles).[67] For those jurisdictions that have indicated they will move forward with a best interest standard, they should move forward quickly to prohibit embedded commissions - a best interest standard should include a prohibition against the acceptance of embedded commissions and other conflicted compensation.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Marian Passmore at 416-214-3441/marian.passmore@faircanada.ca.

Sincerely,

Marian Passmore

Canadian Foundation for Advancement of Investor Rights

Cc British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador

[67] See FAIR Submission on 33-404, *supra* note 11.

Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

To the OSC and CSA,

I am a younger advisor at HollisWealth, an independent dealer, and I rely on embedded investment costs for a large percentage of my income. I am writing to urge you not to place a ban on this type of compensation structure.

I have read arguments for and against discontinuing the embedded costs. I do agree with having transparency; however, I also agree with having choice. With the new disclosures, fund facts, point of sale disclosure, and the annual fee letter---those are a great start to full disclosure. Having the fund companies send out an annual fee letter should be introduced also, so the investor can see the full costs of the funds. It is important to have the banks send out the same letters and materials as well. It is not fair to investors that the same level of transparency is not available to them at the major banks[1]. They also operate on a model of embedded investment costs and they should have the same disclosure as all businesses who sell the embedded products.

Disallowing the embedded model will also have negative outcomes on smaller investors. The current model supports Canada's middle class, which is the majority of the population, so they can have easy access to financial advice---thus better life outcomes. There are many studies which illustrate how having access to financial advice provides better financial outcomes for people[2]. The IFIC report specifically states that, "Advised households have substantially higher investible assets than non-advised households, regardless of household income level"[2] (pg.5). How do we define smaller investors? I have reviewed Morningstar's report on this matter[3]. Morningstar is an unbiased entity that reports topics in a very objective manner. They specifically cited a study by Allianz Global Investors that found investors with portfolios of less than GBP 50,000 ($85000 CAD) would not be serviced by investment firms. They went onto say it is now harder for investors with smaller portfolios to get advice. Having a fee based model, whereby the investor pays an upfront fee is problematic due to that fee being a larger amount of their portfolio---further incentivizing them not to pursue professional financial advice. A recent report from Schroders in the UK also confirmed the initial report from Allianz.

A fee based approach also has inherent problems as well. The dealer costs are displayed monthly; however, the mutual fund company's costs are not shown. IIROC recently released a bulletin on their concerns with fee-based accounts[4]. One of their concerns was there still may not be adequate supervision. The mutual fund companies can also still give gifts (soft dollars) to advisors for promoting their funds. At the bank level advisors get bonuses based on how much mutual funds they sell. I would assume that equity funds generate higher levels of bonuses as well, although that is not disclosed to clients, and therefore not verifiable. The disclosure rules do not apply to segregated funds either which insurance companies sell. They have very high management costs (3-4%) and the CRM2 rules do not cover them.

I am very careful when recommending a particular mutual fund to a client that is has the right risk profile for that client and has returns that are in line with the benchmark on risk adjusted basis. I take the time to explain this to clients also. I can see there is room for all advisors to have more of those conversations with their branch managers perhaps, so that there are checks and balances on what an advisor is recommending. If supervisors and branch managers had skill and expertise in that area, then they could better assess whether an advisor's recommendations are suitable. More frequent and comprehensive enforcement, and audits in that respect could pay larger dividends for clients than banning the embedded model.

I am convinced that there is more room to continue to reform the present system through more transparency from the mutual fund, insurance companies and the banks. As well making the exams more rigorous for advisors entering the business which ensures that the quality of advice would be higher and more thorough. The answer seems to lie with applying the CRM2 rules to all constituents in the investment industry equally and leaving customers to choose what method of investing they prefer. There are also now online digital advisory firms (robo-advisors) that will place additional competitive pressures on all advisors to give quality advice and recommend investments that perform well on a risk adjusted basis. I will summarize by saying that banning embedded costs will have a negative outcome for younger advisors, like myself, who have multiple smaller accounts, as well as the middle class clients that we serve.

Thank you

Sincerely,

Troy Iwanik

References:

1. http://business.financialpost.com/personal-finance/managing-wealth/why-its-not-time-to-celebrate-the-new-investment-fee-disclosure-rules-just-yet
2. https://www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650/
3. http://tools.morningstar.ca/cover/videoCenter.aspx?region=CAN&culture=en-CA&id=796958
4. http://www.advisor.ca/news/industry-news/are-clients-being-pushed-into-fee-based-accounts-unnecessarily-232337

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June 9, 2017

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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Consultation Paper 81-408: Consultation On The Option Of Discontinuing Embedded Commissions (the "Paper")

Thank you for the opportunity to provide comments to the CSA on the Paper.

Fidelity Investments Canada ULC ("**Fidelity", "we**" or "**us**") is the 4th largest fund management company in Canada. We manage approximately $137 billion in mutual funds and institutional assets and offer approximately 200 mutual funds and pooled funds to Canadian investors. Millions of Canadian investors entrust us with their hard-earned savings and we take their trust and financial future very seriously. That is why we are committed to always putting them first in everything we do.

For over 70 years, including 30 years in Canada, Fidelity has put investors first by working hard to help them achieve their financial goals. We recognize that the CSA is also committed to improving outcomes for investors, and we are pleased to work collaboratively with the CSA toward our shared commitment.

Overview

Our detailed response to the Paper is attached to this letter in Appendices A and B. In Appendix A, as requested in the Paper, our comments cover new empirical evidence. We believe that the CSA will find this information valuable to its evidence-based policy development process. Specifically, this section addresses the following topics:

1. The Modest Investor
2. The Importance of Preserving Investor Choice
3. The Importance of Financial Advice
4. The Importance of Enforcing Existing Rules Around Conflicts of Interest
5. Global Trends
6. Robo-Advisors
7. Passive and Active Investment Strategies
8. Deferred Sales Charges
9. Proposed Options

Appendix B provides specific answers to the questions posed in the Paper.

Regulatory Goals and Public Policy

Fidelity shares the goal of the CSA and its regulators to strengthen investor protection and to foster fair and efficient capital markets. To achieve this regulatory goal, regulatory measures must be carefully designed in a balanced and principled manner so that they:

1. Protect access to financial advice for Canadian investors
2. Preserve choice in how Canadian investors can access financial advice according to their unique needs
3. Maintain or enhance competition in the marketplace

A growing body of empirical evidence continues to prove that financial advice helps Canadian investors save and be better prepared for retirement. We believe in the value of advice. Canadian investors – especially modest investors – should have access to financial advice and they deserve a fair chance to save for their future.

The current Canadian regulatory system has come a long way toward achieving this goal, and we applaud the work of the CSA and its regulators who have helped make meaningful differences for Canadian investors. We believe improvements can be made and we are pleased to propose potential improvements in this letter for the CSA's consideration.

While Fidelity supports many balanced and carefully crafted measures, we do not support the proposal to ban embedded commissions. Independent research suggests that the ban would exacerbate the problems the CSA seeks to resolve through this regulatory measure.

Compensation alternatives offered in the Paper will create new and different conflicts of interest which could potentially put Canadian investors' savings at greater risk. Most importantly, a ban of embedded commissions will reduce access to financial advice and limit the choice of investments that middle-class Canadian investors count on for their retirement security. That outcome would be misaligned with the public policy objectives of provincial and federal governments in an aging Canada.

Given the highly consequential public policy implications, we believe the debate on whether or not to ban embedded commissions must include provincial and federal governments. They need to understand the potential policy risks and impacts on the retirement savings of Canadians and the health of the Canadian economy. While the CSA plays a meaningful and critical role in protecting investors, we believe that it is one part of the overall picture and cannot act in isolation. We believe that the inclusion of the governments in the debate will ensure that regulatory policies are not only balanced and principled, but in support of public policy objectives.

Effective Changes Already Implemented by the CSA have had a Meaningful Impact

The CSA should be credited for the volume of regulatory measures it has implemented in recent years to raise investor awareness and strengthen investor protection. These measures have been balanced and they are achieving clear and positive outcomes for Canadian investors.

Among many regulatory changes in the last few years, CRM 2 and the point of sale regimes have simplified disclosure and made a meaningful difference in accessibility and transparency of fees on mutual funds and other securities products. Recent research by the British Columbia Securities Commission ("**BCSC**") confirms that since the introduction of CRM 2, investors are more aware of fees and the performance of their investments. In particular, investors with small portfolios have become substantially more aware of direct fees. We believe that the third phase of this important research will show even greater awareness of fees by investors and how their investments are performing toward their retirement goals.

Leading up to the implementation of the final phase of CRM 2, financial advisors were proactively having clear and explicit conversations with Canadian investors about the cost of advice. We have also seen a meaningful increase in the sale of F-series mutual funds, increased price competition and a focus on investments in stronger performing funds.

Furthermore, recent media coverage around other regulatory proposals, such as the best interest duty and targeted reforms, as well as compliance reports from the CSA, its regulators and self-regulatory organizations ("**SROs**") relating to sales practices, have raised public awareness, particularly related to the fees Canadian investors pay and how mutual funds are sold and operate. This is a positive outcome that complements recent regulatory measures and is improving financial literacy of Canadian investors.

Taken altogether, we believe that the CSA has and will achieve its objectives to improve the Canadian mutual fund industry and financial advice. Thanks to the balanced leadership of the CSA, Canada is in an enviable position leading the world in investor protection and it enjoys an accessible financial advice system for all Canadian investors.

We thank you for the opportunity to comment on the Paper. As always, we are committed to working with you to put investors first and are willing to meet with you to discuss any of our comments.

Yours truly,

"Rob Strickland"

Robert S. Strickland
President

c.c. Sian Burgess, Senior Vice-President, Fund Oversight

APPENDIX A – Fidelity's Comments

1. The Modest Investor

5.2 million (33%) Canadians save through mutual funds. 76% of investors have less than $50,000 in investable assets. Approximately 4.5 million households (22% of Canadians) save through the embedded fee option.[1] 80% of Canadian mutual fund investors have chosen embedded commissions as an accessible payment option to obtain advice and save toward their financial goals. These modest investors will be most impacted if they cannot purchase mutual funds through the accessible payment option. The impact of a ban on the modest investor must be considered and analyzed.

It is now clear that an advice gap emerged in the United Kingdom ("**U.K.**") after the Retail Distribution Review ("**RDR**"). Given many similarities between the U.K. and Canada, the risk that an advice gap will emerge in Canada is real, significant and should not be taken lightly. The impact on retirement savings rates in Canada as a result of a ban is also likely to be significant. Canadian investors save through mutual funds more than any other country to meet their retirement needs. The risk of impacting retirement savings is therefore greater in Canada than anywhere else. Consequently, the proposal to ban embedded commissions must be taken very seriously, thoroughly examined, and supported by a strong body of empirical evidence to ensure that Canadian investors' retirement savings are protected.

To date, however, we have only seen conjecture by the CSA, with no solid empirical evidence, that modest investors will not be harmed by a ban.[2] Until we know with reasonable certainty, corroborated by a strong body of empirical evidence that an advice gap will not emerge, we believe it would be ill-advised and irresponsible to move forward with a ban on embedded commissions.

The Paper even acknowledges that the structure of the Canadian marketplace will change potentially for the worse in a world where embedded commissions are banned. According to the Paper, the modest investor will be served increasingly by the Canadian banks and less so by the independent fund managers and dealers. Although the banks do service a high number of modest investors, it is clear from the Mutual Fund Dealer's Association's ("**MFDA**") recent research report that independent MFDA advisors play a key role in servicing a significant share of the modest investor segment.[3] We believe that a balanced and principled marketplace with healthy competition must be protected. This will ensure that modest investors who have chosen independent advice according to their unique needs can continue to save toward their retirement goals.

[1] The Investment Funds Institute of Canada, "IFIC CEO Responds to Release of CSA Consultation Paper on Embedded Commissions", *The Investment Funds Institute of Canada* (January 10, 2017).
[2] Canadian Securities Administrators, "CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions", *Canadian Securities Administrators* (January 10, 2017) at 63.
[3] Mutual Fund Dealers' Association, "MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients", *Mutual Fund Dealers' Association* (May 19, 2017).

The recent MFDA research report also highlights the importance of the deferred sales charge ("**DSC**") option in allowing smaller asset advisors to continue to provide financial advice. Surely, it is incumbent upon the CSA and its members to foster competition in the financial advice industry. This must include the smaller MFDA dealer firms and financial advisors who serve the modest investor and offer independent financial advice and choice of products.

We do know that modest investors are costly to serve relative to the assets they invest and the fees they generate for dealers and financial advisors. In the Canadian marketplace, there are many dealers that have high asset thresholds before a client is taken onboard. These thresholds can be $100,000 or even as high as $250,000. Yet the majority of households with investable assets have less than $100,000. One study by Pricemetrix demonstrated that the number of small households (defined as less than $25,000 in assets) had a significant negative effect on the future production of financial advisors.[4] It found that advisors actually pay a penalty in terms of decreased future revenue for the small households they keep on their books. The study went on to quantify this impact. Another Pricemetrix study found that diversifying away from small households dramatically improves production.[5]

We were struck by a recent article written by the Honourable Joe Oliver and we recommend that the CSA take his comments into consideration.[6] Given his background, the Hon. Oliver is uniquely placed to understand both the securities regulatory regime and the broader public policy issues impacting Canada. He was a former President of the Investment Dealers' Association and a former executive director of the Ontario Securities Commission ("**OSC**"). Eventually, he went on to be a Member of Parliament and the Federal Minister of Finance discharged with, among others, the responsibility of strengthening retirement security of Canadians. Here is what the Honourable Joe Oliver said in his recent article:

> Banning embedded fees to ensure that advisers face no financial conflict of interest, so as to protect financially unsophisticated retail clients, means clients will have to start paying upfront for advice. Many will instead forgo the advice entirely. This is just one of many unintended consequences that could come from banning embedded fees. Others include a fall in savings and returns and, most critically, undermining the competitive structure of the securities industry, shrinking the weakening independent brokerage sector even further.
>
> Still, we have to resist the temptation to try to protect everyone from everything that may pose a risk, regardless of the cost, the limits on freedom of choice and the unintended consequences.
>
> What policy-makers must rigorously avoid is creating an advice gap between the wealthy who will pay for advice and the smaller, less sophisticated investors who, more often, will not, hurting the very people who most need protection. That would also burden the retirement system and reduce liquidity in the markets.

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[4] Pricemetrix, "Moneyball for Advisors", *Insights: Volume 7* (October 2012) at 6 online: https://www.pricemetrix.com/cms/wp-content/uploads/PriceMetrix_Insights_Moneyball-for-Advisors_English.pdf.
[5] PriceMetrix, "Small Household Metrics", *Insights: Volume 1* (June 2010).
[6] Joe Oliver, "Joe Oliver: Banning embedded mutual fund fees will only hurt the investors we should be helping", *Financial Post* (April 17, 2017), online: http://business.financialpost.com/fp-comment/joe-oliver-banning-embedded-mutual-fund-fees-will-only-hurt-the-investors-we-should-be-helping

A lot is at stake in determining the right balance. We had better be careful.[7]

2. The Importance of Preserving Investor Choice

We believe that investors should be entitled to decide how they wish to pay for financial advice and save toward their retirement according to their unique needs. Considering the diversity of the needs of Canadian investors, as a matter of principle, less choice is rarely a good option and more choice is almost always a better option. That is why Fidelity would support a regime in which financial advisors are required to offer both embedded and unembedded fee options. Financial advisors would explain the implications of various options to their clients so that they can choose for themselves, instead of being limited by regulatory fiat to fewer choices that may not be suitable.

Fidelity regularly consults with a cross-section of dealers to understand the needs of Canadian investors. According to our consultations, dealers tell us about 50% of their investors say that they prefer the embedded fee. This preference has been validated in a recent study released on May 30, 2017. Given the choice of paying directly or indirectly, 55% of Canadian investors say they prefer to pay indirectly.[8] These investors are interested in the bottom line – how their account performed and how much they have saved toward their retirement. Anecdotally, some investors tell their dealers that they do not want to see the fees because they know they need financial advice and do not want to be deterred by seeing the cost. This is consistent with a recent U.S. study by J.D. Power. This study found that investors do not want to switch to a fee-based payment model in their retirement accounts. In response to a question about willingness to switch, only 8% of commission-paying investors favour the switch, 33% say they probably will, 40% lean toward disagreement, and 19% adamantly refuse.[9] These studies demonstrate that investors in both Canada and the U.S. need choice that is suitable to their needs. A majority of investors in Canada actually prefer the embedded fee as an accessible payment option.

The Paper acknowledges that the CSA expects that a ban on embedded fees will hurt independent financial dealers and advisors. It also says a ban will result in an increased number of modest investors being served by the banks. Clearly there is an important role for the banks in providing financial advice. But a healthy, competitive industry which the CSA and its regulators are mandated to uphold thrives on the availability and choice of independent or captive products. Canadian investors should continue to benefit from competition and have this choice for their retirement security. The reduction of potentially thousands of independent financial advisors raises an additional public policy risk relating to jobs and local economies. Many, if not most, independent financial advisors are small business owners and employers in the communities – often small communities – in which they work. Beyond providing financial advice and helping Canadian investors better prepare

[7] *Ibid*.
[8] The Gandalf Group, "The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services", *The Gandalf Group* (May 30, 2017) at 21, online: http://www.gandalfgroup.ca/downloads/2017/Investors%20Survey%20Report%20May%202017%20Release.pdf
[9] Michael Foy, "Insights: Fiduciary Roulette", *J.D. Power* (2017), online: http://www.jdpower.com/resource/wealth-management-fiduciary-roulette

for retirement, they employ thousands of Canadians and support local economies through their supply chain. Competition must be maintained to preserve choice for Canadian investors who benefit from independent advice and products for their retirement security.

The banks are under increasing scrutiny in Canada for alleged misselling and compensation conflicts of interest. On April 27, 2017, the Investment Industry Regulatory Organization of Canada ("**IIROC**") published findings related to compensation-related conflicts of interest.[10] IIROC found that in some cases advisors were paid higher commissions to offer proprietary products over independent third-party products. IIROC also found an increase in the use of fee-based and managed accounts and that those account types had their own conflicts of interest. In other cases, the offering of a fee-based account for some clients was found to be "unsuitable" where it resulted in an increase in fees to investors. This report highlights that there are conflicts of interest for any payment associated with fee-based accounts.

We have also seen an increased trend toward servicing high net worth investors in bank brokerages and other dealers, leaving the modest investor to bank branches (sometimes with fewer and lower-quality services, likely due to the cost of service). Even Investors Group ("**IG**"), who was built at the kitchen tables of modest investors, has recently announced that it will increase its focus on high net worth investors.[11]

The independent dealers service the truly modest investors on the frontlines. They play an important role in serving those who are just starting to save, new Canadians, those with disability savings plans or registered education plans, and other vulnerable groups that stand to benefit most from advice. The independent channel must be protected and fostered because modest Canadian investors with $500, $5,000 or $50,000 must have access to advice. And choice must exist for high-net worth Canadian investors as well. Forcing all Canadian investors to a bank may mean that they will be offered only bank products and be exposed to other conflicts of interest. That may be fine from your perspective, but you shut Canadians out of the choice of a range of fund products and services that may provide for their needs in different and potentially better ways.

The Australian Securities & Investments Commission ("**ASIC**") recently released a report on major financial institutions which charge advice fees without providing advice. ASIC found that some customers did not have an advisor assigned to them, but they were charged a fee for ongoing advice. This has resulted in 27,000 bank customers receiving $23.7 million (AUD) of fee refunds and compensation. ASIC estimates that by the time the review is fully complete, fee refunds and compensation may increase by $154 million (AUD) plus interest to over 175,000 additional customers.[12] All of the major Australian banks were implicated

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[10] Investment Industry Regulatory Organization of Canada, "Notice 17-0093 - *Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review*", *Investment Industry Regulatory Organization of Canada* (April 27, 2017), online: http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=5365CB5BE384477F8FC08C2B9450424A&Language=en

[11] Geoff Kirbyson, "IGM downsizing, focusing on HNW clients", *Investment Executive* (May 5, 2017), online: http://www.investmentexecutive.com/-/igm-downsizing-focusing-on-hnw-clients

[12] Australian Securities & Investments Commission, "Report 499: Financial advice: Fees for no service", *Australian Securities & Investments Commission* (October 2016) at 7, online: http://download.asic.gov.au/media/4054607/rep499-published-27-october-2016.pdf

and are paying these refunds and compensation.[13]As a result of these conflicts of interest issues that are harming Australian investors, ASIC stated that they will soon release a new policy around product misselling of proprietary products within the banks.

The point here is not that the banks should not serve the modest investor in Canada, but simply that they are not the main and only solution. Canadian investors deserve healthy and robust competition in the marketplace. The independent advice channel must be protected so that Canadian investors can continue to have choice in how they access financial advice and prepare for retirement.

3. The Importance of Financial Advice

We know that financial advice improves outcomes for Canadian investors and that investors have positive views about the value of financial advice that their financial advisors provide in respect of their retirement goals.

According to one study[14], 97% of Canadians are satisfied with the financial advice they receive from their financial advisor.[15] 82% credit their advisor with helping them to achieve better savings and investment habits.[16] In a study released on May 30, 2017, these results were confirmed. This study says that 94% of Canadians were satisfied with their financial advisor providing *unbiased* advice.[17] Our own study also found that 94% of Canadian retirees who benefited from working with a financial advisor reported being financially prepared.[18]

Several studies indicate that when confronted with an upfront fee or an ongoing hourly fee, investors are unwilling to pay for financial advice. A 2011 study found that the willingness to pay upfront for advice depends on the level of wealth, formal education and financial knowledge of the investor.[19] In fact, only 16% of Canadian investors say that they would be either absolutely certain or very likely to continue using their financial advisor if they had to pay a direct fee that was higher than their current embedded fee.[20] Less than one-quarter (24%) say that they would be less likely to seek out advice if embedded commissions were banned.[21]

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[13] *Ibid* at 4.
[14] Pollara Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry", *Pollara Inc.* (2016) at 5, online: https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/
[15] *Ibid* at 19.
[16] *Ibid* at 20.
[17] *Supra* note 8 at 10.
[18] Fidelity Investments Canada, "Retirement 20/20: The right advice can bring your future into focus", *Fidelity Investments Canada* (June 2017) at 8.
[19] Michael S. Finke, Sandra J. Huston and Danielle D. Winchester, "Financial Advice: Who Pays", *Association for Financial Counselling and Planning Education* (2011), online: http://files.eric.ed.gov/fulltext/EJ941908.pdf
[20] Pollara Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry", *Pollara Inc*. (2013) at 29, online: https://www.ific.ca/wp-content/uploads/2013/09/IFIC-Pollara-Investor-Survey-2013.pdf/4625/
[21] *Supra* note 8 at 23.

This is consistent with studies conducted in both Australia and the U.K. In a 2010 study, ASIC found that Australian investors were unlikely to be willing to pay for the true cost of financial advice.[22] Similarly, in the U.K., several studies show that financial consumers are reluctant to pay upfront for advice. 27% of survey respondents said that they would stop taking advice if charged directly for an advisor's time.[23]

We think Canadians have good reason to be happy with financial advice that they receive. One study shows definitively that Canadian investors who access financial advisors for 15 years or more accumulate 3.9 times more in savings than comparable investors without advice.[24] This study is consistent with other international studies, all of which are reviewed in the PricewaterhouseCoopers ("**PwC**") paper submitted by the Investments Funds Institute of Canada in their submission to the CSA.

Based on research, we expect two major consequences if there is a ban on embedded commissions in Canada: A decline in the number of Canadians receiving financial advice and a significant decline in the amount of savings. According to the PwC paper:

> …those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice.[25]

4. Importance of Enforcing Existing Rules Around Conflicts of Interest

We agree with the CSA and its regulators that there are conflicts of interest in our industry that need to be addressed. However, there are conflicts that exist in any model where fees are paid for financial advice. Eliminating embedded commissions in favour of other payment models will not eliminate and is likely to lead to other conflicts of interest altogether.

The industry has moved aggressively toward fee-based accounts driven by changing market conditions. Just a few years ago, sales of fee-based series were in the neighbourhood of 2% of gross sales in the industry. We estimate that this figure has risen sharply to 40%. At the same time, redemption rates for fee-based series have been significantly higher than for front load and deferred load assets (in the neighbourhood of 20%). These redemption rates may be further evidence that Canadian investors may eventually be unwilling to pay upfront fees and stay invested for their retirement. A Strategic Insight study confirms that redemption rates are higher in fee-based accounts, as there is greater turnover, and for

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[22] Australian Securities & Investments Commission, "Report 224: Access to financial advice in Australia", *Australian Securities & Investments Commission* (December 2010) at 49, online: http://download.asic.gov.au/media/1343546/rep224.pdf

[23] Deloitte, "Bridging the advice gap: Delivering investment products in a post-RDR world", *Deloitte* (2012) at 7, online: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-rdr-bridging-the-advice-gap.pdf

[24] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", *Cirano* (August 2016) at 24, online: https://www.cirano.qc.ca/files/publications/2016s-35.pdf

[25] PwC, "Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds", *PwC* (June 2017) at iv.

some investors they can be more expensive.[26] There is plenty of evidence that this is also true in Canada.

There are already rules in place to address compensation-related conflicts of interest. National Instrument 81-105 - *Mutual Fund Sales Practices* ("**NI 81-105**") was introduced in 1998. The conflicts covered by NI 81-105 had their genesis in the 1995 report of Glorianne Stromberg, who was hired by the OSC to study conflicts of interest in the industry.[27] Until recently, there has been little focus on this powerful regulatory tool and yet many of the compensation-related conflicts that the CSA takes issue with are already dealt with in NI 81-105. It is simply a matter of enforcing this rule.

Although we think NI 81-105 is a powerful tool as it is currently stands, we do think there is at least one area that should be modernized. The sales practices rule should apply to all competing products. We have seen a big move away from mutual funds to managed accounts, particularly at the banks. They are not subject to the same disclosure requirements as mutual funds. They are also not transparent – there is little publication of the performance of separately managed accounts, although investors do receive reporting after they buy these products. There is no Fund Facts and they are largely unregulated as far as disclosure is concerned. There is also no publicly available price information about these products, or that they may be available with different pricing depending on the client and their asset levels.

In its recent report on its targeted review of compensation-related conflicts of interest, IIROC endorsed the CSA's proposals for targeted reforms and guidance on conflicts of interest. [28] IIROC also identified three significant areas of concern: (i) excessive reliance on disclosure or poor disclosure of conflicts of interest; (ii) a lack of oversight of compensation models (particularly for proprietary products and fee-based accounts) and the conflicts they create; and (iii) a shift toward fee-based accounts without appropriate supervision and monitoring. In addition, IIROC found that the use of fee-based accounts could be unsuitable for some investors.[29]

Interestingly, the Securities and Exchange Commission ("**SEC**") is also looking at this issue. In their Examination Priorities for 2017, the SEC said that it would, as part of its mandate to protect retail investors, be reviewing share class selection. [30] The SEC will review conflicts that advisors may have in receiving higher compensation to sell certain share classes that have higher loads and distribution fees. Therefore, the issue of conflicts in compensation models is a focus for U.S. regulators as well.

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[26] Strategic Insight, "A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the U.S. Mutual Fund Industry" *Strategic Insight* (November 2012) at 5; Staff of the U.S. Securities and Exchange Commission, "Study on Investment Advisers and Broker-Dealers", *U.S. Securities and Exchange Commission* (January 2011) at 152.
[27] Glorianne Stromberg, "Regulatory Strategies for the Mid-90s - Recommendations for Regulating Investment Funds in Canada", *Canadian Securities Administrators* (January 1995).
[28] *Supra* note 10.
[29] *Ibid*.
[30] Office of Compliance Inspections and Examinations, "Examination Priorities for 2017", *U.S. Securities and Exchange Commission* (January 2017), online: https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf

5. Global Trends

A. There is a Global Trend to Protect Access and Choice

We often hear that the banning of embedded commissions is a "global trend" and that if Canada does not ban embedded commissions, we will fall behind the rest of the world. This is not true. Schedule 1 to this letter shows the countries that have banned embedded commissions compared to some of those which have examined and decided to keep embedded commissions. It is evident that the global trend is ***not*** to ban embedded commissions. In the diagram, we illustrate 4 countries that have decided to ban after an active debate, versus 17 that have not. As you are aware, and as the regulators in both the U.K. and Australia have said to us in-person, the ban in those jurisdictions occurred after serious scandals in those countries. Both regulators commented to us that they find it interesting that Canada has not had similar widespread scandals.

Even here in Canada, other than Ontario and New Brunswick, the CSA jurisdictions have decided to abandon the pursuit of a best interest standard and have shifted their focus to the implementation of certain targeted reforms. Suffice it to say, we believe that the global trend is shifting away from regulatory action that would limit choice and access to advice in favour of protecting them.

B. Misunderstandings About Australia and the U.K.

There are many myths about the impact of the RDR in the U.K. and the Future of Financial Advice reforms in Australia. We have visited both countries on a fact finding mission in preparation for this comment letter and have had meetings with our Fidelity colleagues, industry associations and the regulators in both jurisdictions. In addition, we have reviewed and studied many papers and regulatory guidance coming from those jurisdictions. We think the representations made in Canada about the impact of these reforms have been overstated and misunderstood.

(i) United Kingdom

Some in Canada say that an advice gap did not emerge in the U.K. post-RDR. We have also heard that the advice gap only emerged because of the professionalization of financial advisors in the U.K. Both of these statements are untrue.

In March of 2016, the Financial Conduct Authority **("FCA")** published its Financial Advice Market Review ("**FAMR**") Final Report.[31] As a result of the advice gap that had emerged, this report was commissioned by the U.K. government to find solutions to fix this advice gap. The report identifies increased standards and professionalism as well as the move to fee-based advice as the two causes of the advice gap:

[31] Financial Conduct Authority and HM Treasury, "Financial Advice Market Review – Final Report", *Financial Conduct Authority* (March 2016), online: https://www.fca.org.uk/publication/corporate/famr-final-report.pdf

> These changes have highlighted concerns that there is an "advice gap". The Economic Secretary to the Treasury and the Board of the FCA shared this concern and so launched FAMR as a joint FCA/HMT Review. FAMR's Call for Input defined the advice gap as situations in which consumers are unable to get advice and guidance…[32]
>
> …respondents also highlighted that a number of issues with the UK's financial advice market remain following the RDR. Some suggested that, despite the benefits of removing 'commission bias', the move from paying for advice via commission to paying adviser fees has contributed to many people not being able to get the advice they want and need at a price they are willing to pay.[33]

The report states that up to 17 million people could be trapped in the U.K.'s advice gap. In addition, it clearly shows that there are 25% fewer financial advisors in the U.K. post-RDR. The report also notes that two-thirds of investment products in the U.K. are bought without professional advice which is up one-third from 2007. An FCA survey of advice showed that over the previous two years, the number of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. A further survey indicated that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000 to invest). Further, the report cited a 2016 survey that indicated that 69% of financial advisors had turned away potential clients over the previous 12 months for reasons of affordability.[34]

Three working groups were struck by the FCA to address three of the recommendations in this report. One of the working groups dealt with addressing advice and guidance – how best to find advice and guidance for those that had fallen into the advice gap. The group then expanded its mandate to try to come up with a definition for advice along with guidance. This working group reported to the U.K. Treasury and the FCA in March of 2017. It is very clear that the Treasury of the U.K. has recognized that advice is too expensive for many post-RDR. The working group found that it costs between **£1,000 and £2,000** for advice (either based on an hourly rate or based on an unembedded commission structure) which is unaffordable for someone who only has **£50,000** to invest (which is more than the average modest investor has in investable assets in the U.K.). The focus now is on how to get financial advice for the modest investor and how to ensure that the modest investor can access financial products.[35]

Let us dispel the myth that no advice gap emerged in the U.K. post-RDR. The U.K. government is clearly very concerned about the advice gap and is looking for concrete ways to address this very serious public policy issue.

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[32] *Ibid* at 6.
[33] *Ibid* at 17.
[34] *Ibid*.
[35] Financial Advice Working Group, "Consumer explanations of 'advice' and 'guidance'", *HM Treasury* and *Financial Conduct Authority* (March 2017), online: https://www.fca.org.uk/publication/research/fawg-consumer-explanations-advice-guidance.pdf

(ii) Australia

Australia has a very different market structure. A very high proportion of investable assets are invested through mandatory superannuation funds ($2.2T with another $0.5T in other investments). Currently, 9.5% of employment income must be contributed to a superannuation fund. The contributions occur at significantly advantageous tax rates (15% tax on contribution and no tax on withdrawal). The highest marginal tax rate in Australia is in the neighbourhood of 47%. Currently, Australians can invest up to $35,000 per year into their "supers". In addition, the regulators require providers of superannuation funds to offer a low cost series – generally between 70 – 80 basis points.

As a result, for very good tax and pricing reasons, the vast majority of investments by Australians are made into these superannuation funds. And of those who invest, a high proportion does not have financial advice. According to one report, an in-depth study of Australians' appetite to obtain financial advice, 14.5 million Australians are unadvised, the majority of whom will need and want assistance with their investment decisions. [36] Non-advised adults collectively hold 70% of the total wealth in circulation. 4.3 million Australians intend to conduct financial activity without the help of an advisor in the next two years. 80% of Australians do not currently use or intend to use a financial planner. In discussions with an Australian industry association and ASIC, both expressed concern about the need for more financial advice for Australians.

Most investments "default" into the default option within their superannuation funds. In other words, Australians are not making a conscious financial choice in their supers and are not receiving the much needed financial advice.

There are only 16,000 financial advisors in Australia. It is difficult to tell if this number has declined because financial advisors were required to be registered only two years ago. Bank financial advisors are unregistered to this day. However, recent findings relating to misselling in Australian banks is causing the regulators to consider registration among other strong measures to address misselling in the banks. As already stated, ASIC recently released a report on the charging of advice fees without providing advice at major financial institutions.[37]

Another interesting fact is that the best interest duty in Australia does not apply to stock brokers. Lastly, insurance commissions are likely to be capped rather than banned for insurance investment products. Capping is obviously seen as a viable alternative to a ban in Australia.

[36] Investment Trends, "2015 Direct Client Report", *Investment Trends* (2015), online: http://www.investmenttrends.com.au/our-work/key-industryreports-australia
[37] *Supra* note 12.

C. United States

Partly as a result of the potential fiduciary rule from the Department of Labor, and partly as a need to address conflicts of interest, there are structural changes occurring to the offering of mutual funds in the U.S.

Today, investors who buy class A shares of a mutual fund pay a sales charge that may range from 2.25% to 5.75%. This payment is “bundled” in with the cost of the fund’s total MER, as is true in Canada.

However, recently, the industry has started to launch “clean shares”. These shares charge a fee to manage and operate a mutual fund. They do not include payments to broker-dealers or retirement plan platforms. They do not include compensation to brokers for providing advice or 12b-1 fees. These are similar to our series F securities. If investors want advice, they will pay for advice separately. These shares are being launched in order to address the perception of conflicted advice. Firms that want to continue to receive commissions are likely to sell clean shares plus a commission that is the same across all competing products.

At the same time, the mutual fund industry is introducing new “T shares”. These also are intended to address conflicts of interest because these shares provide one uniform price across the board. So, advisors will not be tempted to choose a fund with higher compensation over one with less compensation. T shares will generally charge a 2.5% front load along with a 12b-1 fee.

In both cases, the U.S. market is evolving to address the issues of transparency and conflicts of interest. It is interesting that clean shares already exist in Canada similar to our series F securities. T shares are a bundled offering, like A shares with a mandate to have level fees so that the potential conflict of differing compensation is eliminated.

Unfortunately, the CSA seems to have rejected the notion of level fees without a real debate about its merits. However, it is clear that the U.S. thinks that both of these models address conflicts of interest and, in fact, would meet the standard under the fiduciary duty rule.

D. Sweden

In 2016, Sweden decided not to proceed with a ban on embedded commissions. One of the reasons was the importance of maintaining healthy competition in the Swedish market. Sweden’s fund market looks surprisingly similar to Canada in terms of structure, bank dominance, investor behavior, and more. The Swedish Competition Authority published a report in 2013 that aided in Sweden’s decision not to move forward with a ban (in spite of the securities regulators’ strong recommendation to do so).[38] The question posed by the report was what would the consequences of a commission ban mean for competition in the Swedish financial services market. The report stated the following:

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[38] John Söderström, Diego Gomez Ruales et al., “Competition on the financial services market – Deposits, mortgages and funds”, *The Swedish Competition Authority* (June 2013), online: http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/competition-on-the-financial-services-market---deposits-mortgages-and-funds.pdf

> The primary purpose of a ban on commission should be to ensure that the advice received by the consumer is adapted to their individual needs. However, the question is whether a ban on commission would in reality have the desired effect and thereby achieve the purpose of such a ban….it is probably that other factors that can give the advisor direct incentive to prioritize high-price products would remain…. A possible consequence of a ban on commission for financial advice is that the banks and insurance companies' hold on the fund market would be tightened as the consumer, who is often in need of advice, would probably be more likely to forgo financial advice….. A development of this kind would likely result in a number of small and medium-sized fund companies having problems with profitability and, in the long term, disappearing from the markets.[39]

In the final announcement by Sweden's Minister for Financial Markets and Consumer Affairs, announcing that Sweden would not ban embedded commissions, all of the issues that are of concern in Canada were outlined – the importance of access to advice, competitiveness, a level playing field among competing products and access to and choice of a broad range of funds.

E. Other Countries

Other countries like New Zealand, Singapore, Hong Kong, Germany, Switzerland and Ireland have had robust debates on this issue. They have all determined that a ban would not produce the best outcome for their country. We think that it makes sense to consider the alternatives as those countries have. A ban is not the only viable option for Canada.

6. Robo-Advisors

Fidelity is supportive of the concept of robo-advisors. However, we question whether they will solve the potential advice gap that may emerge. It appears that many millennials and more modest investors want broad personal financial advice. That kind of advice might include advice beyond strict investments. It is not clear that robo-advisors are the ultimate answer for these investors and would-be investors.

In its recent 2017 research, Ipsos Reid surveyed 2,006 Canadians of which 488 were millennials (35 years or younger). That research found that 81% of millennials do not currently use a robo-advisor. Among those millenials who are not using a robo-advisor, 27% said that they were unlikely to start using one, 63% were neutral, and only 9% were likely to start using a robo-advisor. The top reason why? They wanted to communicate with a financial advisor face-to face. Secondly, they wanted to be able to communicate with an actual person, not just automated software. Lastly, they wanted a financial advisor to keep an eye on their portfolio.[40]

Robo-advisors provide asset allocation services – no more and no less. And for that they charge fees in the area of 60 to 70 basis points. Robo-advisors generally do not provide education to investors or offer behavior modification ("the gamma factor"). They do not help

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[39] *Ibid* at 179.
[40] Ipsos, "The Canadians & Financial Advice Report 2017", *Ipsos* (2017).

them with their personal circumstances or provide many of the other services investors receive from financial advisors such as estate planning, financial planning or even succession planning. They also do not help investors with managing their emotions, fostering savings discipline and staying invested, especially in down markets. There are tangible and intangible benefits of having a financial advisor. For less than an additional 30 basis points, investors receive a whole host of services from financial advisors, in addition to the benefits of financial advice already outlined.

Robo-advisors are not yet gaining traction in a meaningful way in any jurisdiction. Although robo-advisors exist in marketplaces like the U.K. and Australia, they have had very little take up. Even the largest robo-advisors in those markets have not reached profitability after many years. This is also true in Canada. A recent study found that only 7% of Canadians are likely to trust recommendations from robo-advisors.[41] It is only the more sophisticated investor that is, in small numbers, gravitating to robo-advisors. In the U.S., there is slightly more take up, but it is because financial advisors are using robo-advisors to help them to service their clients.

While there will be a growing market for robo-advisors, they will not solve the advice gap in Canada. There are still many investors who prefer face-to-face interactions and would not entrust their monies to automated devices. Robo-advisors may offer a platform that is a lower-cost alternative for investors, but they lack the full capabilities that traditionally come with face-to-face advice and mutual fund investments.

7. Passive and Active Investment Strategies

Fidelity supports the choice of either active or passive products in the Canadian marketplace. We think allowing mutual fund registered advisors to sell passive investment products makes sense. However, there are overtones in the Paper and in regulatory pronouncements that passive solutions are better than active solutions because they are cheaper and perform better. This is not a balanced representation. There is an important place for both options and investors should continue to have the choice of either option without regulatory intervention.

Fidelity has funds that have outperformed their passive comparators over long and short time frames. For example, Fidelity Canadian Disciplined Equity Fund (Series F) has significantly outperformed the iShares Core S&P/TSX Capped Composite ETF when you look at growth of $10,000 over 10 years inclusive of costs. In fact, this fund outperformed its ETF comparator 100% of all 10 year rolling periods from March 1, 2006 to October 31, 2016. Investors should not be deterred from seeking improved returns over the index. Obviously, excess returns from active management can create a powerful wealth compounding effect and better prepare Canadian investors for retirement.

[41] HSCB Bank Canada, “Global study on trust & tech: Canadians twice as likely to trust a robot to perform open heart surgery than to open a bank account for them”, *HSBC* (May 24, 2017), online: http://www.about.hsbc.ca/~/media/canada/en/news-and-media/170524-trust-in-tech-news-release-en.pdf

There are other benefits of active investment strategies as well. The Canadian market is concentrated in a few sectors compared to international markets. Passive investors are exposed to this concentration risk. Active management can also help manage downside risk. Picking stocks in an active context that limit downside risk can enhance growth potential for Canadian investors.

The Investment Executive recently brought to the industry's attention a Dalbar study that showed that over a 15 year period (from January 1, 2001 to December 31, 2016), the average active investor outperformed the passive investor for periods of more than five years.[42] A key driver was the behaviour of investors. Passive investments were found to be more vulnerable to investor behaviour (e.g., poor market timing, increased redemptions, etc.) The report states, “The evidence shows … active investments offer greater preservation.”[43]

Another recent article cited Morningstar statistics that showed the average hold periods for the top 10 ETFs in the U.S., in days, not years.[44] The article notes that “the largest fund, SPY, has an average holding period that lasts about as long as an episode of Hardcore History.”[45] In actual fact, this fund is the SPDR S&P 500 ETF which has an average holding period of 15.4 days. There is plenty of research that shows that short holding periods do not amount to solid long term returns for individual investors.

Clearly there is a role for both active and passive options. There will be market periods when active outperforms passive and vice versa. And there will always be active funds that outperform. We think investors should continue to have this choice, free from regulatory intervention.

8. Deferred Sales Charges

Retirement savings in mutual funds were very small before the DSC was introduced in 1987 in Canada. Since that time, investments in mutual funds have grown dramatically because the DSC made mutual funds available to the average Canadian.

There is much debate around the ongoing viability of the DSC option to purchase mutual funds. It has become popular to argue that the DSC option should be banned. However, the DSC option provides two key benefits. First, it allows modest investors the ability to invest 100% of their money in mutual funds. Second, it allows advisors the ability to service investors with small amounts to invest. This is particularly important for advisors, both new and seasoned, who make a living servicing the modest investor.

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[42] Jade Hemeon, “Active investment strategies outperform passive ones in the long run: Dalbar”, *Investment Executive* (March 16, 2017), online: http://www.investmentexecutive.com/-/active-investment-strategies-outperform-passive-ones-in-the-long-run-dalbar

[43] *Ibid*.

[44] Ben Carlson, “Passive Aggressive Investing”, *A Wealth of Common Sense* (May 7, 2017), online: http://awealthofcommonsense.com/2017/05/passive-aggressive-investing/

[45] *Ibid*.

The MFDA recently released a report which studied the potential impact of a ban on embedded commissions.[46] It used real data from its members. The report concludes that a ban is most likely to impact non-bank dealers and will have the most impact on smaller asset advisors who are more reliant on DSC. Approximately 56% of advisors with non-bank firms rely on DSC to finance their operations.[47] It also points out that most of these advisors are dually licensed (mutual funds/insurance products) and so the outcome may be that these advisors simply sell competing products that continue to have embedded commissions.

Many bank dealers as well as large dealers like IG have announced that they will no longer offer DSC. While eliminating the DSC for IG clients, it is interesting to note that features of the DSC will continue to exist. The amendment to the IG fund prospectus states that after September 30, 2016, IG Consultants may receive a sales bonus of up to 2.50% of the amount invested. Further, if the Consultant has been with IG for less than four years, he or she “may receive an additional amount of up to 40% to help establish their practice.” So while IG, a large and profitable organization, can afford to help these smaller advisors get established in the absence of the DSC, there is clearly a recognition that in lieu of a DSC, some kind of financial assistance is needed for newer advisors. It is unlikely that smaller dealers will be able to afford this kind of subsidization.

Arguments are made that the DSC is missold or is unsuitable for investors. And while that may have been true in the past, we see that the MFDA has made this issue a priority in its exams and bulletins. We believe that this issue has improved consistently and dramatically. If the main issue around DSC is misselling, as investor advocates and regulators alike claim, then we believe ongoing vigilance by dealers, UDPs, compliance officers and regulators is critical. It is important not to throw out a structure that serves a meaningful purpose both for modest investors and newer advisors.

There is evidence that the DSC is actually helpful for some investors. In a 2015 study by Argento, Bryant and Sabelhaus, the authors found that U.S. households under the age of 55 make $0.40 of taxable withdrawals from retirement accounts for every $1.00 of contributions, in spite of tax penalties imposed.[48] This is a major offset for flows and has significant potential implications for retirement security. It also indicates that there is a real issue with self-control around retirement savings.

A 2015 study entitled “Self Control and Commitment: Can Decreasing the Liquidity of a Savings Account Increase Deposits?” is also instructive.[49] This paper studied illiquid financial accounts versus liquid financial accounts. It found that U.S. households have a behavioural bias known as a “present bias”. U.S. households place a disproportionately high weight on present consumption and low weight on the future. The authors of the study

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[46] *Supra* note 3.
[47] *Ibid* at 19.
[48] Robert Argento, Victoria L. Bryant and John Sabelhaus, "Early Withdrawals from Retirement Accounts During the Great Recession", *2015 Contemporary Economic Policy* 33 (1): 1-16.
[49] John Beshears et al., “Self Control and Commitment: Can Decreasing the Liquidity of a Savings Account Increase Deposits?”, *NBER Working Paper Series, No. 21474* (September 6, 2015), online: http://faculty.som.yale.edu/jameschoi/commitment.pdf

point out that in many countries, policy makers address this present bias in various ways, including mandating completely illiquid accounts (until a particular point in time, like retirement) or penalties for early withdrawals. The preference by policy makers around the world is to mandate completely illiquid accounts to address the present bias issue. But the second preference is to offer a partially illiquid account with a penalty to discourage present bias. However, this study argues that for social policy purposes, having a completely illiquid account is most useful for retirement savings, but does not take into account the need to address emergencies like loss of jobs, in which case, people do withdraw money from their retirement accounts.

In addition, this study found that for accounts that prohibit early withdrawal, investments into those accounts actually increase compared to accounts with no penalty or a modest penalty for withdrawal. The paper hypothesizes that investors who are aware of self-control problems are motivated to use accounts with penalties in order to ensure savings are retained.

In the context of DSC, this purchase option may actually be playing an important behavioral role in retirement savings in Canada. It helps people exercise the self-control needed to stay with their savings program.

The last point we would like to make about DSC is simply that it is widely used for smaller registered investments like TFSAs, RESPs and RDSPs. We have heard from advisors that the elimination of the DSC could and likely will have an impact on savings in these vehicles. These are longer term vehicles in any event and in most cases they are suitable retirement products.

9. Options

While Fidelity does have significant concerns with the proposal to ban embedded commissions, we do support options to continue to improve and enhance investor protection.

We would support the following:

1. Create standardized distribution commissions by asset class (i.e. equity, fixed income and balanced). In our view, a level fee eliminates the conflict of differing payments to advisors and neutralizes the conflict of interest. This is a model that is used in the U.S. and is being enhanced through T shares as described above.

2. Offer investors the choice of embedded or other alternative fee structures and explain the implications of each choice in a way that is clear.

3. Provide a list of minimum services that investors must receive in return for the trailing commission.

4. Implement certain targeted reforms under CP 33-404.

5. Enforce NI 81-105 immediately and vigorously, and amend it to apply to managed accounts like separately managed accounts and unified managed accounts.

6. Introduce CRM 3 disclosure to include management fees charged by fund managers.

7. Do not allow full trailing commission series to be sold on discount brokerage platforms.

8. Standardize naming conventions for fund series.

9. Provide further guidance and continue enhanced regulatory scrutiny on the sale of DSC funds.

10. Improve financial literacy and continue to measure other disclosure and regulatory initiatives such as CRM 2 and POS.

11. Roll out similar rules to all competing investment products, including insurance and bank products that are now not governed by comparable rules.

10. Conclusion

It is Fidelity's view that a ban on embedded commissions would not be good for Canadian investors for all of the reasons we have outlined in this letter. We think the Paper fails to take into account the real risk that retirement savings will decline in Canada as a result of a ban. This is understandable. The CSA has the job of investor protection, but not necessarily the public policy goal of protecting or enhancing retirement savings for Canadian investors. It is incumbent upon Canadian policy makers to weigh in on this debate as they have in other countries. In many countries, policy makers have simply decided that they will not risk retirement savings in their countries. They have looked to other measures to address the very same issues that we are facing in Canada. It is clear that the global trend is NOT to ban embedded commissions.

It is also important not to risk the health of financial advice in Canada. It is clear that financial advisors have made a meaningful difference to savings rates in Canada. In fact, as stated above, having advice for 15 years or more increases household assets by 3.9 times compared to households without a financial advisor.[50] The reduction in the number of advisors will not only lead to millions of Canadians being unprepared or underprepared for retirement, but also leave thousands of Canadians unemployed or underemployed.

Most importantly, we think that investors should continue to have meaningful choice. Once embedded and unembedded models are explained to investors, 50% or more want the embedded model for very good personal reasons. It is not up to the CSA to remove choice from the Canadian investor when at least half of those investors want this choice.

[50] *Supra* note 24.

Fidelity INVESTMENTS

SCHEDULE 1

Global Trend

After careful examination of the potential impact, 17 out of 21 jurisdictions have committed to protect choice and access for their investors

Protected Choice & Access					Banned Choice & Access	
Sweden	United States		Japan	India	Australia	Netherlands
Denmark	South Korea	Switzerland	Ireland	Israel		
New Zealand	Hong Kong		Italy	Germany	South Africa	United Kingdom
France	European Union *		Belgium	Singapore		

* The EU's MIFID II reforms only apply to commissions paid to independent financial advisors, who represent only 11% of the European market

APPENDIX B – Fidelity's Answers to Questions Posed in the Consultation Paper

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS January 10, 2017		
	SUMMARY OF CONSULTATION QUESTIONS	FIDELITY COMMENTS
	Part 2	
1.	Do you agree with the issues described in Part 2? Why or why not?	No. We state our reasons below. **<u>The embedded commissions model aligns the interests of the fund manager and dealers/advisors</u>** We believe that the Paper fails to acknowledge that in many circumstances dealer/advisor interests are in fact aligned with the interests of their clients. We take issue with the CSA's finding that embedded commissions reduce a fund manager's focus on performance. Our evidence suggests the opposite – when performance wanes, sales drop and redemptions increase. In addition, approximately 96% of mutual fund managers pay standard trailing commissions. Therefore, it is hard for us to believe that embedded commissions encourage recommendations that are biased toward higher compensation – this practice has become more evident in a fee-based world. The embedded commission model represents only one of many compensation models, and we acknowledge that all models contain conflicts of interest. In the absence of any compelling evidence which says otherwise, we cannot understand why the CSA believes that prohibiting one compensation model over others will address this issue. **<u>The embedded commissions model limits investor awareness, understanding and control of dealer compensation costs</u>** We believe that POS and CRM2 have played and continue to play a significant role in enhancing investors' awareness of costs and compensation. In fact, early evidence from the BCSC research on CRM2 confirms that investors are more aware of fees and the performance of their investments. We believe that the CSA did not give ample weight to

		these initiatives in the Paper, which seems to be a departure from the CSA's previous views on these topics. In terms of disclosure, Canada has led the way in comparison to other developed countries, and the CSA has been applauded for its focus on consumer education initiatives by the U.K. and Australia. In hindsight, we believe that other jurisdictions which have banned embedded commissions would have pursued disclosure initiatives first as an alternative to proceeding with a ban. Canada is in an enviable position and we believe that the CSA should wait and see how these initiatives play out over time in order to determine if additional regulatory action is warranted. We are confident that any CSA measures taken to assess POS and CRM2 will show an improvement in investor understanding of securities products and dealer compensation costs. **<u>The embedded commissions model does not align with the services provided to investors</u>** We believe that the CSA did not provide compelling evidence to support this conclusion. While choice is available, the embedded commission model facilitates affordable and accessible financial advice. Research shows that Canadian investors who access financial advisors for 15 years or more accumulate 3.9 times more in savings than comparable investors without advice. We find it again surprising that the CSA can come to a conclusion in light of POS, CRM2 and compelling facts that suggest otherwise. In addition, investors have different needs and expectations regarding the level of services they should receive. For example, someone who has $15,000 to invest may not require the same level of services of someone who has $250,000 to invest may require. However, as investors move through the cycle of life, their needs change. Nevertheless, if clarity of services is what the CSA seeks, we do not object. Of course, it will be important to have a strong industry dialogue around exactly what the services should be and how they should be measured.
2.	Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.	Yes. One of the CSA's stated goals for this initiative is investor protection. We are concerned that the CSA is considering only the protection of investors who invest in mutual funds. While regulatory arbitrage was briefly acknowledged throughout the Paper, we believe that it is imperative that like products be treated in a like manner – e.g. segregated insurance products and managed accounts. There is a broad social goal of

		protection for all investors. Other goals include the need to increase savings rates for retirement and the overall health of the Canadian economy. If the CSA drives investors to other less regulated and transparent products, it will not accomplish its overarching goal of investor protection for all investors. It is equally important for the CSA to liaise with other regulators, like the CCIR, before the CSA proceeds with any policy initiative that will cause irreparable harm to investors.
3.	Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.	Yes, there are significant benefits to the embedded commission model. As discussed in the main body of our letter, the embedded commission model serves a large percentage of the mass market households that invest in mutual funds today. As you know, approximately 80% of Canadian mutual fund investors do not pay a direct fee for advice and more than half of Canadians prefer to pay for advice through the embedded commission model. If the CSA proceeds with a ban in Canada, an advice gap will develop – similar to the advice gap that developed in the U.K. post-RDR. If Investors will be forced to pay upfront fees, which we know many of them will not want to do – only 16% of Canadian investors would be certain or very likely to use a financial advisor if they had to pay a direct fee that was higher than their current embedded fee. As a result, many investors will choose to forego investment advice entirely. This is not a good result. The U.K. experience post-RDR should not be misunderstood. It is clear from the FCA's Financial Advice Market Review – Final Report, which was published in March 2016, that an advice gap developed in the U.K. – because of the move to fee-based advice and increased professionalism standards. The FCA's report was commissioned by the U.K. government because of the advice gap that developed and was aimed at finding solutions to fix it. The report states that up to 17 million people could be trapped in the U.K.'s advice gap. In addition, it shows that there are 25% fewer financial advisors in the U.K. post-RDR. The report also notes that two-thirds of investment products in the U.K. are bought without professional advice which is up one-third from 2007. An FCA's survey of advice showed that over the previous two years, the number of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. A further survey

		indicated that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000 to invest). Further, the report cited a 2016 survey that indicated that 69% of financial advisors had turned away potential clients over the previous 12 months for reasons of affordability. The embedded commission model has enabled millions of middle-class Canadians, who otherwise could not afford upfront fees or who are unwilling to pay upfront fees, to access financial advice and save for retirement through mutual funds. The CSA needs to recognize this fact. The overarching goal of the CSA should be to foster healthy competition in the marketplace and protect investors, not inhibit competition and harm investors.
	Part 3	
4.	For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption: • mutual fund • non-redeemable investment fund • structured note should the product be subject to the discontinuation of embedded commissions? If not: a. What would be the policy rationale for excluding it? b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?	Yes. See our response to question 2 above.
5.	Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?	No.
6.	Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?	See our response to question 2 above.
7.	Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?	No. We do not believe that the Paper went far enough to prohibit other types of payments, including internal transfer payments of proprietary fund sales at the banks, which may not be tied to the purchase or continued ownership of a fund security. While certain of the banks have made it clear in their disclosure documents that the internal transfer payment paid between affiliated companies is a trailing commission, others have not. If the internal transfer payment is being paid out of an

		MER, then it should be prohibited. In addition, the Paper did not address the compensation related conflicts associated with separately managed accounts ("SMA") or unified management accounts ("UMA"). SMAs and UMAs are increasingly becoming popular among the banks. While SMAs and UMAs are considered fee-based accounts, investors may not be aware of the fact that a higher portion of the fee goes towards advisor compensation than the trailing commission on a mutual fund. Rather, SMAs and UMAs are being pitched as a cheaper and superior alternative to mutual funds, which in many cases they are not. Therefore, the CSA must address the compensation conflicts associated with these products as well.
8.	Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; b. referral fees; and c. underwriting commissions Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?	Yes. See our response to question 7 above. Fidelity does not believe that the payment of money and the provision of non-monetary benefits in connection with marketing and educational practices under Part 5 of NI 81-105 should be discontinued. Marketing and educational practices that currently constitute an acceptable primary purpose are beneficial to advisors and investors. Investors expect a wide range of information in order to make informed investment and financial planning decisions. It is therefore equally important to help equip advisors with the tools they need to appropriately engage their client base. If the CSA were to discontinue these benefits, the CSA would be denying investors and advisors access to important education and information in what is otherwise permissible areas. In addition, the costs associated with marketing and educational practices which are supported in part by fund managers could ultimately shift to retail investors. This would not be ideal. Fidelity believes that NI 81-105 is a useful and principled regulatory tool, if enforced appropriately. Many of the conflicts associated with accessible payment options would be mitigated if NI 81-105 was simply enforced. We would, however, urge the CSA to enhance NI 81-105 to cover other types of retail investment products, including managed accounts and insurance products.
9.	If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are	See our response to question 8 above.

	maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?	
10.	With respect to internal transfer payments: a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds? b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products? c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?	See our response to questions 7 and 8 above. We believe that NI 81-105 has not been effective at regulating internal transfer payments within the banks such that there is a level playing field among proprietary and third-party funds. There is a misconception across industry participants that internal transfer payments from affiliates are different from trailing commissions, even if the payment is not directly tied to activity in a client's account. However, they are not much different at all. For example, in MFDA Bulletin #0654 – P, the MFDA considered the reporting of internal transfer payments received from affiliates in the context of the implementation of CRM2. The MFDA opined that members who receive transfer payments instead of commission revenue must make a reasonable estimate of what it would have received if it earned commission revenue and report it. These payments are undoubtedly connected to registrable activities. The MFDA's consideration of this issue can be viewed as an explicit acknowledgement by a regulator that internal transfer payments received from affiliates are generally akin to trailing commissions.
11.	If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.	Yes, fund managers should be allowed to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.
	Part 4	
	Addressing the issues	
12.	Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?	See our response to question 1 above. No. We believe that banning embedded commissions would have more negative impacts on investors and industry participants than positive ones – loss of jobs, savings rates will be jeopardized, and the middle-class and Canadian economy will suffer as a result. We believe that the conflicts associated with the embedded commission model can be appropriately managed as opposed to avoided. The goal of the CSA should be to foster choice and broaden access to financial advice. Mass market households

		should be able to decide how they want to access and pay for financial advice. Research has shown that in an unembedded world, the cost of advice generally increases. Mass market households simply cannot afford and are generally unwilling to pay upfront fees. Therefore, the CSA should be taking measures to enable choice and access to advice as opposed to taking measures, which could eliminate them.
13.	Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?	We believe that there are other ways in which the CSA could address these issues, while preserving choice and access to advice. See our response to question 8 above. In the absence of a ban, we have seen: 1) A significant rise in fee-based sales; 2) A reduction in mutual fund costs through healthy competition; 3) Innovative technology enhancements; 4) Simplified pricing models like Fidelity's Preferred Program; and 5) Increased investor awareness of the costs associated with mutual fund investments. We believe that these initiatives could address some of the issues without the need for further regulatory action. In addition, there are recent global trends that the CSA should take note of. Based on our research, a number of countries around the world have not banned embedded commissions. For example, Sweden most recently came out in opposition of a ban because of, among other things, the disproportionate harm to small investors. The U.S. administration recently directed the Department of Labor to review the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. Also, the U.S. administration released an executive order outlining the core principles for regulating the U.S. financial system – one such principle being to "empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build financial wealth". Even here in Canada, other than in Ontario and New Brunswick, the CSA jurisdictions have decided to abandon the pursuit of a best interest standard and have shifted their focus to the implementation

		of certain targeted reforms set out in CP 33-304. Suffice it to say, we believe that the global trend is shifting away from regulatory action that would limit choice and access to advice in favour of preserving them.
14.	Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?	As indicated in our response to question 1, all compensation models have conflicts. In December of 2016, the CSA and SROs published staff notices, which shed light on many of the inappropriate sales practices, including proprietary sales practices at the banks and other large integrated financial services firms. In the cases of fee-based accounts, individual advisors may be paid more compensation with respect to fee-based programs in comparison to the compensation they would receive from trailing commissions on a mutual fund. Investors may not be aware of these practices or may not have knowledge of what their account fee pays for. In addition, whether such fee-based account fee is charged hourly, flat or based on a percentage of total assets, many retail investors are generally not in a position to negotiate or understand if the account fee is appropriate. Even if the fee was dependent on the level of services required, it is more likely that the investor will be given a menu of options with stated prices to choose from. It would be impractical to expect advisors to calibrate their fee to the level of services provided. For example, the banks generally charge minimum fees to service fee-based accounts. The fees are tiered and based on total assets often with little to no room to deviate from. As a result, retail investors are often placed in a natural conflict position based on information asymmetry. Overall, we believe that fee-based platforms generally incentivize advisors to recommend products that focus on maximizing their compensation rather than focusing on meeting the investor's investment objectives. In spite of the existence of conflicts in fee-based scenarios, no jurisdiction, including Canada, has proposed to eliminate direct fee arrangements. Rather, the CSA believes that because a fee-based world is transparent, it is sufficient for these conflicts to exist. However, we believe that the CSA should not prohibit one compensation model in favour of another – that is not the role of the regulators. Rather, the CSA and SROs should focus

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<tr><td></td><td></td><td>on enforcing current conflict of interest and sales practices rules to ensure that compensation programs are designed in such a way that there is no financial motivation to bias an advisor to sell one product over another.</td></tr>
<tr><td></td><td colspan="2">Change in investor experience and outcomes</td></tr>
<tr><td>15.</td><td>What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:
Will investors receive advice and financial services that are more aligned with the fees they pay?
What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?
Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?
What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?
What effect will the proposal have on the cost and scope of advice provided to specific investor segments?</td><td>If the CSA proceeds with a ban, Fidelity does not believe that the outcomes and experiences for all investors will be positive. A ban will undoubtedly lead to negative consequences for mass market households.

We saw no compelling evidence in the Paper that suggests a misalignment of interests regarding advice and services received in exchange for fees paid. There is also no compelling evidence that suggests that embedded commissions in Canada have led to an abuse of investors by advisors. Our dealer community has told us that CRM2 is doing a good job in explaining advice and services received in exchange for fees paid.

With respect to automated advice channels, while we appreciate the growth of robo-advisors and acknowledge a place for them in the marketplace, we believe that they are not the main solution to solving the advice gap. It has become apparent in foreign jurisdictions where robo-advisors have grown that they have limitations that inhibit them from effectively serving all types of investors – which is the opposite of what the regulators had predicted. In Canada, where robo-advisors are relatively new, they are generally only attracting higher net worth investors and do not offer complete financial services. In addition, there are still many investors who prefer face-to-face interactions and do not entrust their monies to automated devices. While robo-advisors may offer a platform that is a lower-cost alternative for some investors, they lack the full capabilities that traditionally come with face-to-face advice and mutual fund investments.

In terms of the discretionary advice channel, we believe any increase in their use will be marginal. We note that many retail investors today simply cannot access this channel because of the premiums and liability involved. If the CSA proceeds with a ban, it is difficult for us to envisage how retail investors will access this channel if they cannot access it now.

See our response to question 14 above with respect to the effect that the</td></tr>
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		proposal will have on the cost and scope of advice provided to specific investor segments. Prohibiting accessible payment options will cause irreparable harm to investors and the mutual fund industry. As we have seen play out in the U.K. and Australia, the predictable consequences of a ban are: (i) higher cost of advice; (ii) less access to advice; (iii) fewer advisors to service investors; and (iv) lower savings available at retirement.
16.	What types of payment arrangements are likely to result if this proposal is adopted? In particular: • Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?	See our response to question 14 above.
17.	Do you think this proposal will lead to an advice gap? In particular: • Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc. • Do you agree with our definition of an advice gap? • Should we differentiate between an advice gap for face-to-face advice and an advice gap generally? • What types of advice or services currently provided today would be most affected by the proposal? • Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap? • How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated? • Do you think that online advice could mitigate an advice gap? If so, how? • Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?	Yes, the proposal will lead to an advice gap. See our response to question 3 above. The segment of the market most likely to be impacted is the segment that the CSA should most closely protect – those with less than $100,000 to invest. 5.2 million (33%) Canadians save through mutual funds. 76% of investors have less than $50,000 in investable assets. Approximately 4.5 million households (22% of Canadians) save through the embedded fee model. Currently, 80% of Canadian mutual fund investors who purchase their mutual funds through a financial advisor choose embedded commissions as an accessible payment option to get advice and save toward their financial goals. Retail investors need and value financial advice. We expect that a ban will drastically limit retail investors' access to financial advice as investors will no longer seek advice as they will perceive the costs to be too high. Mutual funds allow small investors to access professional money management because the services are subsidized by larger investors in the funds who pay higher fees. Similarly, smaller investors are serviced by advisors because, in total, their fees from smaller and larger investors allow them to be able to afford to service small investors. However, if the CSA proceeds with a ban, it will not be economic for advisors to service smaller investors in many cases. The risk of an advice gap developing in Canada is real and should not be taken lightly.

		As discussed in the main body of our letter, we know that modest investors are costly to serve relative to the assets they invest and the fees they generate for dealers and financial advisors. In the Canadian marketplace, there are many dealers that have high asset thresholds before a client is taken onboard. These thresholds can be $100,000 or even as high as $250,000. Yet the majority of households with investable assets have less than $100,000. One study by Pricemetrix demonstrated that the number of small households (defined as less than $25,000 in assets) had a significant negative effect on the future production of financial advisors. It found that advisors actually pay a penalty in terms of decreased future revenue for the small households they keep on their books. The study went on to quantify this impact. Another Pricemetrix study found that diversifying away from small households dramatically improves production. We believe it is important for the CSA to understand the true cost of advice and the amount of time it takes to service a small versus large investor. While no compensation model is perfect, the embedded commission model in Canada has worked well for retail investors. Canada is in a very different position than other jurisdictions that have banned embedded commissions. The real issue, we believe, has to do with the lack of regulatory enforcement of existing conflict and sales practices rules. In our view, if the CSA and SROs would focus on enforcing these rules, we would find ourselves in a much different position. Also, POS and CRM2 have done a good job in helping retail investors understand the costs associated with securities investments and how advisors are paid. Unlike other jurisdictions, the CSA has worked hard over recent years to enhance disclosure initiatives. Therefore, we feel that these initiatives should be given the time to play out and then be assessed to determine if additional regulatory measures are needed.
	Industry change independent of regulatory response to discontinue embedded commissions	
18.	Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:	We believe that it is unlikely that the fund industry will transition away from accessible payment options in the absence of regulatory action. However, we do think that modest investors will continue with the embedded fee model while more affluent investors will move more and more to fee-based accounts. See our observations stated in question 13 above.

	• Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	In recent years, Fidelity has seen a significant increase in series F sales and more recently a spike in series F redemption rates. We expect that this phenomenon equally applies across the fund industry as a whole. Fidelity redemption rates in series F are on average 50% higher than our embedded commission series. We believe that this spike in redemptions may, in part, be attributable to advisors feeling that they need to justify their fee with account activity. In almost all circumstances, though, research has shown that frequent trading is almost always detrimental to long-term results. Fidelity advocates for choice, and having accessible payment options will, in our view, remain the best option for mass market households to access advice and professional money management. We will, however, in the absence of a ban, continue to see markets evolve in a way that preserves choice and allows all investor segments the ability to choose how they wish to access and pay for financial advice.
19.	How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular: • Do you see payment options and business models evolving at present? • How are they likely to change over time if the CSA were to choose not to move forward with the proposal?	We believe that this question would more appropriately be responded to by dealers.
20.	We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?	From a fund manager's perspective, we do not believe there would be obstacles specific to Canada in limiting the use of fee-based series by dealers. We note, however, that there are dealers who are set up exclusively to transact using the embedded commission model. Therefore, we suspect that these dealers will have significant infrastructure costs in order to limit their shelf to fee-based offerings.
	Potential impact on competition and market structure	
21.	Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular: • Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with	We do not agree with the analysis set out in Part 4. Many of our responses to this question are dealt with in preceding questions.

	respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms? • What are the likely impacts on investor outcomes and market efficiency of any potential consolidation? • What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups? ○ Independent dealers? ○ Independent fund manufacturers? ○ Integrated financial service providers? ○ Mutual fund dealers? ○ IIROC dealers? ○ Online/discount brokers? • What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products? • What would be the impact on dually-licensed mutual fund dealers and insurance agents? • Will the proposal lead new, lower-cost entrants to the market? Why and how? • Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how? • Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated? • Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how? • What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?	According to the Conference Board of Canada, the Canadian mutual fund industry has an economic footprint of $17 billion in GDP, contributes $7 billion in tax revenue and supports 192,600 jobs across Canada. After the U.K. banned embedded commissions, it saw a significantly negative impact on jobs and investors. The number of financial advisors fell by 9,000 (22%) from 40,000 to 31,000. As many of these advisors were small business owners, which directly and indirectly supported additional jobs, the total impact on jobs is estimated to be much higher. Likewise, if Canada were to proceed with a ban, Fidelity anticipates that the number of advisors will be significantly reduced, by as much as 20,000, with the most devastating impact to small investors who rely on these advisors. In addition, another significant negative impact in the U.K. was a dramatic decrease in the percentage of opening of new accounts by middle-class citizens. The U.K. saw a 50% drop in new accounts being opened because middle-class citizens who relied on embedded commissions as an accessible payment option could not afford or simply chose not to pay upfront fees. In Australia, upfront fees increased by 22%. In Canada, we also anticipate that a ban will result in higher upfront fees for advice, which will in turn result in fewer middle-class Canadians accessing advice and saving for retirement. Fidelity estimates that there will be a 20% to 30% decline in middle-class Canadians receiving advice. That translates to 1.5 million “orphaned” households, which could pose a significant challenge in an aging population. We disagree with the CSA’s view that the solution to the advice gap will be the banks and robo-advisors. We do not believe it is the role of the CSA to favour one distribution model over another. The CSA’s role is to regulate. In order to have a healthy securities industry, all stakeholders need to co-exist. When Sweden decided against a ban, it reasoned: 1) Firms with their own distribution would be in a more favoured position; 2) The potential negative effects on smaller, independent asset managers were not desirable; 3) A ban could lead to the unfavourable outcome of concentration of asset management with the banks; and

		4) There was a likelihood of the development of an advice gap, similar to what happened in the U.K. We believe that Sweden's recent decision is an example of a jurisdiction that was concerned with the negative consequences of a ban on competition, small investors and the resultant concentration of ownership among the banks. Finally, approximately 85% of financial advisors licensed with the MFDA are dually licensed as insurance salespeople. And similarly, of IIROC advisors, 63% are dually licensed. We are concerned that with the regulation of fees for mutual funds and the unbelievable increase in compliance burdens faced by these advisors, they will feel that their only option is to sell less regulated, transparent and unsuitable products to their clients. This is not a good result.
22.	What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular: • Is there any specific operational or technological impact that we should take into consideration?	If the CSA proceeds with a ban, Fidelity would need to decommission and reconcile all existing holdings that have embedded commissions with its dealers, as the ban would impact transfer agency, accounting systems, finance, FundServ, etc. In addition, depending on what the grandfathering rules would be, there could be substantial conversion efforts and enhancements to systems if Fidelity had to convert all ISC/DSC series to series F at an inopportune time. We note that transitioning to a fee-based world will put pressure on dealers to consolidate client billing from across their nominee and client name businesses. For smaller planners, this will be an issue, and is one reason for why Fidelity launched its redemption of units ("ROU") program. Operationally, fund managers will need to spend more time launching and administering their ROU programs to accommodate dealers. Alternatively, we believe FundServ will need to work on an industry enhancement to make it easier for fund managers to collect and remit redeemed units (and the corresponding sales tax) to dealers.
23.	The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts	Generally, mutual fund managers do not monitor advisor conflicts with respect to embedded commissions – that is a dealer responsibility. Fidelity's systems have controls in place that do not permit inappropriate

	of interest today. • Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight? • To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?	switches between certain series, or switches that would trigger new DSC schedules for existing units.
24.	Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?	We believe that smaller independent dealers who transact exclusively using the embedded commission model would be most harmed by a ban. We suspect that these dealers would be unable to compensate for the loss of revenue with direct pay arrangements – not only because of significant infrastructure changes, but primarily because their clients will most likely fall into the advice gap and would be unwilling to pay upfront fees for financial advice. Therefore, these dealers may be forced to consolidate or shut down.
25.	Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?	Fidelity believes that the real issue is that current conflict and sales practices rules have not been enforced appropriately. We encourage the CSA and SROs to take strong regulatory action against sales practices that do not meet current standards. We believe that it is important for the CSA and SROs to set out exactly what sales practices and incentives are permissible and those that are not. More recently, IIROC released Notice 17-0093 on April 27, 2017, which set out the detailed findings and analysis regarding their compensation review. Of particular note, IIROC found a bias on the part of most dealers towards fee-based accounts over commission-based accounts – i.e. most dealers provide the highest possible grid payout to their advisors for fee-based revenue. IIROC is concerned that investors may be moved into fee-based accounts, whether or not such accounts are consistent with the investor's best interest. Most IIROC dealers said they believe that fee-based accounts align registrant interests with client interests better than commission-based accounts. However, IIROC acknowledged that while this may be true in some cases, there are other cases such as "buy and hold" where this may not be true. As previously mentioned, we believe that all compensation programs should be designed in a way that removes any financial motivation to bias an advisor to recommend one

		product over another.
26.	What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the: • career path; • attractiveness of the job; • typical profile of individuals attracted to the career; • recruitment; and • relative attractiveness of careers in competing financial service business lines?	See our response to question 21 above.
	Part 5	
27.	How practicable are the mitigation measures discussed and how effective would these measures be at assuring: • access to advice for investors, • choice of payment arrangements for all investor segments, and • a level playing field amongst competing investment products?	Not practicable at all. See our response to question 21 above.
28.	What other measures should the CSA consider to mitigate the above unintended consequences?	We strongly urge the CSA not to proceed with a ban. We offer, however, the following measures the CSA could consider to mitigate the conflicts associated with the embedded commission model: 1) Create standardized distribution commissions by asset class (i.e. equity, fixed income and balanced). In our view, a level fee eliminates and neutralizes the conflict of differing payments to advisors; 2) Offer investors the choice of embedded or other alternative fee structures and explain the implications of each choice in a clear way; 3) Provide a list of minimum services that investors must receive in return for the trailing commission; 4) Implement certain targeted reforms under CP 33-404; 5) Enforce NI 81-105 immediately and vigorously, and amend it to apply to managed accounts like separately managed accounts and unified managed accounts; 6) Introduce CRM3 disclosure to include management fees charged by fund managers;

		7) Do not allow full trailing commission series to be sold on discount brokerage platforms; 8) Standardize naming conventions for fund series; 9) Provide further guidance and continue enhanced regulatory scrutiny on the sale of DSC funds; 10) Improve financial literacy and continue to measure other disclosure and regulatory initiatives such as POS and CRM2; and 11) Roll out similar rules to all competing investment products, including insurance and bank products that are now not governed by comparable rules.
29.	Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular: • Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain. • To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors? • What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?	Fidelity does not object to compensating dealers through periodic fund redemptions facilitated by the fund manager. An ROU in non-registered accounts would result in a disposition for tax purposes, and the investor would be subject to tax on capital gains or incur a capital loss. Unitholders may not be able to deduct the dealer compensation fee if the CRA takes the view that the dealer compensation does not meet the specific requirements in Section 20(1)(bb) of the *Income Tax Act* (Canada), which the fees must be: 1) reasonable; 2) represent fees for advice provided to investors regarding their purchase/sale of specific securities or includes the provision of administration or management services in respect of the securities; and 3) paid by the investor to the dealer whose principal business is advising others regarding the purchase/sale of specific securities or includes the provision of administration or management services in respect of the securities.
30.	With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements, • to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?; • does the existence of this form of cross-subsidy suggest that	Cross-subsidization is an inherent part of the mutual fund structure. While Fidelity's two-series structure avoids many of the issues associated with cross-subsidization, the vast majority of the mutual fund industry uses a combined series structure. Fidelity is an advocate for different series for each purchase option and particularly the reduction in fees for front-end investors. There is little doubt that Fidelity's front-end purchase option is cheaper for the fund manager and we have chosen to pass on those savings to our investors. While we acknowledge that cross-

	high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and • what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?	subsidization is a standard practice, we did not see any sufficient evidence in the Paper to suggest that this practice is a problem. In our view, to the extent that valuable advice and professional money management is being provided to investors, we do not object to this practice.
31.	What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?	See our response to question 28 above. As previously mentioned in our response letter, Fidelity does not believe that a ban is an appropriate solution to lessen the conflicts that may stem from the embedded commission model.
32.	For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs. • Are there unique costs or challenges to specific businesses? • What transition period would be appropriate? • Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?	See our response to questions 20 and 22 above. From a fund manager perspective, we expect there to be significant upfront operational and structural challenges in order to successfully transition to a direct pay model – e.g. investor mailings, prospectus filings, data conversion efforts, etc. We also expect, however, that dealers will face even more significant operational and structural challenges – to the point where smaller independent dealers may be forced to consolidate or shut down.
33.	Which transition option would you prefer? Why? Are there alternative transition options that we should consider?	Should the CSA decide to proceed with a ban, Fidelity would prefer if the CSA adopted a transition period of at least 60 months. We would, in addition, propose that investors currently in DSC funds be grandfathered until their DSC schedules mature. If no grandfathering provision is permitted, we question who would absorb DSC fees, if applicable.
34.	As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?	We question why the CSA would consider a fee cap as an appropriate transition measure, but not consider a cap as an appropriate measure to help mitigate the conflicts associated with the embedded commission model.
	Part 6	
35.	Please explain whether you think each of the initiatives discussed above will, either alone or in combination: • address the three investor protection and market efficiency	Yes. We believe that POS and CRM2 will address many of the issues identified in Part 2. Both these initiatives have, in combination, increased transparency on the fees and costs associated with mutual fund and other

	issues and their sub-issues identified in Part 2; and • address or not address any additional harms or issues that you have identified.	securities investments. Recent research by the BCSC confirms that CRM2 is accomplishing what the BCSC has hoped to accomplish – an increased awareness of fees and the performance of investments. If the goal of the CSA is to ensure that investors have a better awareness of costs and fees, we believe this would be better accomplished through proper disclosure and literacy initiatives as opposed to an outright ban. Unlike those jurisdictions that banned embedded commissions, the CSA is in a unique position and should give POS and CRM2 the time to run their course and be assessed to determine if appropriate regulatory measures are needed. Of course, Fidelity acknowledges that disclosure initiatives alone may not entirely address the investor protection issues identified in Part 2. However, we believe that the CSA has many regulatory tools that they should use – i.e. enforce NI 81-105 and current conflict rules, implement certain targeted reforms in CP 33-404 and continue with their sales practices compliance reviews. If these tools are used and enforced appropriately in combination with disclosure and financial literacy initiatives, the CSA will likely find a reduction in inappropriate sales practices. This will undoubtedly lead to better conflict management and would allow the Canadian marketplace to evolve in a positive way that preserves choice for investors and allows all compensation models to co-exist.
36.	Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.	See our response to question 28 above.

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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
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Re: Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

Dear Sirs/Mesdames:

Independent Financial Brokers of Canada (IFB) welcomes the opportunity to provide further input to this important discussion. IFB has made previous submissions on this topic in 2015, and more recently responded to the CSA's Consultation Paper 33-404*: Proposals to enhance the obligations of advisers, dealers and representatives toward their clients*, which explored 10 targeted reforms and a best interest duty.

IFB is the pre-eminent voice of financial advisors who have chosen to be independent. Its members are self-employed, generally operating small-to-medium sized financial practices in communities across Canada. To be clear, they are not career agents, or employees of financial institutions. They do not work for proprietary firms. In fact, IFB members pride themselves on their ability to offer financial advice on insurance, wealth management and every day financial planning. They can access products from a range of providers to address their individual client's needs. The majority are dual-licensed as mutual fund registrants and life insurance agents. These advisors, and their clients, stand to be impacted the most by these proposals, and IFB frames its response to this submission with this uppermost in mind. To learn more about IFB and how it supports its members, please visit www.ifbc.ca.

IFB appreciates the CSA's efforts to gain a deeper understanding of the interplay between the current compensation practices in the securities sector, and positive investor outcomes. To wit, the CSA's public interest mandate is both to protect investors **and** encourage a competitive and efficient market. It is imperative that in advance of implementing this Proposal, and initiating very fundamental change to this market, there is a fulsome discussion of the consequences – both intended and unintended. It's important to get it right from the outset, to minimize future change and disruption.

The CSA should consider, and measure, whether regulatory objectives could be achieved effectively through less burdensome means. IFB believes this calls for a more principles-based approach when setting regulatory policy to ensure it remains adaptable to change. Principles-based regulation allows regulators to set desirable outcomes to shift the market. In this instance, a principles-based approach to compensation, coupled with some targeted prescriptive measures to deal with specific higher-risk situations, will be better positioned to endure over cyclical and evolving markets, while at the same time preserving choice for investors.

IFB is responding on behalf of its nearly 4,000 individual advisor members. IFB is a member-driven association – it gives a voice to its members, and they guide its direction. To inform this response, IFB conducted an informal online survey comprised of many of the CSA questions posed in this consultation paper. Participation was voluntary. Hundreds of advisors responded – often with in-depth and detailed answers. Advisors from nearly every province and territory participated. Most respondents were from Ontario, with Alberta and BC respondents making up the next largest groups.

Throughout this submission actual quotes from these respondents are highlighted, so the CSA can hear directly from advisors in communities and provinces across Canada.

Potential Impact on Competition and Market Structure:

Independent advice channel will be disproportionately affected

The CSA has asked for input on the potential effects of a ban on embedded fees and trailers (the "Proposal") on representatives in the mutual fund industry. IFB welcomes the opportunity to contribute to a better understanding of the potential impacts on independent advisors.

According to the MFDA's latest statistics, there are currently 83,000 licensed mutual fund representatives. 32,000 are licensed through Financial Advisory firms, where they are responsible for building their own book of business. These advisors, which include IFB members, currently service 2.36 million households.[1] This is not an insignificant number of advisors, or households, which stand to be disadvantaged through this Proposal.

[1] MFDA Client Research Report. May 2017. Page 19.

Many IFB members started their career as employees, or captive agents, of a financial institution. They then moved on to start an independent financial practice, which allowed them to offer clients advice, and products from a wider range of providers. This is reflected both in the age of the survey respondents (62% are between 51-69 years of age)[2], and their years of experience (80% have been financial advisors for over 15 years).[3]

They have built their businesses through the only compensation model available to most of them – commissions and trailers. As self-employed individuals, they have no pension plan. They rely on the trailers to help offset the cost of servicing smaller (less profitable) accounts, and to help finance their business expenses. It is also a source of income to support their families, to fund their retirement, and to enhance the value of their book of business when sold.

My retirement would be in ruins, since my book of business would be close to worthless.
- IFB Survey Respondent

I wouldn't be able to feed my family. I would have to leave the business.
- IFB Survey Respondent

IFB and its members believe that the outcome of the Proposal will have the most detrimental effect on independent firms and advisors operating in the MFDA channel, and by extension their clients. Most of these advisors serve clients and families with modest accounts or investable assets. The Proposal as set out will force many of them out of the business, and leave their clients with little recourse to access personalized advice.

Clients wouldn't be able to afford to pay fee-for-service. I would leave the investment industry completely. I wouldn't be able to continue to work and not make money.
- IFB Survey Respondent

This "unplanned" exit was borne out in the IFB survey results. When initially asked, 62% of advisors said they do not plan to retire in the next 5 years. However, when asked (later in the survey) how likely they would be to exit the business if embedded fees and trailers were banned, the number of those who said they would retire, sell or otherwise leave the business, jumped significantly. Nearly 70% indicated that a move to fee-for-service would motivate them to exit the business[4].

I have a Succession Plan in place and it depends upon trailers to make it happen. To preserve my family's income, I would close the business and 9 employees would be let go to find employment elsewhere.
- IFB Survey Respondent in British Columbia

[2] 30% of respondents are between 51-60 years; 32% are between 61-69 years of age.
[3] 33% have 16-25 years of experience; 47% have over 25 years of experience
[4] 21% said they would retire, 46% said they would sell or otherwise leave the business

This points to the potential for a sudden exodus of many highly experienced independent financial advisors from the industry. It is difficult to see how this will benefit investors – and the small to mid-sized investor in particular.

IFB reiterates its comments, made in the last consultation, that regulatory policy should not affect market competition to the point of driving those who make a legitimate living, working under the current regulatory regime, out of the market. At the end of the day, selling investments and providing investment advice is a business, and an advisor must be able to derive sufficient income from his or her business for it to be a going concern.

It is alarming that the CSA appears to accept as a given that its Proposal will have the greatest negative impact on independent firms and, as a result, reduce the number of independent, smaller mutual fund dealers and advisors. This impact has also been asserted by the MFDA in its recent Client Research Report[5]. It is unclear how reducing the advisory choices currently available to investors contributes to the CSA's investor protection mandate, or to a fair and competitive marketplace.

The vast majority of consumers in communities across Canada are satisfied with, and value, their relationship with their advisor. Yet, as previously stated, the survey results demonstrate that the most experienced independent advisors (those with 25 years of experience) are likely to exit the business if trailers and embedded commissions are banned. The CSA suggests this 'gap' can be filled by bank channels or robo/direct investment firms. IFB and its members fail to see how either of these choices is a suitable replacement for the advice of experienced advisors.

> *Embedded commissions and trailers represent the years that advisors do not have any pension plan or union to protect them. No EI coverage. No mandated employee benefit plan, and no retirement age. No overtime or statutory holidays. Plus, advisors, like lawyers, spend the first half of their career underpaid and sacrifice family life.*
>
> - IFB Survey Respondent based in British Columbia

Change in investor experience and outcomes

The CSA has asked for input on the effect the removal of embedded commissions will have on investors.

IFB agrees with the regulatory objectives of ensuring investors are treated fairly, understand the fees they pay, and that incentive-based compensation arrangements should not undermine the provision of sound financial advice. IFB fully supports the regulatory goals of insurance and securities regulators, and self-regulators, that clients should be provided with clear and transparent reporting on the costs associated with their investments, and the performance of their investments. IFB members feel strongly that they add substantive value to their client relationships in this regard, that investors who use online channels do not have access to.

[5] MFDA Bulletin #0721, Client Research Report. http://mfda.ca/wp-content/uploads/Bulletin0705-C_2.pdf

It is equally important to note that IFB Members' clients are often the middle income (mass market) individuals and families who might not otherwise gain access to professional, personalized advice. Removing trailers is unlikely to create better outcomes for these clients if firms and advisors can no longer service them. Today, many financial institutions and firms are increasingly concentrating on more profitable high net worth clients.

> *The cost of compliance and service could not be met on a fee-for-service basis. E.G. 25K account pays me now $125. My cost per client has me losing money at that point. Now service for my entire book remains possible based on larger average accounts.*
> - IFB Survey Respondent from a small town in Alberta

> *I have a smaller practice, with less than 100 families. As it is, the revenue from embedded commissions from larger clients essentially subsidizes the level of service that I can provide to my smaller clients. I can't very well charge a smaller client with, say, $25,000 in assets $1,000 or more a year, yet in terms of time required that would be what it costs to provide the level of service that I give to all clients. Often, it seems, the smaller clients are the ones who are on a shoestring and need more advice than the larger client does!*
> - IFB Survey Respondent in a large Alberta urban area.

As the CSA, itself, points out: *"A potential negative impact of the discontinuation of embedded commissions for mass-market households is that some independent fund dealers may choose not to continue to service these households.*

Overwhelmingly, survey respondents stated that the Proposal will force many of their clients away from personalized advice, because clients will not be able to afford the kind of direct fees the advisor would have to charge if the account is no longer supported by trailers. Some of these advisors today offer choice in the ways clients can pay them. However, they see no value in reducing these choices for all investors, and thereby harming those with small accounts. The ability to cross-subsidize income received from trailer fees allows advisors to service smaller clients.

Advice Gap.

The CSA suggests that there will be no advice gap created by the Proposal, largely because it surmises that consumers will obtain advice and products from deposit takers, like banks, or online channels or other means of direct investing. What underpins this viewpoint is the assumption that online advice is interchangeable with face-to-face advice. Many investors, however, are unlikely to be comfortable in completely replacing personalized advice. Financial advice has value that extends beyond the selection of a financial product, as articulated in various studies the CSA has referenced in its paper. Some investors will be comfortable with non-advised channels, but this should not be a forced choice.

> *Smaller accounts would likely end up in bank deposits because fees would be too high for the client.*
> - IFB Survey Respondent

Many of my clients are young professionals or families without a lot of investable assets, and would not be able or willing to pay the cost associated with an upfront, out-of-pocket fee. Upfront commissions help compensate me for my time, without them paying out of pocket.

- IFB Survey Respondent

IFB strongly believes the Proposal will lead to an advice gap for a particular segment of investors. It will reduce the ability of mass market households to receive personalized advice, especially those households with less than $100,000 in investable assets. Studies, supplemented by our survey results, have shown this group of investors is less likely to be able to afford, or willing to pay, upfront fees.

The MFDA's Client Research Report indicates that 37% of investors with less than $100,000 in assets are over 55 years of age[6]. This statistic takes on greater significance when viewed in conjunction with the IFB survey results, which show many advisors would exit the business in the face of this Proposal. Under this scenario, clients nearing retirement will have fewer experienced advisors to rely on, and at a time when more, not less, advice is needed.

In a fee-based world, AUM will dictate whether you work with a client or not, given the significant costs associated with being an independent advisor, and yet it is those lower income families that really require the help of a professional.

- IFB Survey Respondent

IFB shares the grave concerns of its members that a ban on embedded fees across all investment funds will impair investor outcomes. Mutual funds are the investment of choice for mass market households.

Removing choice from the market will create additional concerns that can be better addressed by education, better transparency and disclosure of costs. Consumers have choice in how they invest now. They can opt for a fee-for-service model, or use online self-directed investing platforms, or go to a bank that doesn't charge upfront fees but incents its salesforce through bonuses and other means. ETFs are a fast-growing segment of the investment market. This provides choice for investors who do not want to deal with an advisor and/or wants to reduce their costs.

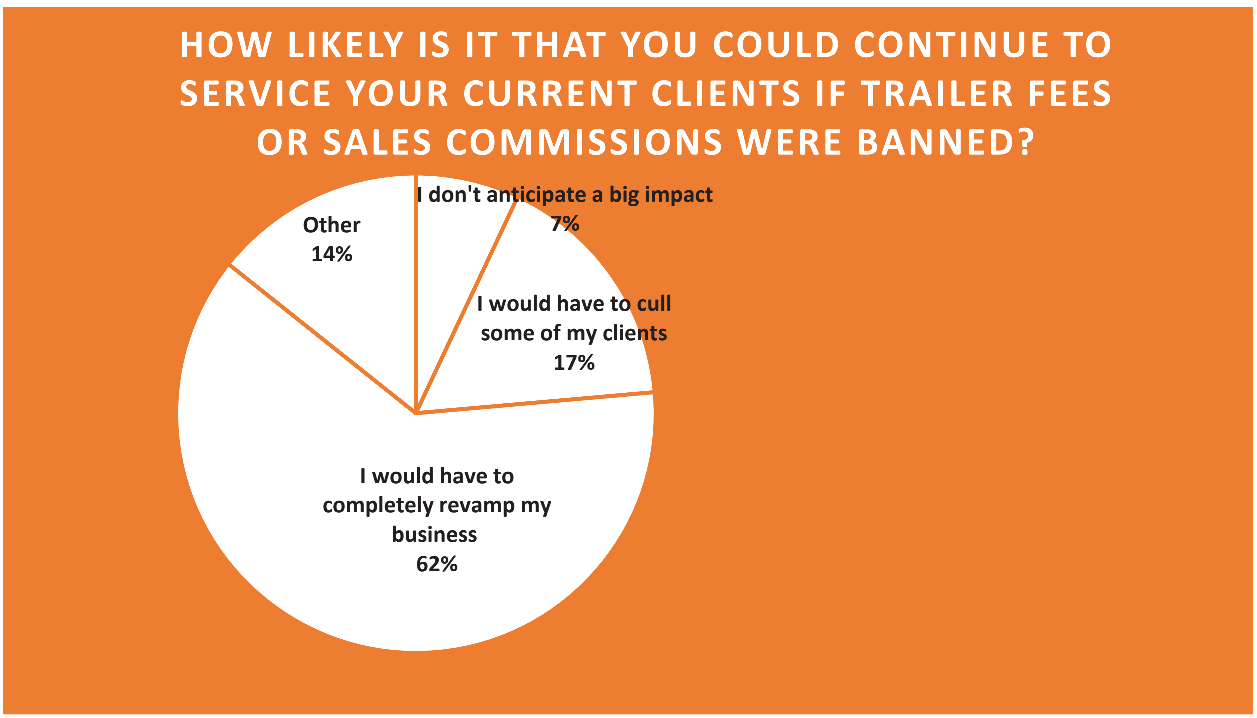
It reduces us to piecemeal pricing and that is just not good for clients who need to be able to call us with any financial question without us charging them each time we do something.

- IFB Survey Respondent from small-town Ontario

[6] Ibid. page 10.

> *Embedded commissions allow advisors to take care of small investors and grow them to large investors. We know we will not make a lot on new investors but if we help them grow their wealth it pays off eventually for both us and for them.*
>
> - IFB Survey Respondent from small-town Ontario

Not only did IFB members indicate that clients would likely resist direct pay arrangements, client-focused advisors resist the idea of having to charge the client for every interaction. In today's market, independent advisors bundle advice and services for clients that would not be possible under the proposal. The benefits of this arrangement are not captured in the research done to date. In addition, how will mass market, smaller investors negotiate with advisors? They will lack skill, or perhaps confidence, as well as the investable assets to do so effectively. IFB and its members question whether trailer fees do, in fact, represent a more expensive option for consumers, given this gap in the research.



Direct pay may <u>appear</u> more transparent, and less complex for investors to understand. With CRM2, however, these fees are broken out. Clients can vote with their feet and search out another competitor if they are unsatisfied with the service received relative to the cost of an investment.

If independent firms and advisors are pushed out, clients will be forced to move to the banks and bank-owned firms, concentrating the mutual fund market even more than it is now. The MFDA reports that, *"The deposit-takers have the vast majority of household relationships (72%) and assets (59%) in the MFDA membership. FA firms are the second largest category with 27% of households and 39% of* *membership assets. Direct sellers represent 1% of all household relationships and 2% of assets within the MFDA membership.* [7]*.*

No discussion of conflicts arising from fee based practices.

The lack of consideration given to conflicts that can arise from fee-based advice is, in our view, a major omission in this consultation paper. It is inevitable that all forms of compensation connected to the sale of a product can create a potential conflict. It does not follow, however, that potential conflicts of interest inevitably give rise to inappropriate conduct. And, while direct fees may be more transparent to clients than embedded fees, this is being addressed, and equalized, through CRM2.

In addition, clients, especially those who are inexperienced or those with small accounts, may be uncomfortable negotiating a fee with the advisor, or may not be eligible to engage a fee-based advisor based on their investable assets. This will reduce the investment advisory choices available to them. Under a direct fee arrangement, a client may be aware of the fee they pay from a set percentage, say 1.5% to manage the portfolio, but, this may be no more transparent if the client doesn't know if this is reasonable number.

Merely exchanging one form or compensation for another does not remove conflicts. One common approach to setting fees is to tie it to the client's AUM. This creates an incentive to increase the AUM. The potential downside is that the advisor may not consider other strategies such as more suitable investments, or divestures, or using assets to reduce debt. If the advisor is paid to gather more assets that may well become the focus. Fees deducted directly from the client's account, can be less obvious to the client (as compared to explicit disclosure such as is prescribed with CRM2), and may go unquestioned. A further consequence (as noted by advisors in many of the survey responses) may be that the client will, in fact, pay higher fees for the same level of service.

Instead, IFB recommends that the CSA consider other improvements to the current compensation system which we believe will address its concerns, while permitting investors the greatest flexibility in how, and where, they choose to obtain their financial advice. We believe a fundamental flaw in the CSA Proposal is that it does not distinguish by size, risk or business model.

I work in a fee-based Financial Planning practice. Our insurance operation is not the larger part of our business, however, it does pay a portion of ongoing expenses. Our lower net worth clients would not be serviced if we did not have the insurance operation and receive mutual fund commissions.

- IFB Survey Respondent

[7] MFDA Client Research Report. Page 8. http://mfda.ca/wp-content/uploads/Bulletin0721-C.pdf

Impact of Technology

The financial services industry continues to evolve at a rapid pace. Technology, particularly innovation related to distributed ledger technology and blockchain, stands to substantially reform many of the administrative and compliance processes in place today. It is likely that many paper-based transactions and records, like KYC and client identification, will become digitized and form instant and permanent records. This could well lighten the compliance load for firms, advisors and regulators in the near future.

> *I think there will be a group of people that want 'robo' advisor advice. But most clients I deal with want a personal review that includes more than their risk tolerance and some cookie-cutter approach. So in the short term, I think the robo/discount firms will grow and in the process a lot of people will lose their advisor. The advisor will have to leave the business or cull clients – and I am not talking about really low net-worth. Clients with what used to be a good amount (i.e. $100K in assets) now are too small to be a fee-based account.* - IFB Survey Respondent

Better enforcement of existing standards

Regulators, including IIROC and the MFDA, already have considerable authority to discipline firms and advisors, including issuing a permanent suspension from the industry. Better enforcement of existing rules may well address many the investor protection issues without the unintended consequences that this Proposal may bring.

For example, National Instrument 81-105 prohibits dealers from providing incentives that favour the sale of proprietary funds over funds of third party companies.[8] Yet, the MFDA and IIROC found that integrated firms paid higher commissions to promote sales of their own products, and paid hefty referral fees to move investor accounts to associated parts of the company (e.g. to portfolio managers within the bank owned dealer). [9] We look forward to receiving more information on the enforcement action IIROC and the MFDA takes, and to learning more details of these cases. These conflicts should be addressed, and action taken. At the same time, these firms also have the greatest market concentration. A ban on embedded fees will serve to push more investors to these firms, leading to even greater market concentration and reduced competition.

On this point, the Financial Market Authority in New Zealand has noted "*potential conflicts from vertically integrated models is something the FMA has highlighted in its strategic risk outlook as being an*

[8] National Instrument 81-105: Mutual Fund Sales Practices. http://www.osc.gov.on.ca/documents/en/Securities-Category8/rule_20090918_81-105_unofficial-consolidated.pdf

[9] MFDA Compliance Bulletin #0705, Review of Compensation, Incentives and Conflicts of Interest. December. 2016. http://mfda.ca/wp-content/uploads/Bulletin0705-C_2.pdf
IIROC Notice 16-0297, Managing Conflicts in the Best Interest of the Client - Status Update. December 2016. http://www.iiroc.ca/Documents/2016/4dd98e70-f053-4980-bc75-10ceb6f3940d_en.pdf

inherent driver of risk in financial markets in New Zealand". IFB submits that this risk should receive the attention of Canadian regulators, yet it is not addressed in the Proposal.

Setting registrant proficiency requirements is within the regulators' jurisdiction and formed part of CP33-404. We understand the CSA plans to advance the proficiency reforms through a separate CSA project.

In addition, the CSA has indicated it intends to proceed with further refinement of the targeted reforms and best interest evaluation which are intended to strengthen the advisory standard of conduct, and make the client-registrant relationship more centered on the interests of the client.[10] Moving forward on this initiative, the improved disclosure for investors required by CRM2 and POS (Fund Facts) and the findings from the CSA's evaluation study will all contribute to a better understanding of how these changes have addressed the CSA's concerns.

IFB looks forward to commenting on these initiatives as they proceed.

Structural conflicts not addressed.

A ban on embedded fees does not address the wider issue of conflicts arising from compensation strategies within financial organizations. The Proposal focusses on embedded fees as conflicted remuneration between advisors and clients, yet the companies, dealers and manufacturers control how advisors are paid. A broader examination of these structural conflicts needs to be undertaken.

Certainly, the recent revelations by CBC's "*Go Public*" (which has now led to Parliamentary hearings) alleging that consumers faced high pressure sales tactics from bank employees under intense pressure to achieve sales targets – sales targets set by management -- emphasizes this point. Clearly, if executives, senior staff, and middle management all benefit from increased sales, this creates a much wider culture of incentive-based selling, far beyond the control of individual advisors. We believe this speaks to the need to ensure compensation practices dovetail with good governance practices.

> *Young advisors will have no ability to build a book. Trailers are the single most important way to keep an advisor looking after their current clientele. If trailers go away, the advisor will be forced to sell more to new clients, and give less attention to current clients.*
>
> \- IFB Survey Respondent

These allegations are especially troubling, given that the CSA paper states that deposit-taker and insurer-owned MFDA firms administer 90% of mutual fund assets and employ 93% of approved persons. Other MFDA firms account for 73% of member firms but only 6% of approved persons. It is clear, then, that the majority of mutual fund firms also sell proprietary products.

[10] CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers and Representatives towards their Clients. April 2017. http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20170511_33-319_proposals-enhance-obligations-advisers.pdf

The CSA observed in its report on compensation arrangements and incentive practices of firms that "*these arrangements favour proprietary products over third-party products whether through higher payout rates, bonuses, increased revenue recognition or through other forms of additional compensation. Only integrated firms reported these practices. Some firms reported paying their representatives a higher grid payout rate for all their proprietary mutual funds while others paid a higher rate only for a subset of their funds. Other firms based a part of representatives' annual bonus on the performance of their business unit, which included both distribution and asset management. Other firms also reported annual performance review processes that seemed to focus on representatives' activity vis-à-vis the sale of proprietary products over and above their ability to generate revenue for the firm generally.*"[11]

The CSA has noted that incenting "*representatives and the firm to drive sales of proprietary products…can result in inappropriate advice and inferior client outcomes*".[12]

We expect the Proposal to have a disproportionately negative effect on the ability of independent firms and advisors to remain in business if implemented, which <u>will expose more clients to this inappropriate advice and inferior outcomes</u>.

Improved Investor engagement, through broader consultation.

The voice of investors who have had satisfactory experiences with advisors, often over the course of many years, is absent from these consultations. This has led to an imbalance in perspectives. We hope regulators will actively reach out to and engage with a broader cross-section of the investing public, so the dialogue is representative of a variety of viewpoints.

Promote financial literacy

Financial advisors are also <u>financial educators</u>. Clients report that they turn to their advisor for information and advice. Advisors should have the appropriate level of proficiency to be able to inform clients. Information asymmetry exists in many professional occupations, and financial advice is no different.

> *Clients need help and advice to navigate, not just investments, but government plans and programs.*
>
> - IFB Survey Respondent

Improving the general level of comfort with, and understanding of, financial information is imperative to improving the conversation between consumers of any financial product and those who offer those products. CRM2 builds on this, as do the Fund Facts.

[11] CSA Staff Notice 33-318 Review of Practices Firms use to Compensate and provide Incentives to their Representatives. http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20161215_33-318_incentives.pdf

[12] Ibid. page 4.

Financial literacy is the focus of many regulatory and government initiatives. Industry associations, financial firms, and consumer groups have also been actively providing access to information, increasingly in plain language formats. While much more needs to be accomplished, consumers – especially younger consumers - are more informed and comfortable questioning the information they receive. Statistics show younger consumers conduct as much as 90% of their research online before they get to the purchase stage. We live in an age of consumer activism, driven by social media. We see media reports of consumer whistleblowing leading to large scale action (the FCAC investigation and Parliamentary hearings stemming from the CBC Go Public allegations into bank sales practices is a good case-in-point).

Recommendations.

To improve investor outcomes, while preserving access to independent advice, IFB recommends:

1. Retain choice in compensation models but standardize embedded fees to remove any incentive to promote one fund over another; Set appropriate standards for receiving trailer fees, for example expectations for client service and removing trailers from DIY or other non-advice channels.
2. Retain DSCs, as they have value to some clients, but reduce the time from 6-7 years to 3 years. In effect, create a low load hybrid, which preserves the choice of investing in a DSC.
3. Explore a standardized approach to assessing risk tolerance to be used across the industry. Inappropriate risk tolerance is often connected to complaints, and methodology varies widely.
4. The CSA should encourage a broader perspective of investor feedback to provide balanced input from a wide range of investors.

> *How are any new advisors going to break into the industry? If it's only proprietary or integrated firms with in-house sales personnel, they will sell only their own products, and not what is in the best interest of the client.*
>
> - IFB Survey Respondent

Conclusion

IFB agrees that improvements can be made to the current regulatory system that will lead to better client outcomes. However, we see this happening in conjunction with the full rollout of CRM and CRM2, Fund Facts improvements, and some additional tweaking. <u>We do not see the need for a wholesale disruption</u> – <u>the negative impacts of which will be disproportionately greater for smaller, independent dealers and their advisors</u>. This outcome is especially problematic, because the CSA's and MFDA's own research suggests conflicts related to incentivized compensation is more prevalent in integrated firms.

I fear having to close my doors due to operating my business with a store front in a small community. I am not convinced (my clients) would adapt to paying a fee-for-service. I have a 10-year lease for my office, and a staff and a family to support. I'm very concerned about a commission ban.

- IFB Survey Respondent

The CSA recognizes that a transition to direct pay arrangements would require adopting new business models and processes. There is no doubt that integrated firms will be far better positioned to absorb the cost incurred with migrating away from the current system of compensation. Again, leaving smaller firms and their advisors less able to be competitive.

The Proposal also fails to consider the value independent advisors see in the work they do with clients, and the pride they take in serving them well. They want to help clients be more financially secure. Many have chosen to set up an independent practice after having worked for a bank or proprietary firm. As experienced advisors, they offer clients support that goes beyond product selection.

If the public truly understood how this will impact their financial options, I don't feel they would be in favour. In speaking with many clients over the years and coming from the banking industry myself, it is a fact that just because an advisor is paid an hourly wage does not confirm they will have the client's best interest. I would argue that BECAUSE I ONLY rely on commissions, I have more at risk to ensure my client is receiving the service and education they deserve in order to keep my clients. I don't consider my clients to be 'customers'. My business is not dependent on offering 'transactions'. My business is based on relationships. I am very concerned about being forced to convert my business to fee based. In talking to my clients they do not like the idea of paying a fee for service and said they would likely not continue to work with me if it becomes the case. That has me very concerned. I have invested 18+ years of my life into my career…I don't want to be forced to close my doors if I can't find a way to make this new process work for my client base.

- IFB Survey Respondent

Integrated financial institutions, like banks, benefit from ongoing contact with individuals and businesses who deal with them on a regular basis. This provides them with the opportunity to continually up-sell and cross-sell. Independent advisors, on the other hand, build their own book of business and fund their own business expenses. These advisors must reach out to potential clients, and be persistent to attract and retain them as clients. They spend a great deal of time – often unpaid – before this happens. Commissions and trailers help compensate for this. How will reducing this choice – for both advisors and clients –lead to better investor outcomes or a better marketplace?

IFB CISF

We thank the CSA for the opportunity to provide our comments, and urge the CSA to explore options that will address its investor concerns, without creating the negative consequences that we have identified in this submission.

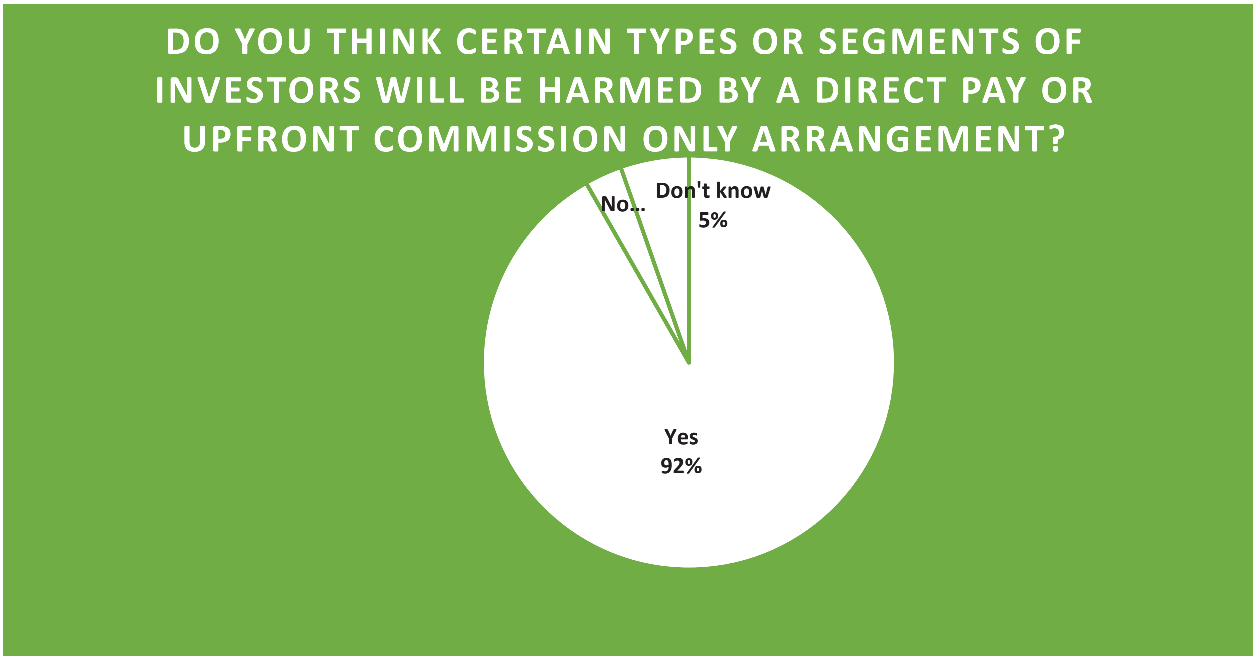
We would be pleased to discuss our submission and the survey results at your convenience. If you wish to do so, please contact the undersigned, or Susan Allemang, Director Policy & Regulatory Affairs (email: sallemang@ifbc.ca).

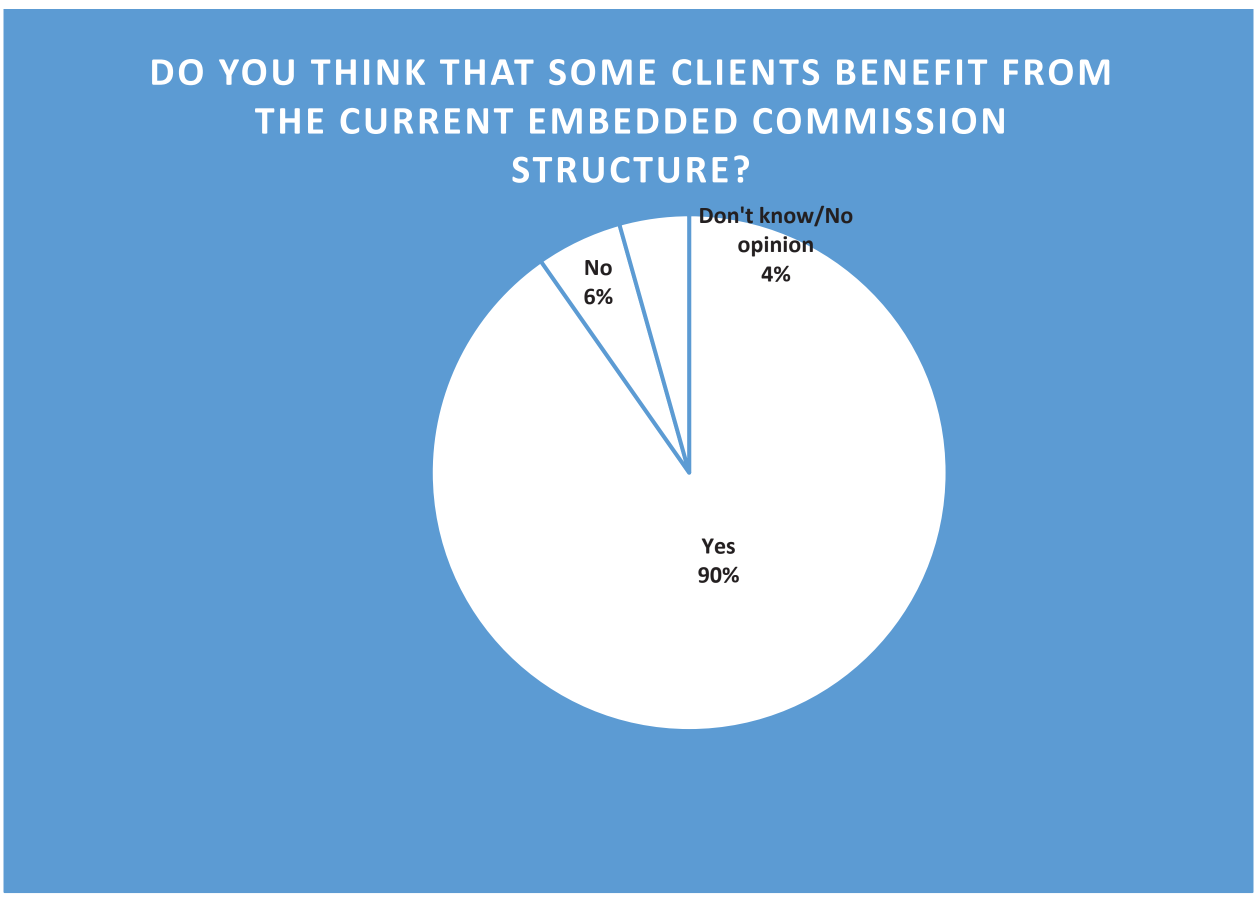
Yours truly,

Nancy Allan
Executive Director
Email: allan@ifbc.ca

Scott Findlay
President & Chair, IFB Board of Directors

Appendix


DO YOU THINK CERTAIN TYPES OR SEGMENTS OF INVESTORS WILL BE HARMED BY A DIRECT PAY OR UPFRONT COMMISSION ONLY ARRANGEMENT?
No...
Don't know
5%
Yes
92%


DO YOU THINK THAT SOME CLIENTS BENEFIT FROM THE CURRENT EMBEDDED COMMISSION STRUCTURE?
Don't know/No opinion
4%
No
6%
Yes
90%

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

comments@osc.gov.on.ca:

RE: CSA Consultation Paper 81-408 – Option of Discontinuing Embedded Commissions: These comments from a small MFDA member to be distributed to all participating CSA regulators.

We have followed with interest the various submissions made public to date with respect to this matter.

It is our position that a ban is premature at this point in time or in the near future until all investment products such as segregated funds are included in a ban if that indeed is the intention of the regulators, taking into consideration all other issues with respect to the implications and possible unintended consequences of such a ban on both the industry and the investing public.

We provide full disclosure and allow our clients the choice of either fee for service or payment through trailer fees and the question of fees has never been an issue with clients. What we have discovered over many years is that most clients are "happier" when fees come from their investments rather than directly billed, even though we show that paying through "fee for service" can potentially be more economical.

What effect elimination of trailer fees would have on our business is difficult to determine, as this is basically our main form of compensation for mutual funds. We have a significant number of smaller clients for whom, even today, trailer compensation hardly covers the cost to service these accounts, many of which require financial education and financial planning with respect to other vital areas of their lives.

It seems to have gone unrecognized that unlike other professions, such as lawyers and accountants, financial planners and most advisors are in long term relationships with clients and not just dealing with specific "one issue" matters such as a home purchase or making a will or tax preparation and being billed as such for these services. We are there for clients for all matter of financial concerns, market cycles and life transitions, etc. all covered by the current compensation model and in particular trailing commissions which might better be referred to as ongoing retainer fees.

While perhaps requiring some modification, especially with respect to a level playing field such as the capping of trailer fees and requiring service levels tied to trailer fees, the Canadian model is not broken. Many of the negative public comments are from parties that do seem removed from the realities of the "marketplace" and appear driven by theoretical and at times doctrinaire reasoning rather than practical considerations of the client advisor relationship.

Sincerely,

Linda Cartier, CFP, R.F.P., CFDS
President
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Federation of Mutual Fund Dealers
Fédération des courtiers en fonds mutuels

June 9th 2017

Alberta Securities Commission
Autorite des marches financiers
British Columbia Securities Commission
The Manitoba Securities Commission
Financial and Consumer Services Commission of New Brunswick
Nova Scotia Securities Commission
Ontario Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Registrar of Securities, Prince Edward Island
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

The Secretary
Ontario Securities Commission
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorite des marches financiers
Consultation-en-cours@lautorite.qc.ca

Dear Sirs and Mesdames:

Re: CSA Consultation Paper 81-408 – *Consultation on the Option of discontinuing Embedded Commissions*

The Federation of Mutual Fund Dealers (the "Federation") has been, since 1996, Canada's only dedicated voice of mutual fund dealers. We currently represent dealer firms with over $124 billion of assets under administration and 18 thousand licensed advisors that provide financial services to over 3.8 million Canadians and their families and as such we have a keen interest in all that impacts the dealer community, its advisors and their clients.

A. INVESTOR PERSPECTIVE:

The CSA has identified three key investor protection issues related to embedded commissions:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.

2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.
3. Embedded commissions paid generally do not align with the services provided to investors.

The Federation conducted an independent qualitative research study to explore investor perceptions of the issues identified by CSA.

- The Federation commissioned an independent, qualitative research study with a sample of mass market Canadian investors aged 25+ who are in an advised relationship with portfolios of $100,000 or less, comprised mostly of mutual funds.
- The purpose of our study was to understand the potential impact on mass market investors currently in advised relationships of the proposed CSA ban on embedded commissions.
- The study included online interviews with 30 participants and in-person interviews with 8 participants. The findings of the study are summarized in the Report attached separately as Appendix A. (Note that Appendix A refers to "Complete transcripts of online and in-person research sessions". We have not included those here, however, they are available upon request.)
- Qualitative research does not replace quantitative research; rather it provides a different perspective. This approach was chosen for its ability to dynamically probe investors' processes for considering options and making decisions. In exchange for a smaller sample size, this approach allows for actual conversations with investors (even online) about what they believe, how they interpret the questions, and why they answered the way they did. Other studies have demonstrated that the concepts of embedded fees are not well understood by investors, so we chose this approach to probe the beliefs and perceptions that inform a response. This approach also allowed us to test investor understanding and perspective.
- Based on the sample size, this approach replaces "conclusions" with "insights and findings". These insights and findings are directional and instructive as to the psychology behind investor behavior. They shed light on these issues in unique and compelling ways.
- Due to the transformative impact of the insights gathered from speaking directly to investors, we recommend the CSA conduct additional qualitative research to test its assumptions about investor behaviour.
- The qualitative insights and findings could also support a quantitative study, where the questions could be informed by this qualitative research to ensure alignment with investor perspectives.
- The findings are expressed in verbatims and narratives that provide insight into how an investor interprets, thinks about, and makes decisions about investing and related fees.
- We have highlighted a few key verbatims in this letter. The Report includes more verbatims from the participants.
- Where appropriate, we've included findings from other recent quantitative studies that are consistent with the insights gleaned from our qualitative study.

Key takeaways from the Federation's investor research study:

- In the CRM2 era, a ban, in and of itself, does nothing to increase the surprisingly low investor awareness of their fees (70% of the participants in our research study said they believe they don't pay their advisor).
- This is consistent with the BCSC Study (Part 2)[1], where 3-in-10 B.C. investors indicated they were not sure how their advisor is paid, highest among those with under $50k invested.
- Investors value payment convenience (77% of participants want the option to continue to pay indirectly).
- Investors are reluctant to change either their investing model (i.e. move to unadvised channel) or their payment approach.
- With a direct pay approach, investors may forego paying for advice and choose investing alternatives that may not support good long-term investing behaviour.
- This is also reflected in the AGF Study[2], where 24% of investors would be less likely to use an advisor if the ability to pay fees indirectly through products was discontinued and they were charged directly for advice and service. This potential "advice gap" was consistent for those with under $50,000 in assets to those with over $500,000 in assets.
- The change also needs to stand up to a cost-benefit analysis – it is not clear that the benefits of a proposed ban outweigh the costs.
- Our overall conclusion: we don't expect the outcome of banning embedded commissions to materially address the three concerns highlighted in the CSA's consultation paper.

1. CONFLICTS OF INTEREST

In our opinion, there are weak indicators of investor concern about conflicts of interest.

- Among the research participants, some investors were concerned about a conflict of interest; some felt it was a reasonable way for an advisor to be paid; while some were comfortable with indirect fees, but wanted more transparency.
    - Quote from a research participant: *"I feel ok about it. They have to get paid in some way."*
- There was no strong conclusion that this is a problem overall.
- Also, many investors favoured the convenience of indirect payment.
- While it is possible that embedded commissions may mask an advisor's bias toward recommending higher-commission funds, there has been massive standardization of embedded commissions across industry in recent years – so advisors are no longer financially motivated to recommend one fund over another in a particular category.
- Furthermore, CRM2 and POS are in place to make direct and indirect fees more transparent, although more time is necessary before investors properly digest the fee information. Our recommendation is to encourage advisors to use these regulations to demonstrate that compensation isn't a driving factor.

Federation of Mutual Fund Dealers
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2. REDUCED INVESTOR AWARENESS, UNDERSTANDING AND CONTROL

In our opinion, investors still have a low awareness of fees.

- Among the research participants, many investors continue to have a low awareness of fees related to their investments and they are not familiar with how or if advisors are paid. (70% believe they don't pay their advisor.)
- When the direct pay option was explained to them, some participants did not want to pay fees directly – they saw it as another bill they'd have to pay.
  - Quote from a research participant: *"I don't need another bill to pay directly. If anything, I'd probably drop my financial planner and then end up stopping planning my financial future if I had to pay directly."*
- CRM2 makes all dealer fees clear, including embedded commissions. But, as CRM2 is recent, ongoing compliance with CRM2 should help with future fee awareness among investors.
- Note that even with direct fees, if investors choose to pay through automatic redemptions (41% favoured this approach) or pre-authorized debit, there is unlikely to be an increase in their understanding and awareness of their fees (out of sight, out of mind). In some respects, the fee amount will just be on a different line in their Fee Report.
- Accordingly, it is unclear that banning embedded commissions will materially improve awareness and understanding of investment fees.

In our opinion, while investors desire control over their fee payment method, they are reluctant to change their investing approach.

- Investors prefer choice in how they pay for their investments. (67% of the research participants felt choice is 'Very important' to 'Important').
- Having the choice between indirect and direct payment options increased the feeling of control.
- When presented with the choice between indirect and direct payment options, most investors preferred to continue to have the indirect option. (77% want the option to continue to pay indirectly.)
  - Quote from a research participant: *"I think it should be up to the investor to decide whether or not they pay indirectly or directly."*
- A ban on embedded commissions removes choice from the client and our research shows that choice is important to clients.
- A ban also removes the opportunity for the advisor to discuss with the client the various fee structures and how choosing could impact the client. This is a learning opportunity which we view in a positive light.
- Many investors are comfortable in their advised approach to investing; some would stick with their advisor, even at a higher cost.

In our opinion, investors would be unlikely to negotiate fees with their advisors.

- Among the research participants, there was a lack of awareness that fees for financial services could be negotiated.

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- While a majority of the participants said they would be open to negotiating, when probed further they admitted they had concerns: many felt that negotiations would be awkward or inappropriate, or that negotiations would not lead to a successful outcome (lower fees). It is unclear however, whether investors with less than $100,000 would negotiate.
    - Quote from a research participant: *"I wouldn't know if it's even allowed to negotiate."*
    - Quote from a research participant: *"I wouldn't feel comfortable negotiating with my advisor. Very awkward."*

3. LACK OF ALIGNMENT BETWEEN FEES PAID AND SERVICES PROVIDED

In our opinion, investors are drawn to approaches less likely to support good long-term investing behaviour if they don't have an advised relationship.

There is the potential for an advice gap for mass market investors

- Advice gap = "the group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay".
- Research participants generally did not want to change their current advised relationships.
    - Quote from a research participant: *"I value the relationship that I have with the advisors. I would hate to have to leave and would try to work with them. I wouldn't ask my doctor for free advice so I'm willing to pay for an advisor's knowledge too."*
- In the research exercise, when investors were dislodged from their current advisor, they did not know where to find alternatives and were inclined to consult non-expert resources (i.e. internet, friends, family) for suggestions.
- They wouldn't necessarily look for the things that promote good long-term investing behaviour.
- Investors are inclined to seek another advisor offering better returns at lower fees (which they would be unlikely to find.)
- They would consider alternative investing approaches that additional probing revealed they barely understand.
    - Quote from a research participant: *"I would love to do my own online investments, but I'm overall not knowledgeable enough about stocks, or have the time to learn."*
- Participants generally said that financial literacy education and promotion of good investment behaviour are not things they'd pay for when left to find alternative investing solutions.
- Given the opportunity to build their own customized bundle of services, many participants did not choose the things that behavioural research shows are key to achieving long-term investing success.

Investment options they would consider: Robo-advice

- While 59% of research participants said they might explore robo-advice, when probed it became clear they had an almost complete lack of awareness of what it is and how it works, as well as some mistrust.
- They acknowledge they will get less service from a robo-advice platform, including with respect to healthy long-term investing behaviours.
    - Quote from a research participant: *"I don't want to trust my money and future to a computer program. Too many chances for errors."*
- This is consistent with a recent HSBC Global Study[4] that found: 1) only 7% of Canadians said they're likely to trust a robo-advisor's recommendations; and 2) only 18% of Canadians surveyed feel that robo-advisors are able to offer more accurate advice than their human counterparts.

Investment options they would consider: DIY

- While 55% of our research participants might consider a Do-It-Yourself (DIY) approach, they show considerable fear and lack of confidence in their ability.
- They also acknowledge they will have to make investment decisions on their own.
    - Quote from a research participant: *"DIY would make me nervous because I don't think I'd be committed enough. It takes a lot of work and discipline to keep up with the markets."*

Investment options they would consider: The bank

- While half of the research participants were open to working with a bank-owned dealer, others had mixed views about them.
    - Quote from a research participant: *"I'd consider it, but I think banks make enough money."*

It is not clear that banning embedded commissions will better align fees to services.

- Without knowing how dealer firms would realign their fee and service schedules, it's hard to say whether a ban would more effectively align fees and services.
- Furthermore, it's not clear that a different fee model will better align to service, as investors don't have a good sense of what various services cost or what they should pay for.

INVESTOR PERSPECTIVE SUMMARY

In our view, the outcome of banning embedded commissions will not materially address the three concerns highlighted in the CSA's consultation paper.

- Investors continue to have a low awareness of fees. We question how banning embedded commissions will materially improve investor fee knowledge, unless they are invoiced in a manner similar to a utility bill. This, however, is not a payment model that many investors will accept, and forcing them to pay these invoices like a utility bill may drive some of them to stop investing.

- Instead, if advisors continue to openly discuss fees with their clients and make good use of CRM2 and POS3 information in their client conversations, we feel this will be more effective for improving investor awareness and understanding of fees.
- Many investors are satisfied with embedded commissions and would like to have the choice of paying directly or indirectly for their investments. They did not express concerns about this as a conflict of interest. They did welcome the conversation about choice, however 77% of participants said they would choose to continue paying indirectly if given the choice.
- We support maintaining embedded commissions as a payment option for investors.
- With a direct pay approach, investors may forego paying for advice and choose options that will not support good long-term investing behaviour. They don't know where to look for options, and some do not feel comfortable with some of the most oft-cited options, including robo-advice, do-it-yourself investing, and bank-owned dealers.
- Investors with smaller accounts may have difficulty finding advisors willing to service them.
- Therefore, banning embedded commissions may impact investors' ability to achieve their financial goals.
- We also question whether a proposed ban would stand up to a detailed cost-benefit analysis of implementation.

B. ADVISOR PERSPECTIVE

The commentary that follows is not the result of The Federation's qualitative investor research. Instead, it reflects The Federation's opinion about the potential impact on advisors of banning embedded commissions.

- Absent the ability to use DSC funds, the possibility exists that a group of advisors who currently service the mass market would no longer be able to and/or willing to service those investors.
- This also has the potential to negatively affect the dealer community and its advisors who may be using DSCs to finance the cost of offering advisory services to mass market clients.

C. INTERNATIONAL PERSPECTIVE

The Investment Funds Institute of Canada (IFIC) recently released a report that says "regulators in Canada and around the world have increased their focus in recent years on regulatory reforms to improve investor protection. These deliberations have led to a growing interest in how to address potential conflicts of interest in the sale of retail investment products." While approaches range, "in the most extreme cases" four countries (out of the 16 surveyed) banned embedded commissions.

"Securities regulators and governments in other countries, including Sweden, Hong Kong, Germany, New Zealand, and Singapore, have examined this option and explicitly ruled out a total ban on embedded commissions."

"The majority of markets have made enhanced disclosure a key element of newly developed financial principles and policies. Enhanced disclosure initiatives have been implemented in every country reviewed except the U.S. The majority of disclosure has come in the form of detailed information on fees and commissions to improve transparency."

"The greatest risks of implementing sweeping reforms are the potential for triggering unintended consequences, such as higher investor costs, decreased product choice, or reduced access to advice."

SUMMARY

The UK's Financial Conduct Authority (the UK experience is repeatedly being referred to by Canadian regulators) has found that while the quality of financial advice improved after embedded commissions were banned, access to advice has become limited primarily to the more affluent.

According to the Mutual Fund Dealer Association's research report *A Detailed Look into Members Advisors and Clients*, The "mass market" – households with less than $100k in financial wealth comprises 80% of the market. If we repeat the UK experience, we could therefore disenfranchise 80% of the investing public.

Therefore, we would strongly encourage the CSA to:

- assess the impact, over time, of the fund facts documents required by the CRM2 and POS reforms prior to making any changes proposed in the Paper

- reconsider a cap on trailing commissions which have been harmonizing organically up until now, 94% at this time. We believe that harmonized trails would have the effect of voiding any related (perceived or real) conflict.

- Consider seriously the results of our research that overwhelmingly demonstrates that clients value choice.

We appreciate the opportunity to provide this submission and look forward to further discussions on these very important topics.

Regards,

Federation of Mutual Fund Dealers

Sandra L. Kegie
Executive Director

Sources:
[1] BCSC Study (Part 2): May 2017, 500 BC investors
http://www.bcsc.bc.ca/uploadedFiles/About_Us/Publications/Wave_2_Survey_Report.pdf
[2] AGF Study: April – May 2017, Conducted by the Gandalf Group, 1299 individual Canadian investors
http://www.gandalfgroup.ca/downloads/2017/Investors%20Survey%20Report%20May%202017%20Release.pdf
[3] BCSC Study (Part One): November - December 2016, 800 BC investors
https://www.investright.org/wp-content/uploads/2017/01/Investor-Readiness-for-Better-Investing-Panel-Study-1.pdf
[4] HSBC Global Study: *To Trust in Technology March-April 2017*, 12,000 individuals from 11 countries (1,001 Canadians) http://www.hsbc.com/news-and-insight/media-resources/media-releases/2017/rise-of-the-technophobe-education-key-to-tech-adoption-says-hsbc
[5]IFIC Global Regulatory Developments and Impacts April 2017 https://www.ific.ca/wp-content/uploads/2017/06/Global-Regulatory-Developments-and-Impacts-April-2017.pdf/17239/

Impact of proposed embedded commissions ban

Research study for FMFD
May 10 and 17, 2017

Research Objectives

To understand the impact on investors of the proposed CSA ban on embedded commissions

Research Methodology

- Online interviews with 30 participants
- In-person interviews with 8 participants
- Investors aged 25+ with mutual funds
- Portfolios of $100,000 or less
- Unlike a purely quantitative study, this approach:
  - Animates a decision-making process
  - Enables facilitators to pursue the participant’s thought process as it unfolds
  - Permits probing to ensure understanding by the participants
  - Highly personal in nature (as opposed to demographic)
  - Generates revealing verbatims

Key Investor Research Findings

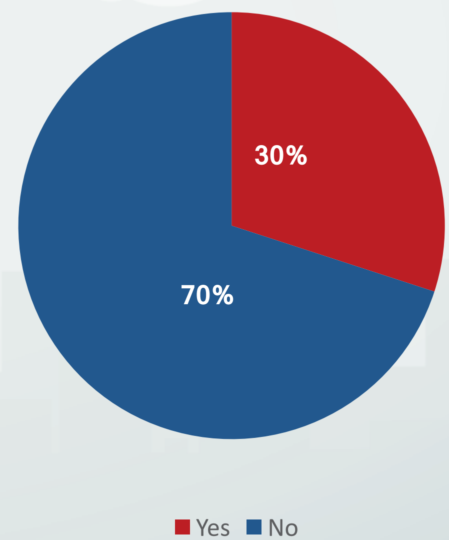
1. Low fee awareness
2. Weak indicators of concern about conflict of interest
3. Desire for control over payment method
4. Unlikely to negotiate
5. Reluctant to change investing approach
6. Lack of awareness about investing alternatives
7. Absent an advised relationship, investors drawn to approaches less likely to support good long-term investing behaviour

1 Low fee awareness

Findings

- Investors continue to have a low awareness of fees related to their investments.
- They are not familiar with how or if advisors are paid.
- 70% believe they don't pay their advisor.

Q: Do you currently pay your advisor for any of the services you receive?



INCLUDES COMMENT LETTERS

1

70% are unaware that they pay their advisor

- “No, I don’t. I’m in a situation where he’s a friend of a friend type ‘deal’.”
- “I’ve been grandfathered in so there are no charges for their business.”
- “I don't pay him, but I guess he does get paid somehow. That's a really good question I never asked.”
- “I pay no fees to meet with my bankers in regards to my investments. I do believe I pay a processing fee if I make changes.”

1 70% are unaware that they pay their advisor

- “As far as I’m aware we’re not charged for the time our advisor spends with us.”
- “My bank reviews or modifies my investments at no charge. I suppose somehow or another this fee is incorporated into my everyday banking fee.”
- “I have a few different investments with different people and companies. I really don't know how it works or how these people get paid.”

1

30% are aware that they pay their advisor, but may not be sure how or how much

- “Indirectly. He receives a percentage for looking after my portfolio.”
- “I believe there’s a fee when there’s enough cash in the account to make a Mutual Fund purchase.”
- “Makes sense. They’ve got to get paid somehow.”
- “Yes, I do pay my Financial Planner a fee. My understanding is they take a percentage on the value.”

1

30% are aware that they pay their advisor, but may not be sure how or how much

- “I pay him fees included in my investments so if I'm losing money he isn't getting paid. I believe he has a base salary but doesn't get any commissions.”
- “Our advisor receives his commission from us on a yearly basis based on the amount of holdings we have with him.”
- “I'm not sure of how much but I know I pay for these services through my investment plan at my bank.”

2 Weak indicators of concern about conflict of interest

Findings

- Even after an explanation of trailing commissions, only a small group of investors perceived that there was a conflict of interest.
- Some investors felt trailing commissions actually aligned interests.
- The convenience of trailing commissions outweighed any perceived conflict of interest.

Q: How do you feel about the fact that your advisor and his/her firm are paid by the mutual fund companies whose funds you buy?

INCLUDES COMMENT LETTERS

2 A small group of investors perceived a conflict of interest

- “Is my financial advisor just buying the ones that pay her the most commission? I have no idea.”
- “I’m familiar with management fees. But didn’t know that the mutual fund was paying the advisor – that’s a shock, I don't like it.”
- “It makes me question what my advisor's real goals are in the transaction and whether they are truly committed to me as a client.”

INCLUDES COMMENT LETTERS

2 Some investors were comfortable with indirect fees, even felt that trailing commissions aligned interests

- “I feel ok about it. They have to get paid in some way.”
- “I am more than ok with that. How else are they going to make their money? The fund management company and my advisor both benefit when my account balance goes up.”

2 Some investors were comfortable with indirect fees, but wanted more transparency

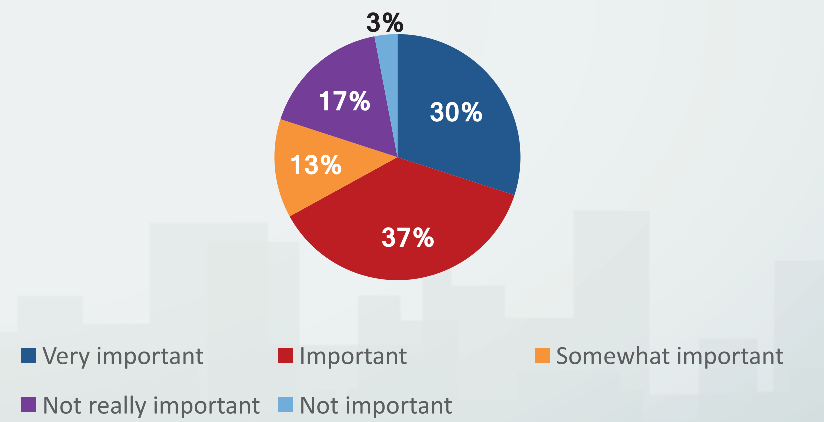
- “I suppose that's fine but I do think it should be laid out differently so that all the investors (including myself) could understand how it's done.”
- “It's important to know what my advisor is paid for each fund, so you can see if they’re pushing you to buy funds that pay them more.”

3 Desire for control over payment method

Findings

- Investors preferred to have choice in how they pay for their investments. 67% felt choice is 'Very important' to 'Important'
- Having the choice between indirect and direct payment options increased the feeling of control.
- When presented with the choice between indirect and direct payment options, 77% want the option to continue to pay indirectly.

Q: How important is it for you to have the choice to pay your advisor directly or indirectly?



INCLUDES COMMENT LETTERS

3 67% of investors felt choice is ‘Very important’ to ‘Important’

- “Choice is important for deciding because it is my money and I should feel like a part of the decision-making process.”
- “I would prefer to have a choice as it feels more empowering.”
- “Paying my advisor indirectly allows me to continue to build wealth and not worry about a surprise bill at the end of the year.”

3

33% of investors felt choice is ’Somewhat important’ to ‘Not important at all’

- “I like to have choices but if the fee would be the same I guess it wouldn't really matter to me how it was paid.”
- “Indirectly or directly … I still pay for the advice.”
- “I’ve never considered it to be an option. I just know who I choose to invest with is looking after my money and doing a good job.”

CRM2 NAVIGATOR

BLUE ID

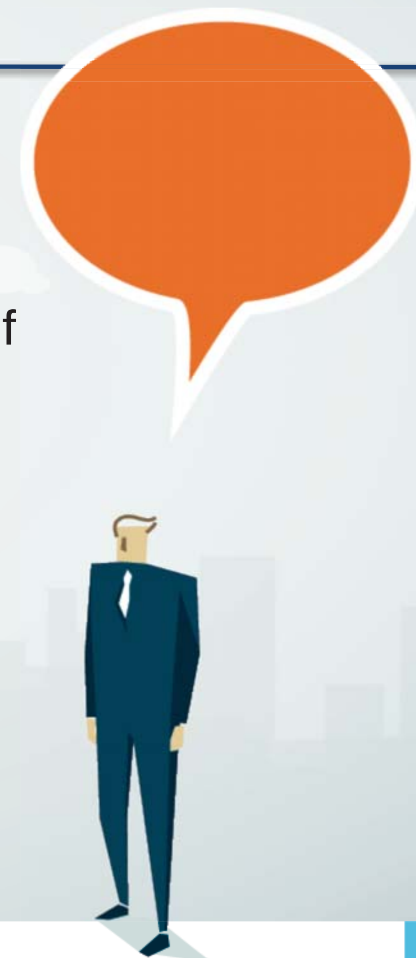
INCLUDES COMMENT LETTERS

3 Investors preferred to have the choice of both options

- “I'd prefer to continue to have both options. I think a freer market would still permit greater consumer choice.”
- “I think it should be up to the investor to decide whether or not they pay indirectly or directly.”

3 Investors preferred to have the choice of both options

- “I think the option of the two methods should be given to each customer. I think these companies would lose a lot of clients if it was forced on them.”
- “While I think paying directly may be a good fit for some individuals, I think there should be a choice provided because not everyone can afford to directly pay their advisor. I think you will see a decrease in people investing.”



INCLUDES COMMENT LETTERS

3 Having choice increased the feeling of control

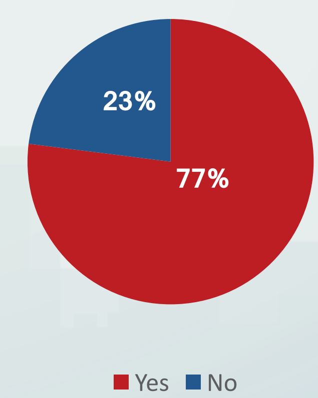
- “I feel I would have more "control" over the situation if I paid the fees directly.”
- “I want to know how much I'm paying and when. Paying directly makes me feel like I have some control.”
- “I would definitely take a hard look at any option that didn't increase my out-of-pocket expenses.”

3

77% want the option to continue to pay indirectly

- "I'm used to the current model and am comfortable with it, so I'd rather not change. It would be another bill I'd have to figure out how to pay."
- "Paying directly would make me more cautious because I would always think of win or lose."
- "I prefer the current model in terms of paying for my advisor's services. Simply, it's hard to miss money I never had."

Q: Would you prefer to continue to have the option to pay indirectly?



INCLUDES COMMENT LETTERS

3

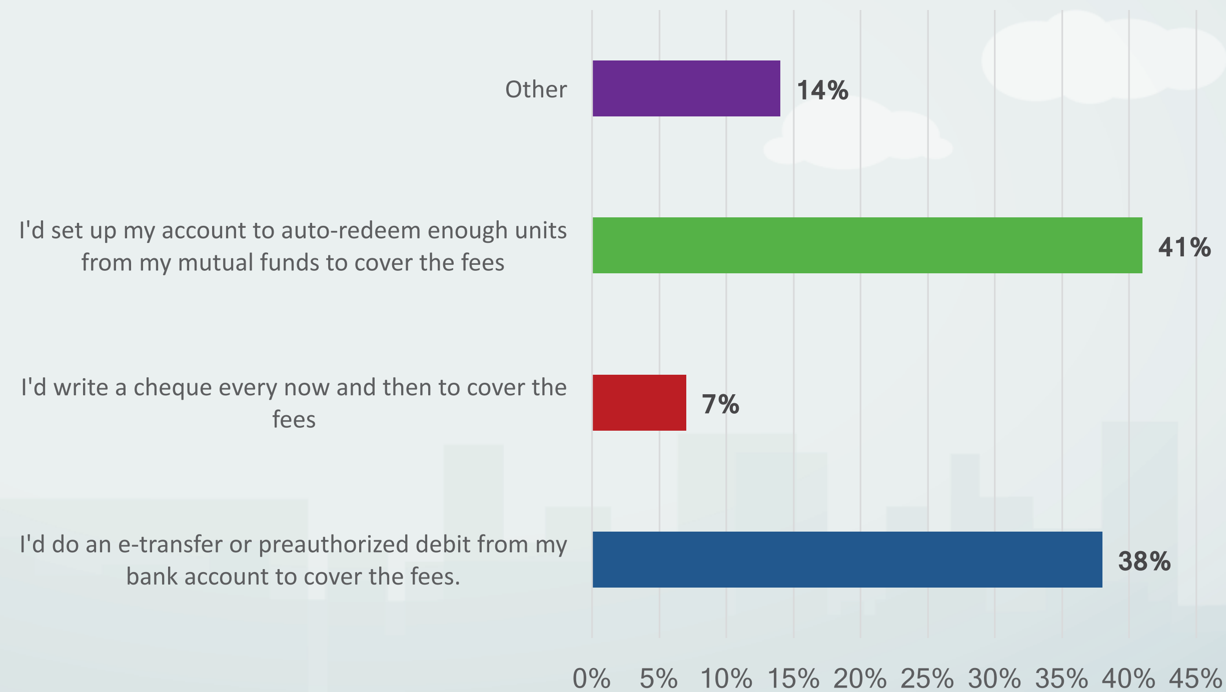
Some investors are not comfortable paying directly

- “I don't need another bill to pay directly. If anything, I'd probably drop my financial planner and then end up stopping planning my financial future if I had to pay directly.”
- “I don't like it. I like the invisible fees. It’s less I have to worry about.”
- “I don't think I like it. If a person is paid upfront for services, where is the incentive to provide a proper service going forward?”

INCLUDES COMMENT LETTERS

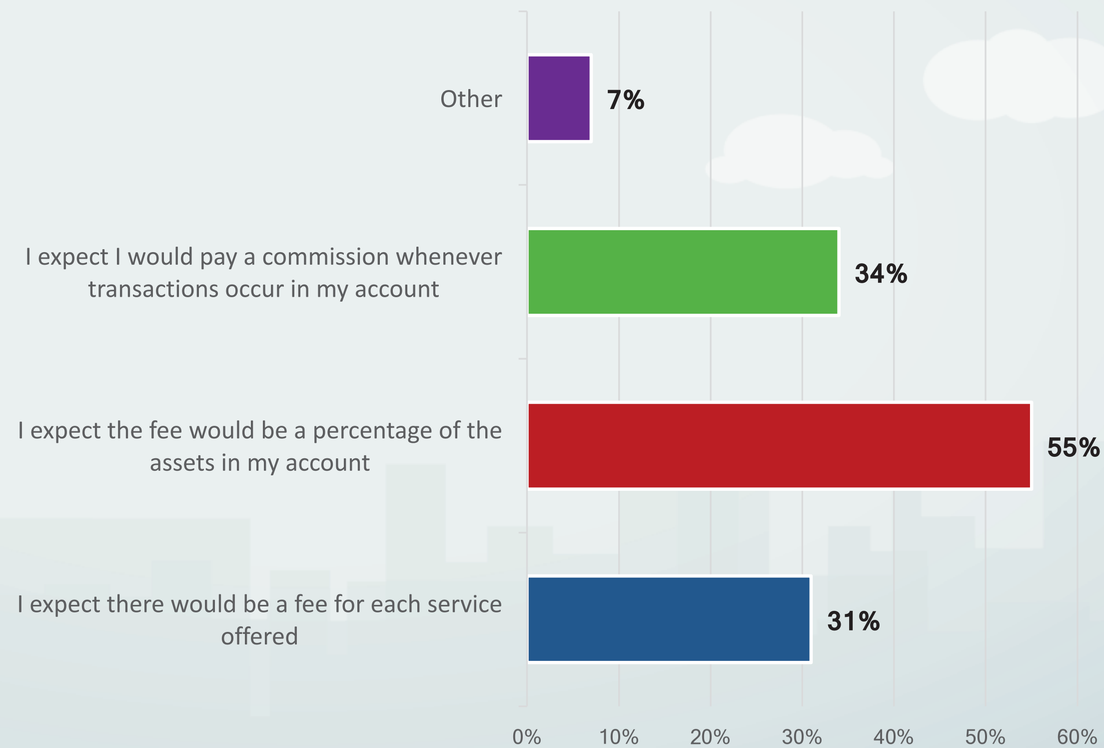
3 With a direct pay option, they'd prefer to auto-redeem units or do an e-transfer

Q: How would you prefer to pay your advisor?



3 With a direct pay option, 55% expect the fee to be a % of their assets

Q: On what basis would you expect the fees in your bundle to be calculated?



4 Unlikely to negotiate

Findings

- Investors were unsure if such fees could be negotiated.
- Investors felt negotiations would not lead to a successful outcome (lower fees).
- Investors felt that negotiations would be awkward or inappropriate.

Q: Would you consider negotiating with your advisor?

4 Investors were unsure if such fees could be negotiated

- ”No, because I'm sure they have set limits or rules.”
- “I wouldn't know if it's even allowed to negotiate.”

4 Investors felt negotiations would not lead to a successful outcome (lower fees)

- “I wouldn't see the point in arguing over what's already been labelled as a 'set rate’.”
- “I would try but I generally don’t think of advisors as a business that bartering works.”
- “I'd try, but like everything with a bank, 15% in my favour, and 85% in theirs.”

4 Investors felt that negotiations would be awkward or inappropriate

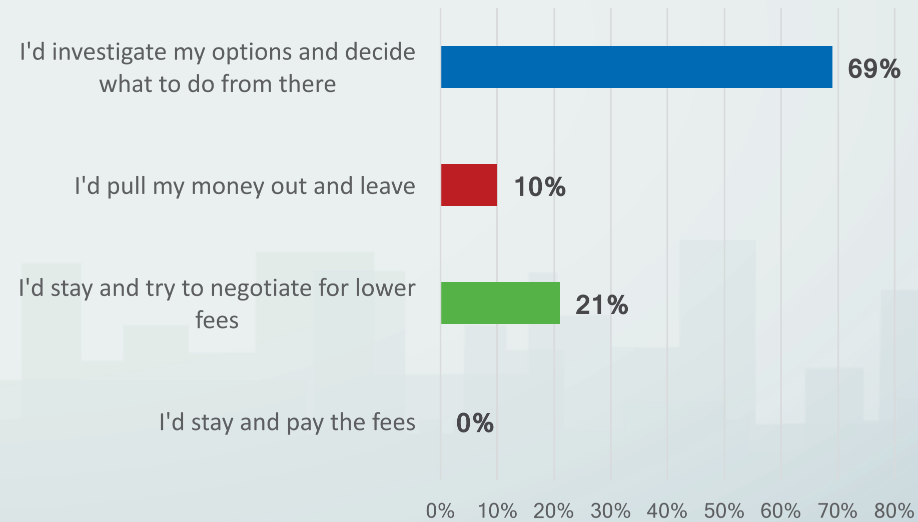
- “I wouldn’t feel comfortable negotiating with my advisor. Very awkward.”
- “No, I don't usually feel comfortable negotiating for services in a professional atmosphere.”

5 Reluctant to change investing approach

Findings

- Many investors are comfortable in their advised approach to investing.
- Some investors would stick with their advisor, even at a higher cost.
- Some investors would consider alternatives.

Q: Which would you most likely do if your advisor couldn't provide the services you wanted and needed at a reasonable cost?



INCLUDES COMMENT LETTERS

5 Many investors are comfortable in their advised approach

- “I like the connection and familiarity, like having the same doctor for a long time.”
- “I value the relationship that I have with the Advisors. I would hate to have to leave and would try to work with them. I wouldn't ask my Doctor for free advice so I’m willing to pay for an Advisor's knowledge too.”
- “I don’t want to move.”

5 Some investors would stick with their advisor, even at a higher cost

- "If I couldn't find a better price then I'd stay and suck it up."
- "If some things aren't available, that's okay – like other things in life, you don't always get what you want."
- "I'd shop around for someone else. Then I'd weigh the cost of changing advisors."

5 Some investors would consider alternatives

- "I'd consider leaving, but it would depend on how much paperwork and runaround there is."
- "If my advisor isn't willing to work with me in regards to the fee structure I'd consider pulling my money and looking elsewhere."

5 Some investors would consider alternatives

- “I’d hate to lose my relationship with my advisor but business is business. If I can't afford it, I’d have to shop around or maybe choose to self-direct my investments.”
- “Cost is not the only factor. A large part of it is feeling valued as a customer. If I’m not worth your time, you’re not worth my money. I’ll pay for a service if I believe it's being earned.”

6 Lack of awareness about investing alternatives

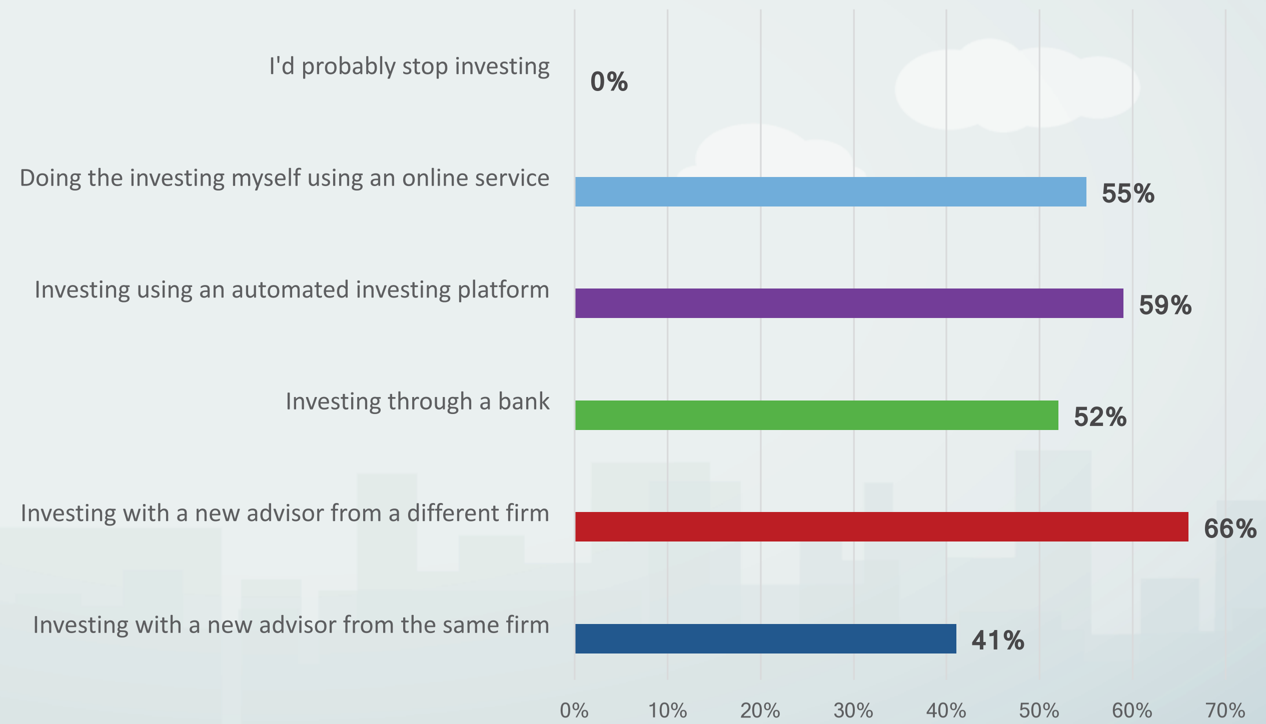
Findings

- Investors have limited awareness of investing alternatives.
  - Lack of awareness and lack of trust around robo-advice
  - Mixed views about bank-owned dealers
  - Fear of DIY approach
- Investors are not aware of reliable sources to compare investing alternatives.

6 Investor reactions to alternative approaches to investing

Q: Which of these options would you most likely do if your advisor couldn't provide the services you wanted and needed at a reasonable cost?

Please check all the alternative ways to invest that you would consider.



6 59% willing to consider robo-advice, but an almost complete lack of awareness

- "I am not aware and it seems risky."
- "I am not that familiar with online investing platforms, but would not feel comfortable investing that way."
- "I am not familiar with these platforms, and no, I prefer to talk face to face."

6 Lack of trust around robo-advice

- “I don't want to trust my money and future to a computer program. Too many chances for errors.”
- “I would not feel comfortable. How accurate is it? Who do I blame if something goes wrong?”
- “No, I need to put my trust in someone not an algorithm.”
- “Yes [I’d invest with a robo-advisor], if there was proof that they worked.”

6 52% willing to consider an advisor with a bank-owned dealer, but mixed views about them

- “We have a good relationship with our bank, so that would be an option.”
- “I don't think you get as much juice out of a bank. The juice is not worth the squeeze.”
- “I trust my banker to lead me in the right direction. They do offer full explanations.”
- “I’d consider it, but I think banks make enough money.”

6

55% would consider Do-It-Yourself (DIY), but investor sentiments show considerable fear

- “This would take a lot of work and knowledge. I’m a long way from that.”
- “Probably not - I know a few people who have done this and lost money.”
- “No, I don't have enough knowledge or skillset to do that.”

6

55% would consider Do-It-Yourself (DIY), but investor sentiments show considerable fear

- “I know how to research a vacation, but I don't know how to research this stuff.”

- “DIY would make me nervous because I don't think I'd be committed enough. It takes a lot of work and discipline to keep up with the markets.”

7 Absent an advised relationship, investors drawn to approaches less likely to support good long-term investing behaviour

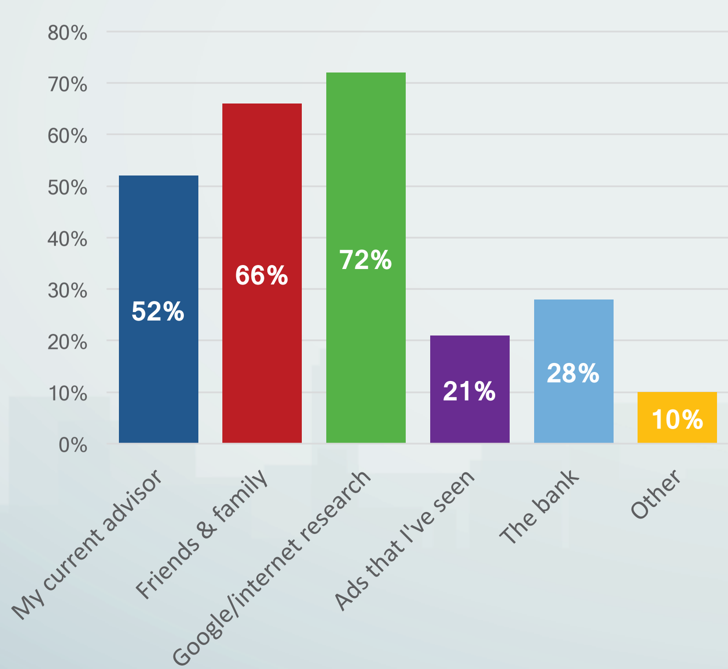
Findings

If an advised relationship was unavailable:

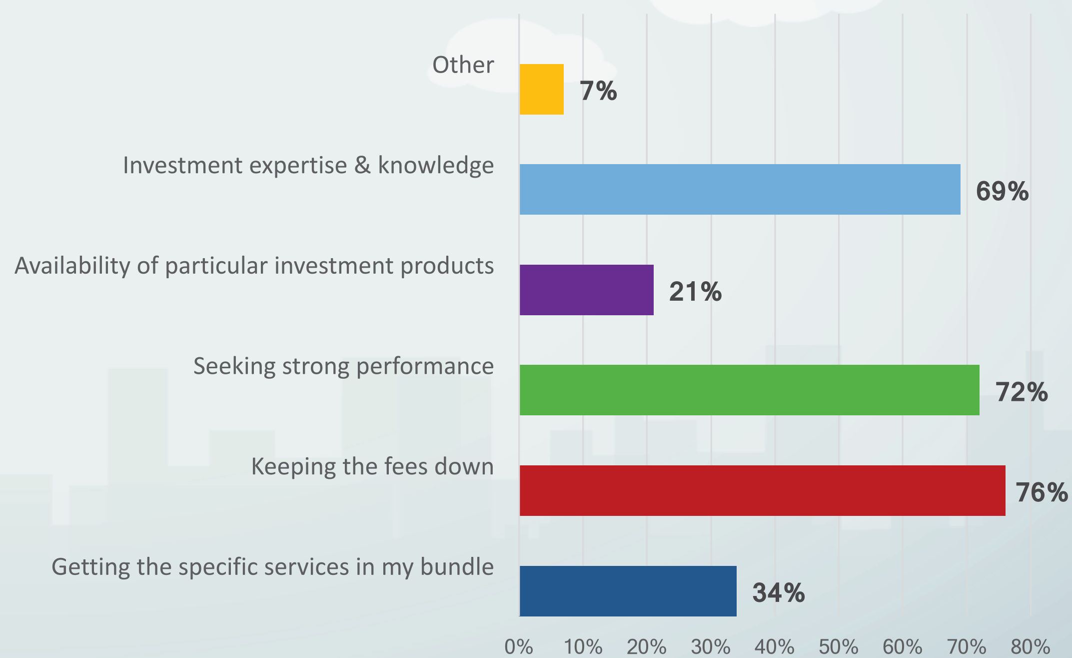
- Investors inclined to consult non-expert resources (i.e. internet, friends, family) for suggestions.
- Inclined to find another advisor offering better returns at lower fees (which is unlikely).
- Failing that, inclined to turn to robos and DIY approaches that they barely understand.
- Understood that doing so would result in lower levels of service, especially in regards to financial literacy education and promotion of good investment behaviour, which they didn't consider "fee-worthy".

7 Growing the advice gap for mass market investors

Q: Which sources would you trust to provide suggestions on alternative ways to invest?

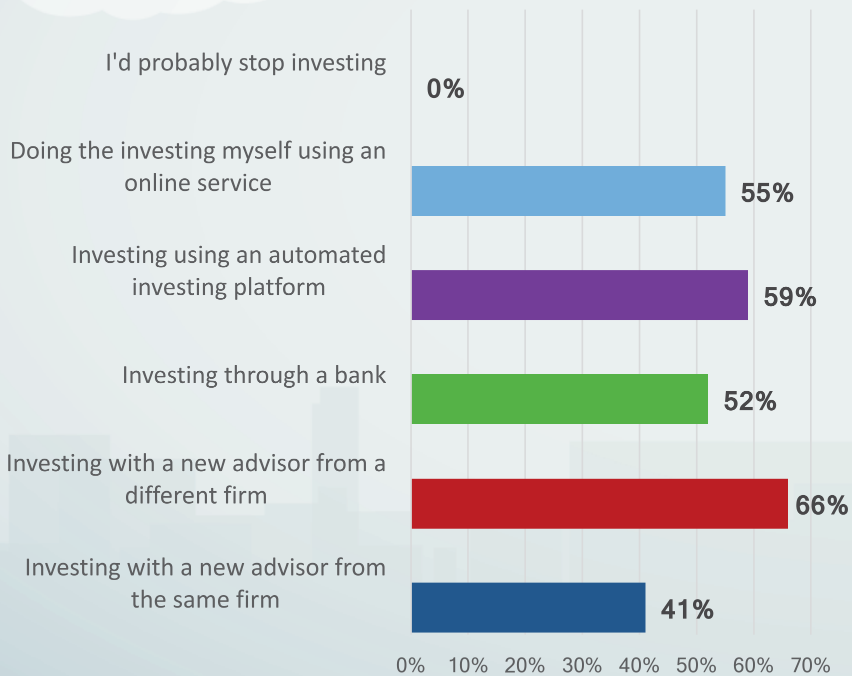


Q: What objectives would guide your search?

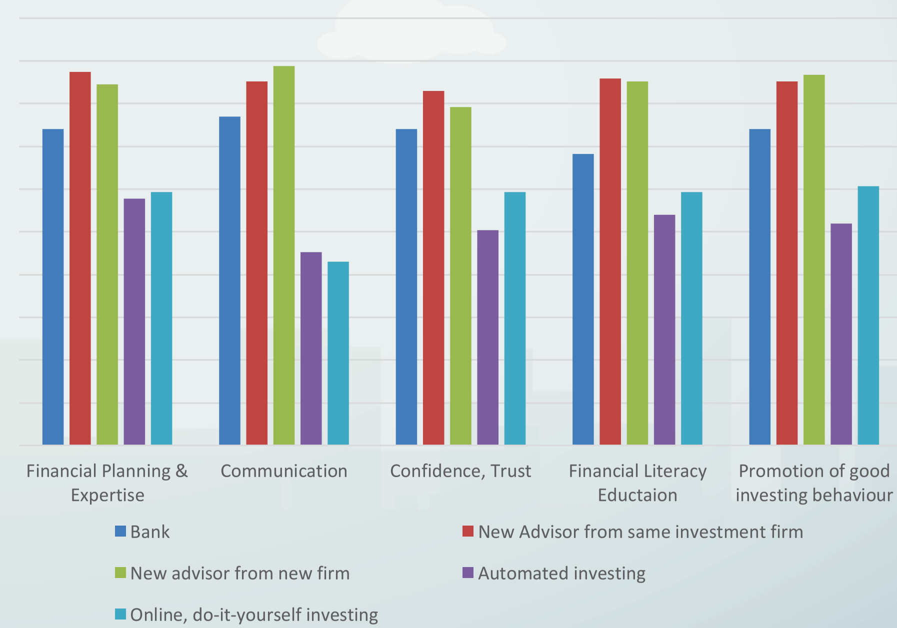


7 Growing the advice gap for mass market investors

Q: Which investment alternatives would you consider?



Q: What services do you think you would get from the following investment approaches?



CRM2 NAVIGATOR

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7 Many investors uncertain about their investment options

- "I have no idea on what other option other than picking what agent I liked and just signing an agreement."
- "I don't know any other options for investing."
- "I have no clue."

Q: After gathering all the information, what ways to invest would you consider? Please name all the possible approaches you would consider.

7 Investors inclined to consult non-expert resources

- “If I received advice from friends or family including internet searches, I would take this to my advisors and act on their advice.”
- “I would find an investment advisor who was referred to me through a trusted source.”

INCLUDES COMMENT LETTERS

7 Inclined to seek another advisor offering better returns at lower fees

- “I will consider to pay for the best price and the best yield for my portfolio.”
- “I'd look for the better investment with the lowest fees.”

CRM2 NAVIGATOR

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7 Would consider approaches they barely understand

- “Investing in private equity locally. I would be very cautious of this because it would be tough not to get involved and 'meddle' with the operation I was invested in.”
- “I guess that would be day trading, or playing the stock market by myself because I do not have the required knowledge or expertise.”

7 Some options do not support good long-term investing behaviour

- “Using a financial advisor. Self directed through online sources. Putting everything into government bonds or T-bills. Not investing at all and just putting it in a savings account.”

INCLUDES COMMENT LETTERS

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Appendix

- Complete transcripts of online and in-person research sessions to be provided in PDF format

Sun Life GLOBAL Investments

ILLUMINATING

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June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Re: CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Dear CSA members,

We are writing to provide our comments on the Canadian Securities Administrators' ("CSA") *Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions*, published on January 10, 2017 (the "Consultation Paper").

At Sun Life Global Investments, we firmly believe all Canadians deserve access to financial advice. They also deserve to have a choice in how they pay for that advice based on personal preference and financial circumstance.

The embedded compensation model offers easy and affordable access to financial advice. It's especially effective for those with less money to invest.

We agree that embedded compensation has the potential to create conflicts of interest.

We do *not* think the potential for conflict of interest means embedded compensation should be banned.

The goal of this letter is to persuade the CSA to consider the following ideas for reform instead of banning embedded compensation:

- A service agreement and enhanced relationship disclosure between advisors and clients
- A standardized naming convention for different types of funds based on compensation structure
- A ban on distributing funds with embedded compensation through channels that do not offer advice
- Implementation of "CRM3" cost disclosure

We've set out primarily to address the third of the Consultation Paper's stated objectives, which is to "obtain feedback on alternative options that could sufficiently manage or mitigate the identified investor protection and market efficiency issues." Our proposals focus on investor protection and to a lesser extent, market efficiency.

Following the description of our proposals, we summarize our views on why we don't think it would be wise to ban embedded compensation. Here, we seek to contribute to the first of the CSA's stated objectives, which is to "assess the potential effects on investors and market participants of discontinuing embedded commissions."

While we acknowledge the CSA's concerns with embedded compensation, we believe the embedded compensation model has played a significant role in growing our country's financial wealth and health, and that it will continue to do so for decades to come.

ALTERNATIVES TO A BAN

We believe the concerns raised in the Consultation Paper can be addressed without banning embedded compensation. We propose these reforms as a means of continuing to give clients the choice of paying for advice through compensation built into the cost of financial products.

A service agreement and enhanced relationship disclosure between advisors and clients

Dealers should be required to enter into an agreement with each client that explains their compensation options (e.g., embedded and fee-based). The agreement would also state the services the client should expect to receive.

The advisor should be required to review with the client both embedded compensation and fee-based options for paying for advice and explain the advantages and disadvantages of each. The advisor would also describe the cost of advice and review the services the client can expect to receive.

The client and the advisor would sign the agreement to confirm the compensation option chosen by the client and the commitment from the dealer and advisor to provide the services. The advisor assigned to the client would then have the ongoing obligation to provide the agreed upon level of service.

The service agreement and the additional relationship disclosure would significantly enhance client awareness and understanding of compensation issues. It would put the client directly in control of the choice between fee-based and embedded compensation.

Clients could determine which compensation options and service packages are the most convenient and cost-effective for them. The service agreement would also give the client a clear basis for comparing the costs associated with different fund companies and the service options provided by other dealers. Empowering clients in this way will add to the market forces driving the industry toward market efficiency and value for clients.

The service agreement would give clients a clear commitment describing the services they will receive. It would make the dealer and the advisor accountable to deliver the agreed-upon services.

All of this will enhance the professionalism of advisors and increase public confidence in the industry.

A standardized naming convention for different types of funds based on compensation structure

Industry standards should be adopted for fund companies to identify if a fund or fund series is fee-based or has embedded compensation. This should be done in a way that clients can readily understand.

A ban on distributing funds with embedded compensation through channels that do not offer advice

It may seem like an obvious piece of investor protection, and yet currently, there don't appear to be adequate systems in place to prevent investors from buying funds that have the cost of advice embedded, even when the distribution channel doesn't allow the provision of advice. Series A mutual fund units, for example, should not be sold in channels where no advice is provided.

Implementation of "CRM3" cost disclosure

We support IFIC's announcement on April 25, 2017 regarding moving to "CRM3" cost disclosure. This would mean providing clients with clear information about the management expense ratio and its components. This will give clients a better understanding of the total cost of ownership of their investments. It will also enhance discussions between advisors and clients and give clients the additional information they need to better understand the compensation disclosure they receive under CRM2.

These reforms effectively address the CSA's three key concerns about embedded compensation:

- **Conflicts of interest** – Explicit relationship discussions focused on compensation options together with a service agreement that sets out those options will increase the visibility and client awareness of embedded compensation. This additional visibility will continue to put downward pressure on funds that have embedded compensation levels beyond industry norms, reducing the potential for conflicts of interest.
- **Awareness, understanding and control** – Taken together, the service agreement, the more detailed compensation discussions and the CRM3 cost disclosure, will significantly heighten client awareness and understanding of compensation costs. The standardized naming conventions will make it easier for clients to understand their options and assess the one that is right for them. Avoiding a ban gives clients more choice and control in how to pay for advice. Clients will continue to have a simple measure of the total cost of their investment that they can readily compare across other mutual funds.

- **Clients getting what they pay for** – The service agreement gives clients a clear and enforceable commitment that they will receive the service for which they are paying.

WHAT'S WRONG WITH A BAN?

We now turn to the reasons we don't believe a ban on embedded compensation is the best way to address the CSA's concerns. We recognize the CSA and other industry participants are likely familiar with the general arguments. Our point is simply to contextualize the proposals above by isolating what we believe are the most important reasons to maintain the embedded compensation model as a choice for investors.

The following key questions posed by the Consultation Paper are just some of those we seek to address with our comments:

- "Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances?"
- "Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?"
- "What effect do you think the removal of embedded commissions will have on investor experience and outcomes?"
- "Do you think this proposal will lead to an advice gap?"

1. Embedded compensation and conflict of interest

Dealers and advisors
The Consultation Paper argues that a ban is warranted because embedded compensation creates conflicts of interest for both fund companies and for dealers and their advisors. However, **the fact that the compensation is embedded doesn't create a conflict of interest. A conflict arises if, all other aspects of the two funds being equal, the embedded compensation for one fund is higher than another similar fund thereby providing an incentive for an advisor to recommend the fund with the higher compensation.** It is these

differences in compensation identified in the Cummings[1] and Brondesbury[2] reports that give rise to potential conflicts, and drive the concerns outlined in the Consultation Paper.

Research says that market forces have reduced embedded compensation levels in recent years. In 2016, across the industry, 94% of equity and balanced funds paid 100 basis points (bps) or less in trail compensation (in the previous year 90% of equity and balanced funds paid 100 bps or less in trail compensation).[3] With only a small percentage of funds paying more than 100 bps, compensation is less likely to influence product recommendations. In addition, many dealers manage their product shelves to avoid offering funds that provide compensation levels outside of industry norms.

Research from PricewaterhouseCoopers concluded that there is no significant evidence that embedded compensation leads to conflicts of interest that influence the behaviour of advisors.[4]

Fund managers
The Consultation Paper states that fund managers are more focused on attracting assets by paying high levels of compensation to dealers and advisors, than on strong performance for investors. It goes on to state that fund managers may have ceased even trying to outperform.

We disagree. The PricewaterhouseCoopers research found no evidence that compensation levels lead to suboptimal fund performance.[5] Fund flows and compensation levels say little or nothing about a fund manager's desire to perform.

Fund managers aggressively compete on performance for their clients and strive to win awards and recognition for strong performance. Fund managers take their fiduciary obligations and professional responsibilities very seriously. An increasing degree of alignment in compensation levels across fund companies[6] has developed in recent years. This is strong evidence that most fund companies aren't using compensation levels to incent advisors to attract flows.

Compensation that is above industry norms will necessarily reduce a fund's net investment performance and make the fund's performance less competitive. Advisors and clients are looking for the top performing funds. Funds with performance above the median attract a higher percentage of sales.

From its inception in 2010, SLGI's strategy has been to earn our clients' business by developing excellent products and establishing a strong record of performance, with downside protection as

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[1] Douglas Cummings, et al, "A Dissection of Mutual Funds Fees, Flows and Performance," October 19, 2015
[2] The Brondesbury Group, "Mutual Fund Fee Research," spring 2015
[3] Internal Analysis from the Investment Funds Institute of Canada.
[4] Pricewaterhouse Coopers, "Economic Impact Assessment of Banning Embedded Commissions in the Sales of Mutual Funds," June 2017, page iii
[5] PricewaterhouseCoopers, page 46
[6] See note 4 above

a core competency. From the outset, we have paid industry standard for embedded compensation. Compensation is not our focus and it has not been a factor in our success.

2. Many clients value the embedded compensation option

Many clients like having the cost of financial advice included in the cost of the financial products they buy. It gives them a simple, effective, and affordable option to pay for financial advice. It gives them a clear view of the total cost of their investments. We see no reason to take that option away. The total cost of owning a mutual fund, including the cost of advice, is less prominent and more difficult to determine in a fee-based model[7] because it requires the client to add the fund level costs reported by the fund company to the cost of advice and distribution provided in a separate report from their dealer.

A recent study by Ipsos-Reid concluded that:

> "The preferred method for being charged for financial advice is for it to be included in the purchase price of investment products."[8]

In that same study, 35% of clients preferred to have the cost of advice included in the cost of investment products they buy.[9] That was the most popular option among the survey respondents. In the 2016 Pollara survey, just over half (54%) said they would prefer to compensate their advisor through bundled fees, while 37% would prefer to pay a direct fee.[10] Clients should continue to have this option.

3. Issues with fee-based compensation

The Consultation Paper suggests that, in a fee-based compensation system, units could be redeemed from the client's account to pay the fees. While redeeming units at the fund level is a convenient way for clients to pay the fees that they have agreed to with their dealer, it will not work in all situations. This option is not available with many types of locked-in accounts and has negative tax implications for registered accounts such as RRSPs or RESPs. For these accounts, clients must pay fees to their dealer by direct payment like cheque or credit card or by redeeming other assets. This may be inconvenient for them and may create a financial burden.

Fee-based compensation likely has its own conflict of interest issues.[11] The Brondesbury report commissioned for the OSC notes:

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[7] Pierre Lortie, "A major setback for retirement savings: Changing how financial advisers are compensated could hurt less-than wealthy investors most," University of Calgary, SPP Research Papers, volume 9, Issue 13, April 2016. Pages 26-27, 29. See also PricewaterhouseCoopers, page 40
[8] Ipsos-Reid, "Canadians and Investment Advice, 2016" page 13
[9] Ipsos-Reid, page 13
[10] Pollara, 2016 "Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry," page 28
[11] PricewaterhouseCoopers, pages 46 and 47

> "While we know that commission has its biases, we also know that FB [fee-based compensation] likely creates some biases. These biases are not as well established as those for commission; but a few are strongly suspected (e.g., reverse churning, more sale of proprietary products). They require further study. …we need to know a lot more about the impact of FB compensation compared to commission, particularly in relation to amount of investable assets."[12]

Brondesbury also says that it is unclear whether the fee-based model will improve outcomes for clients:

> "But while removing commission lowers product cost, advisory fees rise as a means of paying for the cost of service. There may also be new or increased administrative fees, higher costs on margin accounts and lower payments on cash balances. Based on available evidence about fee increases, it is not yet clear whether moving from commission to fees will result in a net improvement in the overall return to the investor, although it is likely that lower cost products will outperform those bought under a commission-based regime, given the negative impact of expenses on investment returns."[13]

> "The impact of fee-based compensation has not been sufficiently studied yet."[14]

A ban may not eliminate conflicts of interest. Since it isn't clear that clients will be better off in a fee-based model, they should continue to have the option to choose the embedded compensation model.

4. The value of advice

SLGI believes in the value of professional financial advice. The vast majority of advisors are committed, qualified professionals who are dedicated to serving the interests of their clients. The Consultation Paper questions whether clients are getting value for the embedded compensation they pay. The 2016 report by CIRANO demonstrates the value that advisors provide in wealth creation:

> "…the presence of a financial advisor proves its effect as soon as the first four years. The additional value reaches 290% for a household with an advisor for fifteen years or more: 3.9 times the value of assets of equivalent non-advised households."[15]

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[12] The Brondesbury Group, "Mutual Fund Fee Research," spring 2015, page 42
[13] Brondesbury, pages 74-75
[14] Brondesbury, page 75
[15] Claude Montmarquette et al., "The Gamma Factor and the Value of Investment advice," CIRANO Institute, August 2016, page 41

Advisors do a lot to add value for their clients. They help clients develop savings discipline. They support clients in rebalancing, budgeting, debt management, and planning for retirement.

Clients also see the advisor's role more broadly. In a recent study, "…fewer than half of clients believe investing services represent 30% or more of the value of an advisor."[16] Any policy development relating to the value of advice needs to reflect all aspects of the services advisors perform for their clients.

5. Access to advice

SLGI has many clients with smaller accounts. These clients in particular need professional advice to help them save adequately for retirement and invest effectively.

Embedded compensation provides these clients with an affordable way to get professional financial advice. It also helps to facilitate access to advice and overcomes the reluctance of many clients to pay directly for financial advice. Many clients prefer embedded compensation.[17]

Some clients are reluctant to pay for advice directly.[18] If embedded compensation is eliminated, we believe that many clients would decide not to invest at all. For others, the advice may become unaffordable.

The cost of advice will likely increase for clients with smaller accounts as the embedded compensation is no longer present as a constraint on fee-based pricing. Fees for smaller accounts will likely rise as dealers must set fee levels for smaller accounts to get sufficient revenue to cover their costs.

Dealers will also target clients with larger accounts and increase pricing on less profitable, smaller accounts.[19] Clients who want to invest may not be able to find a dealer to service them because their account balance is below higher minimum account thresholds set by the dealers.

> "People with less wealth and less income will find it harder to get advice for two reasons. First, it is difficult to generate sufficient income to cover costs, solely from sales of investments to this group. Second, in a fee-paying regime, there is evidence that they are less willing to pay fees to cover their cost of service."[20]

Embedded compensation bans have led to significant advice gap problems in other jurisdictions as dealers and advisors increase account minimums and focus on wealthy clients who are

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[16] Ipsos-Reid, "Canadians and Financial Advice, 2016" page 8
[17] Ipsos-Reid, "Canadians and Financial Advice, 2016" page 13
[18] Lortie, pages 18 and 19
[19] Lortie, page 21
[20] Brondesbury, page 76

prepared to pay directly for advice.[21] Some jurisdictions decided against a ban because of concerns about an advice gap.[22]

6. Robo-advice and passive investments won't prevent an advice gap

The Consultation Paper sees robo-advice and passively managed products as an answer to the risk of an advice gap. However, there is considerable evidence that many clients want face-to-face advice and are unlikely to use a robo-advisor.

- A recent Ipsos-Reid study found that client interest in Canada in using robo-advice is low – 18% of Canadians said they were likely (a rating of 6 or more on a 10 point scale) to use a robo-advisor (only 5% rated their likelihood 8 or more on a 10 point scale). Put another way 82% of Canadians said they were unlikely to use a robo-advisor.
- Of the clients who were interested in using a robo-advisor, most did not see it replacing their existing advisor.[23] The most common reasons for not using a robo-advisor were that clients wanted to interact with a person and valued face-to-face interaction with their advisor.
- Many elderly clients with small accounts will have limited knowledge of technology. They would have difficulty in accessing the services of a robo-advisor.

Clients with smaller accounts should continue to have choice in how they access financial advice, rather than being left with limited options that they don't want or value.

Additionally, clients with smaller accounts should be able to choose either passively or actively managed funds. On one hand, passive strategies are generally more cost-efficient and may outperform in strong markets, as has been the case more recently. On the other hand, active investment strategies, on average, have generated superior returns, after fees, over longer periods in a broad range of asset classes.[24] They have also, on average, generally produced a better reward relative to risk.[25]

Downside protection also plays an important role within the emotional dimension of investing. Looking beyond individual funds at the overall account level, research has found that "active investments produce superior investor returns over long time periods, while passive investments have better investor returns over shorter periods." This research attributes "active higher investor returns to the tendency of these investors to stay invested for longer periods."[26]

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[21] Lortie, pages 22 to 25, 34, 35
[22] Lortie, page 9. PricewaterhouseCoopers, pages 68-70
[23] Ipsos-Reid, pages 29 -32. A recent HSBC study had similar findings: HSBC, "Trust in Technology Report – Country Report/Canada," News Release, May 24 2017
[24] Internal SLGI analysis based on data from Morningstar Direct
[25] Internal SLGI analysis based on data from Morningstar Direct
[26] http://www.wealthmanagement.com/industry/does-active-produce-better-investor-behavior

Passive investments essentially delegate the investment management function to the end investor. As opposed to evaluating a professional for their expertise and overall alignment, the investor is now tasked with evaluating markets. Clients with smaller accounts without personalized financial advice are unlikely to be well equipped to perform this function. In a passive strategy, clients are exposed to significant risk, especially during periods of market downturns and volatility.

CONCLUSION

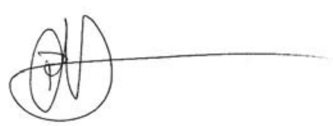
Taken together, we believe the alternative reforms outlined above would effectively address the CSA's primary concerns about embedded compensation. Please consider our suggestions, particularly our recommendation for a service agreement and enhanced relationship disclosure between advisors and clients.

A ban on embedded compensation would risk leaving many clients without adequate access to personalized financial advice and without the support they need to save for retirement.

We urge the CSA to continue to give clients the choice of having their advice fees included in the cost of their financial products.

Thank you for the opportunity to participate in the consultation. I would be pleased to discuss any aspect of this letter with you.

Sincerely,



Rick Headrick

ABOUT SUN LIFE GLOBAL INVESTMENTS

Sun Life Global Investments offers Canadians a diverse lineup of mutual funds and innovative portfolio solutions, empowering them to pursue their financial goals at every life stage. We bring together the strength of one of Canada's most trusted names in financial services with some of the best asset managers from around the world to deliver a truly global investment platform. Sun Life Global Investments manages more than $18 billion on behalf of institutional and retail investors from coast to coast and is a member of the Sun Life Financial group of companies.

Friday, 09 June 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
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Dear Sir/Madame

Re CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

The consultation paper raises the three main investor protection and market efficiency concerns of Canada's securities regulators:

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;

2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and

3. Embedded commissions paid generally do not align with the services provided to investors.

With regard to point 1

The paper focuses on the presumption that embedded commission focuses fund management on sales relationships as opposed to performance and the impact of embedded commission on fund/security selection. I have no disagreement with these points and they are well backed up empirically and anecdotally.

But, the impact of transaction remuneration, embedded or otherwise, does in fact impact the advice process at a much deeper and earlier level, and this is something the paper fails to address. Investment advice should be driven by a process that incorporates a number of inputs: financial needs (size and timing), existing assets, future savings, risk profile, asset class/security risk return profiles and construction, planning and management disciplines. Transaction remuneration, whether embedded or not, and I include internal transfers, overrides the integrity of the advice process by focussing on the returns from transactions and hence advice can be swayed by sales imperatives. The product is not the process, but the output and needs to be treated as such.

A continuing and fundamental weakness of Canadian regulation of retail financial services is that it cannot adequately remove itself from the transaction frame through which it has regulated and assessed regulation. Investors are still assumed to be accessing advisors for product/security recommendations and it is the investor that is assumed to be knowingly retaining discretion over the investment decision and the frame in which those decisions are made.

The paper proposes changes that, in as far as they go, would better serve a best product standard. This is very much in keeping with the earlier consultation paper discussing best interest standards and targeted reforms. It appears from the paper that the CSA is favouring better definition and greater discipline in a key area of retail financial services that it considers to be focussed on product distribution and advice associated with product distribution. It should instead be focused on advice, irrespective of the product.

The removal of embedded commissions, in the limited form proposed (retention of internal transfers and other remuneration conflicts) without a supporting statutory best interest standard (with fiduciary roots) may well create some unstable dynamics in the industry itself.

With respect to point 2

Agreed, in the sense that investors need to know the costs and value of advice in order to decide whether they need and want the advice and to seek other services in the market place if necessary.

However I am not so sure that investors are going to gain the necessary insight into or be able to control dealer compensation costs by virtue of the proposed changes. Many of the dealer costs are costs related to the process of product distribution and not advice and suffer from the same problem as that noted in point 3.

The paper appears to assume that it will be consumers who, once aware of product costs, will initiate the competitive market dynamics that will force a) dealers to better align service costs with service value and b) fund management companies their fund costs with fund value/risk adjusted performance. I say this because the largest part of the market place is owned by vertically integrated bank/insurers with their proprietary business models. The necessary transparency at the proprietary level will not exist under the proposed regulations.

Again, the objective of addressing the issue noted is considerably weakened by a failure to implement a best interest standard (with a fiduciary root) for the provision of advice. Such a standard would focus service processes away from the product, to the provision of advice based service structures against which investors would be able to assess and better validate the costs and value of advice.

I would also point the implied reliance on disclosure by investors for the changes that are expected to follow from a removal of embedded remuneration. Disclosure is a notoriously weak medium in which to enforce consumer responsibility/cognition of the issues, especially with the considerable latitude available to weaken such disclosure. The proposals appear therefore to place the consumer at the heart of the issue, almost as if it is the consumer that is the principal cause of the weaknesses itself:

> "Investors should be provided with a compensation model that empowers them and that better aligns the interests of investment fund managers, dealers and representatives with those of investors."

Investors would be better placed to benefit from the changes if the industry was likewise exposed to the rigours of a proper best interest standard, and hence the proposed changes lack the necessary structural balance and integrity.

With respect to point 3

Embedded commissions do not generally align with services provided, agreed. But just what are the services being provided that the CSA are alluding to? It seems to me that the CSA are still referring to a system where the product/security is the focus of the service and advice is incidental but not all embracing.

One of the problems with commissions is that they focus endeavours on the transaction. In order to align fees with service you also need service processes that match the represented service itself.

Is the objective of the paper to provide a basis through which the costs of product servicing and advice can be better reflected by a so called payment agreement reached between client and advisor, **or** are we trying to focus remuneration on the fundamental processes underpinning personalised investment advice, the actual representation of service that has come to embody the industry?

The former is much simpler and quicker; the latter much more involved and requiring of much more demanding professional and regulatory standards and a longer period of transition. That the paper's proposals are only affecting the visible and direct embedded transaction remuneration, and not the indirect and "invisible" internal transfers, suggests to me that the object of the current proposal is more to do with getting costs and values of product distribution better aligned.

The Consultation is correct when it questions the relationship between service and commission rates. But the primary reason why fixed commissions are an issue in terms of service specification is that they provide little or no incentive to develop processes that either meet more complex needs or the narrower scope and focus of simplified advice. The solution is not as simple as changing the way in which the transaction return is paid for but extends to the need to change service structure and service processes.

The Canadian Solution – reinforcing the bank/insurer product distribution model

> "our goal is to ensure that any regulatory action we may decide to take will provide *a Canadian solution* to challenges specific to the Canadian market , will result in more positive outcomes for Canadian investors and will *minimize disruption for market participants*"

The centrepiece of the consultation paper is the glaring exclusion of internal transfer payments from the proposed reforms.

The consultation, with its omission of cross subsidisation and internal transfers within larger bank/insurer owned, vertically integrated organisations, leaves quite significant conflicts of interest in situ.

The consultation provides no rationale as to why these internal transfers are still to be allowed. Yet, it expresses high level awareness of the risks of such retention; retaining internal transfers poses competitive market pressures on the very segments the consultation is depending on for the success of removal of embedded compensation. Pressure will be placed on independent dealers and fund managers and clients of the same, whereas the existence of what is effectively a transaction return "safe harbour", risks pushing more business into an overly concentrated, bank/insurer dominated, market place.

Is this the Canadian solution?

Does the CSA see no issue with internal transfers that are themselves dependent on sales targets within a product/security distribution model beset with conflicts of interest? The revelations unearthed by CBC GO Public's investigation of Canada's banks should give cause for some concern over the consultations strategic omissions.

Internal transfers – a failure to go beyond the point of sales

The only reason I can see for allowing internal transfers is the CSA's ostensible fixation on the product and its distribution.

The fact that an internal transfer payment cannot be traced directly to a purchase ignores the point.

Within an organisation that does not tie remuneration directly to a client's fund purchase, the view may be that there is no palpable incentive to recommend one product over the other. But within an internal transfer regime, remuneration comes from returns on products and product sales and hence the organisation is susceptible to impairment of advice from sales pressure and the fundamental focus on the product as the be all and end all of the service itself.

In order to fund these internal transfers the costs on many products and securities will be necessarily higher than they would be in a competitive market place. The CSA's 3 objectives are not met with respect investors processed through the proprietary model..

As the consultation states, the bank/insurer product distribution model is the dominant model and it is the model at the heart of retail conflicts of interest.

By exposing smaller independent firms of dealers and advisors and fund managers fully to the competitive dynamics of proposed changes, and shielding the larger vertically integrated firms, there is a big risk that instead of stimulating competition, competition is stifled and barriers to entry raised.

With most of MFDA'a/IIROC's firms' assets administered by bank/insurer owned dealers, there must be a tremendous incentive for firms to bypass the requirements of the targeted reforms and restrictions on payment of embedded commissions affecting the independent model. The risk is that current proposals will accentuate the move towards proprietary funds and to rely increasingly on internal transfers as a means of remunerating advisors. Where is the transparency and accountability?

Other issues

Up front commissions still allowed

I note that the consultation would still allow some form of up front commission payment as long as the payment itself is not embedded in a fund's/security's charging structure. I presume this will mean that such transactions could end up being like a share transaction with a statement showing units purchased and commission costs. This defeats one of the objectives of removing commissions from transactions, which is to focus remuneration on the advice as opposed to the transaction.

Referral fees

Referral fees are one of the most corrupting influences on objectivity. Within large vertically integrated organisations referral fees provide significant incentives to cross sell. Such fees override the analytical algorithms that should be dominant when making recommendations to clients. The cost of advice behind the referral should be covered within the advice relationship as opposed to being an additional cost to investors. In my experience referral fees direct business to whomever is willing to pay the most. Referral fees either increase costs or, where they depress margins, impact the time allotted to service processing. What are mutual fund embedded commissions if not referral fees?

Dealer Commissions Paid out of underwriting commissions

Again, anything that influences the security selection in a way that obviates the processes that should define the construction planning and management of assets, is a material conflict of interest for those receiving advice. Where these payments are received they should be added back to the client's account.

Non monetary benefits

All these type of payments are inducements of a kind and while many may not necessarily have significance over short periods of time, they are intended to build up relationships that are themselves intended to influence product selection.

Leverage

According to the proposal, "The discontinuation of embedded commissions would also eliminate the incentive for representatives to potentially engage in unsuitable leverage strategies."

It is my opinion that the incentive to recommend unsuitable leverage would still remain and that a statutory best interest standard, with a fiduciary root, is required to address this issue.

Confusion over fee based arrangements

Evidence of the CSA's limited understanding of the importance of fee for advice based service process and confirmation of their implied intent to retain the product distribution frame comes with respect to their communications on fee based accounts.

> "There is also the possibility that some representatives may have less of an incentive to service clients after the initial sale were we to move to more widespread use of fee-based arrangements. This may lead to reverse churning"

> "Similar to the push toward online advisory services for investors with less than $100,000 to invest, it is possible that some "buy-and-hold" investors may be moved into fee-based accounts when transaction-based fees may be better for their circumstances (we note that this shift is already occurring today). We anticipate that the concept proposals outlined in CSA CP 33-404, if implemented, would limit this potential impact. As outlined above, there is also the potential for reverse churning in these arrangements"

These accounts are transaction volume discount accounts and are priced for optimising product and transaction distribution. That these accounts are the standard "fee based accounts" for much of the retail industry is another matter and a key reason why regulation needs to focus more on advice based service processes than supporting and refining the product distribution model.

Market competition issues

Independent firms, instead of being forced to compete on performance may well be forced to compete on distribution, compounding the product focus issues of Canada's retail financial services industry.

> "While we anticipate increased access to lower-cost fund products in the IIROC and independent MFDA platforms, we also anticipate that independent investment fund managers will still be at a disadvantage as they may not be able to gain access to those firms with closed, proprietary only, product shelves................"

> "investment fund managers may be required to set up a direct to client channel and obtain a dealer registration in order to compete in this space or alternatively, access these investors via a third party online advisory service"

> "For integrated dealers that choose to offer a closed shelf, as mentioned above, they would not feel the same level of pressure and would, at least initially, still be able to operate mostly as they do today, although as previously mentioned, the cost of the proprietary funds offered may fall"

> "Integrated firms as a whole would have more options, at least initially, to cross subsidize across both securities and non-securities business lines to maintain market share"

Canada needs a strong and vibrant independent financial advisor/er market place. While I see every reason to remove embedded commissions from retail financial advice I see no reason for forcing the independent sector to take the full force of imbalanced regulatory change.

Summary

The CSA seem to believe that the primary function of the advisory segment of the retail financial services industry is to transact and to sell products; if investors want advice, that is in their best interests, they should apparently head for the discretionary route.

> "The discontinuation of embedded commissions, along with any potential enhancements to the obligations of dealers and representatives and the growth of online advisory services, may also drive up the demand and the supply of discretionary management in Canada. This change is expected because these initiatives, along with the CRM2 initiative, may encourage dealers and their representatives to explain their value proposition to clients in a way many have never had to. In some cases, the easiest way for the representative to do this will be to show the client that the use of discretionary advice creates a savings discipline, simplifies their life and frees up their time."

Both discretionary and advisory platforms represent themselves as delivering personalised investment advice and both platforms exercise discretion over the processes through which they construct, plan, manage and communicate. The obligations and responsibilities of both channels in the delivery of personalised investment advice should be one and the same, a fiduciary type best interest standard.

The consultation on the option of discontinuing embedded commissions gives with one hand and takes with the other. On the one hand it looks to remove the obvious and necessary conflict of interest posed by embedded commissions on certain investment products, yet with the other hand it protects the sales conflicts associated with the largest and most dominant players in the market place. In this it expresses profound ignorance over the conflicts inherent in product distribution and the quite significant process differences associated with the provision of personalised investment advice.

The consultation is one of a long line of consultations that aims to provide greater rigour, clarity and discipline to the way in which products are distributed in the Canadian retail financial services market place while sidestepping the niceties of advice.

This is the Canadian way it seems, but it is one which poses serious risks to market competition and the development of best interest standards in the advisory segment, especially the independent sector, of retail financial services.

Andrew Teasdale, CFA, BA Hons Econ.

INCLUDES COMMENT LETTERS

THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

IFIC Submission

Re: CSA Consultation Paper 81-408

Consultation on the Option of Discontinuing Embedded Commissions ("Paper")

June 9, 2017

INCLUDES COMMENT LETTERS

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SUBMISSION

June 9, 2017

Delivered By Email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumers Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

In care of

The Secretary
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19th Floor, Box 55
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

RE: CSA Consultation Paper 81-408 - *Consultation on the Option of Discontinuing Embedded Commissions* ("Paper")[1]

Introduction

The Canadian Securities Administrators (the "CSA") are consulting on whether to prohibit embedded commissions[2] and to require all investors to enter into direct-pay arrangements with their dealer firms. The Investment Funds Institute of Canada ("IFIC" or "we") is proposing an alternative to the prohibition on embedded commissions which will allow Canadians to continue to choose to pay investment funds dealer fees indirectly, address the harms identified by the CSA and avoid the unintended consequences of a prohibition.

[1] CSA Consultation Paper 81-408, *Consultation on the Option of Discontinuing Embedded Commissions*, available at https://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf (the "Paper")
[2] The Paper makes it clear that the practice under review is not the payment of embedded commissions generally but only "the prevailing practice of remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions, paid by investment fund managers."

The CSA have identified the following concerns:

(1) Embedded commissions raise conflicts of interest that can reduce the investment fund manager's focus on fund performance, encourage dealers and representatives to make biased investment recommendations, encourage high fund costs and inhibit competition by creating a barrier to entry;

(2) Embedded commissions limit investors' awareness of dealer compensation costs, add complexity to fund fees that inhibits investor understanding of such costs, and restrict investors' ability to directly control those costs and their impact on investment outcomes;

(3) Embedded commissions generally do not align with the services provided to investors because investors do not receive ongoing advice commensurate with the ongoing trailing commissions and the cost of advice provided may exceed its benefit to investors.

Response to the CSA Concerns

Conflicts of Interest – Fund Managers, Dealers and Representatives

We agree that the payment by the investment fund manager to the client's dealer, which is used in part to pay the advisor (the embedded commission), is a potential conflict of interest. While the conflict of interest can be mitigated in a variety of ways, it can only be eliminated by a prohibition.

We do not agree, however, that a prohibition would be effective in eliminating other similar compensation-based conflicts of interest or that a prohibition is a proportionate response to the potential harms identified. Furthermore, a prohibition on embedded commissions will restrict the availability of investment advice for mass-market households[3] with smaller amounts to invest. This unintended consequence of the prohibition will have long-term impacts on Canadians' ability to plan and save for retirement, leaving them with substantially lower levels of assets to fund their retirements.

The potential for conflicts of interest exists in all financial advisory services payment models. This is because, in all financial advisory services compensation models, there is asymmetric information between advisors and clients (otherwise the client would not need advice) and the value of financial advice cannot be assessed at the time it is provided.[4] Transitioning all embedded commission clients to a direct-pay fee-based arrangement will simply substitute the conflicts in embedded commissions with the conflicts in the selected fee-based direct-pay method of compensation.[5]

The cost of any regulatory proposal should be proportionate to the harm it seeks to address. Risk of harm is present in any conflict of interest situation; however, there is only actual harm when the risk is crystalized. The risk of harm with embedded commissions is that the dealer's representatives may put their financial interests ahead of their clients' interests by recommending a mutual fund solely because it pays a higher commission. The risk of harm in the case of the mutual fund manager is that the manager may pay high trailer fees to ensure their funds are sold to investors on the basis of the compensation the representative will receive and not based on the cost and performance of their funds. If this happens, the risk is crystalized and harm results. This is a contravention of the current rules and discipline is warranted in appropriate cases.[6]

[3] At the end of 2012 mass-market households had investable assets of $100,000 or less, mid-market households had between $100,000 and $500,000 in investable assets, and affluent households had $500,000 or more in investable assets, The Paper, p.27
[4] PricewaterhouseCoopers LLP, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds*, May 2017, (the "PwC Report"), annexed as Appendix G to this letter, p.30
[5] The PwC Report, p.46-48
[6] CSA Discussion Paper and Request for Comment 81-407, *Mutual Fund Fees*, p.101

However the Paper does not provide any evidence that the risk of harm from conflicts of interest is any less, or that investor outcomes would be better under a direct-pay fee-based compensation arrangement than under an embedded commission arrangement.

Research by Cumming et al. provides evidence of the effect of embedded commissions on the mutual fund market but cannot answer the question as to whether fee-based or commission-based remuneration is better for individual investors.[7] Research by PwC agrees that the variation in the size of trailing commissions creates an incentive to recommend particular funds, but could find no credible evidence of widespread abuse by registrants of their clients by virtue of the information asymmetry and inability to validate value of financial advice at the time it is paid for.[8]

CSA, IIROC and MFDA sales practice compliance reviews, while finding some instances of non-compliance, provide no support for widespread non-compliance with registrants' duties - investment fund managers' duty to act in their funds' best interests and dealers' and advisors' duties to make suitable investment recommendations and to deal with their clients fairly, honestly and in good faith.[9]

Conflicts of Interest - Barriers to Entry

The Paper suggests that evidence supporting the argument that embedded commissions constitute a barrier to entry is found in studies published over the past 13 years that show Canadian mutual fund fees are among the highest in the world. In fact, the most recent 2015 Morningstar study does not support this claim. In its 2015 study, Morningstar acknowledged that an appropriate comparison of US and Canadian mutual fund fees must include the cost of advice and federal and provincial tax. Comparing apples to apples places Canadian MERs "in the top half of the lower fee markets" of the 25 countries surveyed. Indeed, research cited by the CSA shows asset-weighted cost of ownership in Canadian advice channels to be 2.02% of invested assets (when the impact of taxes is excluded) compared to approximately 2.0% in the US (which does not levy taxes). For modest US investors with less than $100,000 to invest, the cost increases to 2.40%.[10] In some ways this is remarkable given the advantage of scale in the US's $17T market compared to Canada's $1.4T market.

As we describe under the heading Market Competition and the Changing Funds Industry, the Canadian market for investment products and services is highly competitive and there is no evidence that embedded commissions constitute a barrier to entry.

Investor awareness of fees and value for money

We agree that embedded commission arrangements limit investors' awareness and understanding of such costs. Investors should know all the fees they pay and receive services commensurate with those fees.

The good news is that the "embedded" nature of embedded commission has been made transparent by the combined effect of CRM2 and Point of Sale Fund Facts reforms. Dealers must provide their clients, annually, with a "Report on Charges and Other Compensation" which includes disclosure of the total amount of trailing commissions in dollars and cents.[11] The Fund Facts, delivered before the client's purchase, discloses whether compensation is paid by the fund manager to the dealer and the amount expressed as a percentage of the client's investment and in dollars per $1,000 invested.

[7] Appendix F, Summary of Academic Review of Fund Fee Research; The PwC Report, p.40-41
[8] The PwC Report, p.47
[9] CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representative*s (December 15, 2016); MFDA *Review of Compensation, Incentives and Conflicts of Interest* (December 15, 2016); IIROC *Managing Conflicts in the Best Interest of the Client – Status Update* (December 15, 2016); and IIROC *Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review* (April 27, 2017)
[10] The Paper, p.108
[11] National Instrument 31-103, Registration Requirements, Exemptions and Ongoing Registrant Obligations, s.14.17(h)

This new information seems to be making a difference in investor understanding and awareness. In 2015, before the implementation of CRM2 and POS, 67% of mutual fund investors reported being familiar with the fees they pay their firm directly to operate and administer their account and the commissions that their firm receives from other companies. Fully 48% knew the amount of fees their firm received from other companies for the investments they hold. Early evidence subsequent to implementation of these disclosure reforms showed awareness of direct fees rose to 76% and awareness of indirect fees rose to 59%.[12]

Importantly, it is not necessary that all investors understand the fees they pay in order to curb misbehavior incented by conflicted compensation arrangements. The PwC research shows that where a market is characterized by asymmetrical information, only a subset of all consumers need to be informed in order to produce an effective deterrence that will discourage registrant abuse of less well informed investors.[13]

We believe the costs disclosure can be improved by including the fund company's management expenses in the annual cost report. We will work with the CSA to implement this change.[14]

Unintended Consequences

Finally, prohibiting embedded commissions could reduce access to advice for mass-market investors with negative consequences for long-term savings and retirement readiness.

Prohibiting embedded commissions will have a significant impact on mass-market investors' access to advice. The Paper acknowledges that mass-market households are the group most at risk of falling into the advice gap and that this group makes up the largest share of households.[15] Nevertheless, the Paper states that since the mass market has the lowest percentage ownership of mutual funds of the three investor segments (22%) and "only" 45% of investment fund owning mass-market households use advice, the CSA do "not anticipate a significant advice gap" for mass-market households.[16] If an advice gap develops, the CSA predict that deposit-taker and insurer-owned dealers will fill the gap.[17]

The CSA analysis considers the importance of mass-market investors to the total market for mutual funds and advice. It is equally appropriate to also consider the importance of mutual funds and advice to mass-market investors.

Looking at all investor segments at the end of 2015, Canadian households held $1.4T or 35% of their aggregate financial wealth in investment fund securities. Ninety percent of Canadians purchase investment funds through an advisor. Of those investors, 79% purchased mutual funds using an embedded commission arrangement. It is not clear why, in the absence of demonstrating harmful outcomes for those investors or how their outcomes would improve with the direct-pay fee-based arrangement, the CSA propose to remove the choice for mass-market, mid-market and affluent households when so many households of all segments prefer this option.

Looking only at the mass-market households that own investment funds, there are 8.9 million households serviced by MFDA members. Of those, 7.3 million households (83%) are mass-market households[18]. Assuming those mass-market households hold investment funds, (a fair

[12] British Columbia Securities Commission, *Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2* (report prepared for the BCSC by INNOVATE Research Group (April 26, 2017)), p. 8.
[13] The PwC Report, p.35
[14] IFIC Media Release, *Investment Funds Industry Ready to Tackle CRM3*, April 25, 2017, https://www.ific.ca/en/news/investment-funds-industry-ready-to-tackle-crm3/
[15] The Paper, p.62-63
[16] The Paper, p.63
[17] The Paper, p.63
[18] MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients ("MFDA Report"), p.5-6.

assumption since 95% of MFDA members' assets under administration are comprised of mutual funds[19]) a prohibition could impact millions of mass-market households.

Despite suggestions to the contrary, there is no global trend to prohibit embedded commissions. Only three countries have implemented a ban.[20] While the European Union (EU) proposes to prohibit independent advisors from accepting commissions, the independent advice channel is one of the smallest channels in the European funds industry, representing just 11% of assets. The vast majority of fund sales are made through banks, where the prohibition does not apply. In all, only 13% of total worldwide mutual fund assets of $39.4 trillion are covered, or slated to be covered, by a ban on embedded commissions. Many countries are addressing conflicts of interest through policy and regulatory reforms, but are not doing so through a prohibition of embedded commissions.[21] Of those, several have explicitly considered a prohibition and have decided against it out of fear of an advice gap.

Not only would the impact be significant, but it would be disproportionately felt in Canada versus other jurisdictions that have banned embedded commissions. This is because Canadians hold more investment funds as a percentage of total financial assets than any other country in the OECD. Countries that have chosen to ban embedded commissions - The Netherlands, the UK and Australia - rank 27th, 28th and 32nd respectively. This disproportionate effect will be amplified by the narrow scope of the prohibition in Canada. In The Netherlands, the UK and Australia, the prohibition applies across financial sectors – including securities, banking and insurance. The CSA proposal to ban embedded commissions will only apply to investment funds.

The value of financial advice over the long term is well documented. Academic research shows that while financial advisors (or anyone else) are not able to consistently beat relevant market benchmarks after fees on their investment choices, their advice generates significant net benefits to investors in terms of more disciplined savings behavior, overall higher asset values, more efficient tax planning and retirement confidence.[22] According to one study, a household receiving advice over 15 years accrues 3.9 times the value of investment assets of a comparable non-advised household.[23]

On the demand side, behavioral economics predicts that investors will be less likely to seek financial advice if they have to pay "up front" for credence goods whose value is not fully understood at the time of purchase. The same investor would be more likely to pay for advice using embedded dealer compensation even though the cost may be the same.[24] Mass-market investors who might otherwise seek advice could also be deterred by higher costs for advice.[25]

In addition, evidence from the US and UK where transition away from embedded commissions is largely complete shows that the costs to mass-market investors have increased, providing additional disincentives to seek advice.[26]

On the supply side, firms will have to make up for the lost commission revenue with fees based on a percentage of account assets. While there is little evidence available on the cost of fee-based advice, we know that accounts below $100K will be uneconomic in a direct-pay fee-based arrangement. We also know that 80% of Canadians have less than $100,000 in

[19] MFDA Report, p.4
[20] South Africa is in the process of banning embedded commissions.
[21] Countries that considered and rejected a ban are Sweden, Denmark, Germany, Hong Kong, India, Ireland, Japan, New Zealand, Singapore, United States, Switzerland, Israel and South Korea.
[22] The PwC Report, p.29
[23] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016, p.18-25
[24] The PwC Report, p.39-40.
[25] Appendix D, Measuring Investor Outcomes p.3-4
[26] *UK retail investing fees stay above 2.5% annually*, Financial Times. August 26, 2016. https://www.ft.com/content/ba0ae18c-6a98-11e6-a0b1-d87a9fea034f (requires subscription); and ICI Submission Letter on Proposed Rule; Reexamination of Fiduciary Rule, April 17, 2017, https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf

financial investments.[27] It seems inevitable that fewer firms will serve mass-market investors without embedded commissions.[28]

In addition, the prohibition will further concentrate the market for investment products and services by favoring scale and affiliated vertically integrated financial institutions. The end result will be a market with less choice, less investor access and less competition.[29]

Assuming a prohibition reduces access to advice and forces mass-market investors to become do-it-yourself investors, the move from advised investing to self-investing is expected to reduce the amount of savings available to those Canadians at retirement. Those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate, on average, $240,000 less in savings prior to retirement than those with access to advice.[30]

IFIC's Alternative to a Prohibition

We think there is another way to address the concerns raised by the CSA without the cost and disruption that a ban on embedded commissions would create and without the possible unintended consequences of reducing access to financial advice for mass-market investors.

Instead of a prohibition, IFIC proposes a number of reforms which, if implemented, would address most of the harms identified by the CSA and would continue to allow investors the choice of paying for a mutual fund investment indirectly or directly, and avoid the unintended consequences created by a prohibition.

IFIC's alternative is guided by four investor-focused principles:

- Investors should have real, fully informed choice as to how they pay for investment products and services;
- Investors should know the cost of any embedded commission they pay;
- Investors who do not want advice should not pay for it, and
- When investors pay an embedded commission they should know what they are paying for.

IFIC proposes a "made-in-Canada" approach consisting of the following reforms:

1. Mitigate the conflict of interest:
    a. Cap or standardize embedded fees – This mitigates the financial incentive for an advisor to recommend a fund based only on trailer fee. Consideration would have to be given to transparency of standard rate variability. An approach to capping in the US is described below.[31]

[27] MFDA Report, p.5
[28] The PwC Report, p.52-53
[29] The PwC Report, p.52-53
[30] The PwC Report, p.58
[31] The US industry provides examples of a cap and a standardization of embedded fees. Rule 12b-1 under the Investment Company Act of 1940 requires that, before using fund assets to pay for distribution expenses, a fund must adopt a written "rule 12b-1 plan" that describes all material aspects of the proposed financing of distribution. The rule 12b-1 plan must be approved initially by the fund's board of directors as a whole, and separately by the "independent" directors. The rule does not restrict the amounts of the fees that may be approved under the plan. However, current FINRA Rule 2341(d)(2) and (d)(3) sets the maximum front-end or deferred sales charge resulting from any transaction, and prohibits broker-dealers from selling funds that pay more than 0.25 percent per year of fund assets as "service fees," and more than 0.75 percent per year of fund assets as "asset-based sales charges," effectively setting the maximum 12b-1 fees at those amounts or less. More recently, US fund companies have developed Transaction (or "T") shares which generally have a uniform front-end load (usually 2.5%) across all fund categories, and a 12b-1 fee of 0.25%.

b. Series A units[32] to be sold only in channels where advice is permitted – This mitigates the conflict of interest when investors pay full trailer fees (which include payment for advice) to discount brokerages which cannot provide advice.[33]

c. DSC funds to be available only within established guidelines – This mitigates the unfairness of advisors locking clients into funds which are not suitable given the client's age or time horizon.

2. Improve investor awareness and control of fees

   a. Making embedded commissions more transparent by expanding personalized investment cost disclosure to include the full MER.

   b. Simplify pricing and standardize naming conventions for fund series – This reduces complexity for investors and facilitates comparisons of MERs and trailer fees across fund families.

3. Mitigate conflicts and improve investor awareness and control over fees:

   a. In a direct-pay fee-for-service arrangement, fees to the dealer may be paid, with the client's agreement, by the manager out of redeemed units – This would address the behavioral resistance of investors to pay up front for services whose value is future and uncertain (credence goods). It would also eliminate the conflict of the embedded fee being paid by the investment fund manager without the investor's approval. It would allow the investor to negotiate the fee directly with the advisor (and perhaps the services covered by the fee), but the investor would not need to have the cash on hand to pay the fee immediately. This is proposed by the CSA at p.22 of the Paper.

4. Improve investor awareness and control over fees and align fees with services:

   a. Mandate enhanced discussion about fees and services at account opening and before each purchase, or annually – This mitigates the concern that the investor is not aware of the fees paid or the advice and services that the investor receives (or is entitled to receive) for the fees paid.

5. Align fees and services:

   a. Trailer fee service level agreement at account opening – This facilitates investor evaluation of the value of the advice and services they receive for the trailing commissions.

Furthermore, IFIC believes that vigorous and coordinated compliance reviews of the current rules combined with the strategic use of enforcement action in appropriate cases has proven to be an effective deterrent to misbehavior for registrants with ongoing businesses and reputations to protect.

Responding to Other Issues in the Consultation Paper

The Paper, in addition to making the primary argument that embedded commissions should be prohibited due to conflicts and lack of transparency, makes a number of related observations

[32] Series A units are the most common fund series; they are available to all investors, and have the lowest minimum investment amounts of all fund series. Included within the MER of Series A units are the costs for advice and services provided by the dealer and advisor. Payment of these distribution costs are made to the dealer via a deferred sales charge commission and/or an ongoing trailer fee, depending on the sales charge option selected by the investor.
[33] IDA (now IIROC) Dealer Member Rule 1300.1(t) sets out the basic framework for dealers that do not provide advice to a client. They must apply for and receive approval to be exempt from the requirements in Rules 1300.1(p), 1300.1(r) and 1300.1(s) to make a determination that orders are suitable for such client. As at November 2016, 28 dealer firms are permitted to carry on business as order execution-only firms that cannot provide advice.

about the competitiveness of Canada's investment funds industry, the value of disclosure in mitigating conflicts of interest, passive and active investing and how to best measure investor outcomes. We believe the Paper's perspectives on these issues are incomplete and would benefit from additional context. What follows is a summary of four of the attached appendices that address these issues in detail.

Market Competition and the Changing Funds Industry

The CSA concludes, on the basis of the presence of embedded commissions, that the Canadian investment funds industry is uncompetitive.

By any conventional economic benchmark, the Canadian market for investment products and services is highly competitive. There is no evidence that embedded commissions represent a barrier to entry to low-cost product providers – foreign or domestic. There are plenty of both in the Canadian market now.

Fund managers compete aggressively on the basis of their funds' rates of return – this is evident in their competition for various funds awards and the fact portfolio managers are compensated on their risk-adjusted performance against benchmark.

There is significant evidence of a consistent decline in mutual fund fees over the past decade. At 1.96% at the end of 2015, the asset-weighted MER for long-term mutual funds is at its lowest level—declining 8 bps in just one year[34].

Appendix B, *A Competitive and Changing Fund Industry*, provides more information on current market trends and how they are evolving to address the CSA concerns.

Effective Disclosure

The Paper suggests, based on academic research, that disclosure alone is no longer effective to mitigate the risk of harm from conflicts of interest and that registrants provide more biased advice when a conflict of interest is disclosed. Importantly, the authors of the research relied on by the CSA acknowledged the limits of their study:

> *"Disclosure, at least in the context of the admittedly stylized experiment discussed in this paper, benefited the providers of information but not its recipients. We do not believe that this is a general result – that is, that disclosure always benefits providers and hurts recipients of advice."*[35]

Properly framed and delivered at the right time, the right disclosure can be effective in a long-term client advisor relationship that is mutually beneficial.

Appendix C*, Effectiveness of Disclosure*, provides more information on how disclosure can be made more effective.

Measuring Investor Outcomes

Investor outcomes can be measured in a variety of ways. The Paper measures investor outcomes only in terms of product cost and compensation for outperformance. While these are important, investors also need to measure progress relative to specific financial goals.

The Paper gives little weight to the value of advice in helping investors achieve their financial goals because it wrongly concludes that the influence of long tenured advice is intangible and therefore unmeasurable. A complete view of investor outcomes must include an examination

[34] Strategic Insight, *Insight* report, January 2016.
[35] Cain, Loewenstein and Moore, *Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, The Journal of Legal Studies, Vol. 34, No. 1 (January 2005), p. 20.

of the total client portfolio, associated compensation, advisor services, the value of advice, and long-term client goals.

Appendix D, *Measuring Investor Outcomes*, has more information on measuring investor outcomes.

Passive and Active Investing

The Paper demonstrates a marked preference for online advice incorporating passive investment strategies for mass-market investors.[36] Regulators should exercise caution in signaling preferred market outcomes when widespread use by mass-market investors of online advice and passive investment strategies has yet to weather a full market cycle.

Predicting markets and what is best for individual investors is difficult for both investment professionals and regulators. Both active and passive investment funds can help investors meet their financial goals. The market continues to innovate with Platform Traded Funds, ETFs and hybrids of both that offer a full range of investment strategies and prices.[37] We believe the market should decide how to best meet investor needs.

Appendix E, *Active and Passive Management*, has more information on the attributes of passive and active investing.

Answers to the questions posed by the CSA are attached as Appendix A.

Attached as Appendix F is a summary of the *Peer Review of Funds Fee Research*.

The PricewaterhouseCoopers LLP report, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds*, is attached as Appendix G.

* * * * *

We appreciate the opportunity to comment on the consultation. If you have any questions or comments, please contact me by email (pbourque@ific.ca) or by phone at 416-309-2300.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

Paul

By: Paul C. Bourque, Q.C.
President and CEO

[36] The Paper, p.62
[37] "PTFs a welcome game-changer", Paul Brent, National Post, June 21, 2016; "Alternatives in the rush to low fund fees", Tim Kiladze, G&M Report on Business; "Hybrid ETFs may offer the best of both worlds", Terry Cain, G&M Report on Business, May 16, 2017; "Dalbar's 12 Factors to Measure When Picking Active or Passive Funds", www.thinkadvisor.com, February 22, 2017

APPENDIX A

MASTER QUESTION MATRIX WITH ANSWERS

INCLUDES COMMENT LETTERS

IFIC Responses to Questions Posed in CSA Consultation Paper 81-408
Consultation on the Option of Discontinuing Embedded Commissions

Questions	Industry Response
1. Do you agree with the issues described in this Part? Why or why not?	Although we acknowledge that the three investor protection and market efficiency issues identified in Part I of the Paper are legitimate issues for regulatory consideration, we do not agree that there is sufficient evidence of harm arising from embedded commissions[1] to warrant their prohibition. In addition, we do not agree with the Paper's contention that embedded commissions give rise in any significant way to the four sub-optimal behaviours listed on page 4 of the Paper. While substantial research has been cited in the Paper, the research does not provide evidence that the risk of harm from conflicts of interest is any less, or that investor outcomes would be better, under a direct-pay fee-based compensation arrangement than under an embedded commission arrangement. Research conducted by PricewaterhouseCoopers LLP ("PwC") concludes "there is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour."[2] **Conflicts of Interest**: We agree that embedded commissions, or any compensation model for that matter, can create conflicts of interests. However we find that the Paper takes too narrow a view of client/dealer, client/advisor and client/manager interests. For example, the Paper does not acknowledge that client/advisor interests are, in many respects, significantly aligned. Manager/dealer interest to aggregate assets and increase revenue may be different than a client's interest in getting the best service possible at the lowest cost but these different interests are not in conflict. The fact is neither can succeed in a long-term investment relationship without the success of the other. The PwC report finds that "There is no credible evidence for widespread abuse of this potential conflict of interest in Canada. In fact in the US where embedded commissions are substantially less prevalent than in Canada, there is significant evidence of advisors' interests not being aligned with their clients where in Canada there is evidence to the contrary."[3]

[1] Please see footnote 2 of IFIC's submission letter, to which this document is attached as Appendix A.
[2] PricewaterhouseCoopers LLP, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds*, May 2017, (the "PwC Report"), p. 72 (attached as Appendix G).
[3] The PwC Report, p. 47

Questions	Industry Response
	Investor awareness, understanding and control of dealer compensation costs: The recently implemented Client Relationship Model Phase 2 ("CRM2) Report on Charges and Compensation which discloses whether a trailer fee is paid and, if so, how much that fee is in dollars and cents, and the Point of Sale ("POS") Fund Facts which discloses the percentage and dollars per $1,000 invested of any applicable trailer fee in advance of a purchase decision, have made embedded commissions transparent. This significantly reduces the risk of lack of awareness and understanding of embedded commissions. Previous CSA statements on the importance of these reforms for enhancing investor awareness and understanding of fees support this view. For example: In March 2013, the CSA said the purpose of CRM2 *"is to ensure that clients of all registrants receive clear and complete disclosure of all charges and registrant compensation associated with the investment products and services they receive, and meaningful reporting on how their investments perform."* [4] Regarding POS, the CSA said in June 2010, *"We think that the disclosure required by the Instrument would provide investors with the opportunity to make more informed decisions by giving investors key information about a mutual fund."*[5] In August 2016, announcing the project to measure the impact of POS and CRM2, the CSA wanted to ensure *"that increased transparency about investment costs and performance and the provision of the Fund Facts documents are indeed helping investors make more informed investment decisions*".[6] The Paper provides no convincing evidence why POS and CRM2 disclosures will not significantly improve investor awareness and understanding of fees, including embedded commissions. Recent results from the BCSC's research suggest these reforms are having the anticipated impact of increasing investor awareness of fees and causing investors to consider taking action such as changing their dealer and/or advisor.[7] As noted on page 9 of our

[4] CSA Notice of Amendments to National Instrument 31-103 (Cost Disclosure, Performance Reporting and Client Statements), (2013) 36 OSCB 3173, March 28, 2013.
[5] CSA Staff Notice 81-319 - *Status Report on the Implementation of Point of Sale Disclosure for Mutual Funds*, (2010) 33 OSCB 5449, June 18, 2010.
[6] CSA News Release 2016/67 - *Canadian Securities Regulators to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model*, August 22, 2016
[7] BCSC, *Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2* (April 26, 2017) page 29 (prepared for BCSC by Innovate Research Group) - BCSC study of a group of B.C. investors prior to and following receipt of CRM2 statements found that investors who received CRM2 statements are more aware of the fees, both direct and indirect, they are paying and, after receiving statements, some groups of investors were much more likely to switch advisors.

Questions	Industry Response
	submission letter, the research cited by the CSA on page 88 of the Paper in support of the CSA view that disclosure is of limited value in curbing biased advisor advice does not mention the methodological caveats expressed by its authors. Our submission reproduces the authors' caveats. Appendix C – Effectiveness of Disclosure provides a full description of the methodology for this report and more recent views about disclosure from the primary author of the research. **Embedded commissions do not align with the service provided**: We agree that when investors pay embedded commissions they should know what they are paying for. We are disappointed that the Paper does not mention that this information is currently required to be provided to investors by s.14.2 of NI 31-103[8]. The Paper provides no convincing evidence as to why enforcement or clarification of the existing rules would not achieve the desired objective or why prohibiting embedded commissions is the only solution to the issues cited in the Paper.
2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.	No. We believe the Paper has identified the regulators' significant concerns with embedded commissions - conflicts of interest, investor awareness and alignment of fees to services received. To provide a balanced perspective, embedded commissions provide significant benefits to investors that are not described in the Paper. Please refer to our response to Question 3 below and to The PwC Report annexed as Appendix G.
3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh	Yes there are significant benefits to embedded commissions. We find it interesting that none of the research cited in the Paper quantifies the harms of embedded commissions in terms of investor outcomes. By comparison, the benefits of financial advice and the efficiencies derived from embedded commissions are well

[8] NI 31-103, *Registrant Requirements, Exemptions and Ongoing Registrant Obligations*, Section 14.2, Relationship disclosure information:
(1) A registered firm must deliver to a client all information that a reasonable investor would consider important about the client's relationship with the registrant.

(2) Without limiting subsection (1), the information delivered under that subsection must include the following:
(a) a description of the nature or type of the client's account;
(b) a general description of the products and services the registered firm offers to the client;
…
(e) a description of the conflicts of interest that the registered firm is required to disclose to a client under securities legislation;
(f) disclosure of the operating charges the client might be required to pay related to the client's account;
(g) a general description of the types of transaction charges the client might be required to pay;
(h) a general description of any compensation paid to the registered firm by any other party in relation to the different types of products that a client may purchase through the registered firm;
…

Questions	Industry Response
the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible."	studied and documented but these did not find their way into the Paper. **Access to advice and increased financial assets** Embedded commissions increase the use of financial advisors and increase access to financial advice because they make advice affordable to mass-market investors. It is one of the reasons that Canada has a high number of advised households.[9] Access to ongoing financial advice has been demonstrated to significantly increase household financial assets over unadvised households[10]. The same research shows that dropping or losing financial advice dramatically diminishes investors' asset growth. The benefits of advice combined with public policymakers' emphasis on encouraging individuals to take on more responsibility for financing their retirements strongly indicate that regulatory policy should be focussed on ensuring that as many Canadians as possible have access to individualized financial advice at a price they can afford. Behavioural economics teaches us that consumers reduce their demand for a service when the fees for that service are salient and subject to negotiation, as opposed to being embedded in the overall price of the product, even when they have full knowledge of the embedded fee. It can be expected that this tendency, combined with the inability of consumers to benchmark the outcome of their fee negotiation with their advisor against published information, will lead some investors who currently use an advisor to stop using one and will discourage non-advised investors from seeking an advisor.[11] **Efficiency and cost effectiveness of business models** A range of essential services are paid for through the dealer portion of embedded commissions. They include account administration, account and advisor oversight, investor account statements, complaint handling and advice. Advisory fee levels in Canada for fee-based accounts range from 1.75% to 1.00% of AUM, with an average of 1.4%. This contrasts with the trailer fees for 96% of equity and balanced funds which do not exceed 1.00%. Data from Pricemetrix confirms that, in 2014, even fee-

[9] Montmarquette, C., & Viennot-Briot, N. (2016). *The Gamma Factor and the Value of Financial Advice*. CIRANO, reporting Ipsos Reid data finds that 34% of households use a financial advisor; and *National Smarter Investor Study*. Public Opinion Research. Key Highlights.' BC Securities Commission & InvestRight, 2015, which found that 30% of Canadians age 35 and older invest with an advisor.
[10] Montmarquette, C., & Viennot-Briot, N. (2016). The study shows that investors with advice accumulate 290%, or 3.9 times, more assets after 15 years than comparable non-advised households.
[11]; Appendix D, Measuring Investor Outcomes; and The PwC Report, p. 39-40.

Questions	Industry Response
	based accounts from $1 million - $2 million in assets were paying fees, on average, of 1.16%.[12,13] Many clients have very limited assets when they first begin working with an advisor. Despite the initial low balance, the embedded commissions model allows the advisor to still accept the client. Business is done because the payment model promises a continuing income stream which will grow with the asset level. The client benefits from the commitment of the advisor who will encourage him/her over the life of their relationship to continue to save. The interests of the client and the advisor are aligned – both benefit from the growth of the portfolio. By contrast, in order to achieve economies of scale, fee-based platforms in Canada require a minimum portfolio size of $100,000 (the reason is described in more detail in our response to Question 16), a threshold that is not met by most investors who are using an advisor. The Paper has identified mass-market investors as being most at risk of having reduced access to financial advice (p.62). Research by the MFDA shows that 8.9 million households are served by the MFDA channel, of which 7.3 million are mass-market households with less than $100,000 in financial assets.[14] An estimated 6.8 million households pay their fees through the embedded commissions model.[15] Accordingly a significant number of investors will be left without advice that they would like to access, or be forced to rely on online advice, in the event embedded commissions were to be prohibited.
4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption: • mutual fund • non-redeemable investment fund • structured note Should the product be subject to the discontinuation of embedded commissions? If not:	The prospect of reduced access to financial advice and resulting lower savings balances for Canadians constitute compelling policy rationales for not prohibiting embedded commissions. These lower levels of wealth accumulation will especially disadvantage Canadians with modest investment accounts. If embedded commissions are prohibited for the distribution of mutual funds they should also be prohibited for the distribution of like financial products and services that compete with mutual funds, regardless of whether or not these products are prospectus-qualified. If dealers and advisors cannot receive sufficient compensation to retain the viability of selling mutual fund products, it may encourage them to sell substitutable securities or insurance

[12] *Fee-based accounts: Why such an information gap on fees?* Globe & Mail. http://www.theglobeandmail.com/globe-investor/investment-ideas/fee-based-accounts-dont-advertise-prices-but-its-good-for-business/article25043240/ (Data from Pricemetrix).
[13] Strategic Insight, *Insight Report, 2016*.
[14] MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients, ("MFDA Report"), p. 5-6
[15] Strategic Insight. *Insight Report, 2016*. 79% of mutual fund assets are sold with embedded commissions.

Questions	Industry Response
○ What would be the policy rationale for excluding it? ○ What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?	products for which embedded commissions can continue to be earned. The risk of such arbitrage is significant and real in the MFDA channel where almost all of the advisors are dually-licensed.[16] Harmonization with insurance regulators on registrant conduct and product regulation should be a pre-condition to proceeding with this initiative. Imposing different rules for the distribution of similar financial products creates risk of harm to investors. By prohibiting embedded commissions for the distribution of a limited scope of investment fund products only, securities regulators will be creating opportunities for regulatory arbitrage. It is important to note that the Netherlands, the UK and Australia, which prohibited embedded commissions, all did so across a range of financial services (securities, insurance and banking) and not just for mutual funds. An undertaking by the CSA to monitor the work of the Canadian Council of Insurance Regulators in this area is insufficient to address the harm to investors presented by the arbitrage opportunity created by the regulators.
5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?	Please refer to our response to Question 4.
6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?	Please refer to our response to Question 4.
7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?	No, we do not agree with the discontinuation of all payments by persons other than the investor. There is nothing objectionable to the embedded method of paying dealer compensation, provided the investor is informed. Other indirect payment methods where the investor provides instructions to pay fees to another are also not inherently troublesome as long the investor so instructs and understands the implications of paying fees in this manner.

[16] MFDA Report, p. 19.

Questions	Industry Response
	Survey data consistently shows that most investors prefer to pay through a bundled fee model.[17] For small investors, purchasing mutual funds this way is the best choice to gain access to advice and participation in the capital markets.
8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; b. referral fees; and c. underwriting commissions. Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?	**NI 81-105 – Sales Practices** Prohibiting the distribution of mutual funds using embedded commissions is a significant issue. The sales practices issues are referred to only tangentially in the Paper. We have ideas to improve NI 81-105 and are ready to discuss them with the regulators, but they should be addressed in a thoughtful and comprehensive dialogue dedicated to those issues. Removing the ability of fund managers to help defray the costs of educational conferences is likely to reduce advisor access to both general and product education, a result that is contrary to investor interests and regulators' expectations for enhanced product knowledge – one of the CSA's proposed targeted reforms in CP 33-404. **Referral fees** Referral fees should not be prohibited in connection with the purchase or continued ownership of an investment fund security, subject to disclosure of the fee to the client. However, enforcement should be pursued against any individuals who meet the business trigger for registration under NI 31-103 but who are not registered; for example former advisors who were disciplined for misconduct but continue to receive ongoing referral fees.
9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?	Please refer to our response to Question 8.

[17] POLLARA. *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry 2016* ("Pollara 2016"), p. 28. In survey question 17, Preference for How Advisor is Compensated, 54% of investors responded that they prefer to pay their advisor through mutual fund fees that reduce their investment returns, rather than pay fees directly. This has been a consistent response rate annually since this question was first posed in 2013.

Questions	Industry Response
10. With respect to internal transfer payments: a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds? b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products? c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?	**Internal transfer payments** We believe that NI 81-105 has been very effective in regulating payments within integrated financial services companies, and cite the relative absence of enforcement actions in this area. We would observe generally that, if the CSA are of the view that internal transfer payments are equivalent to trailing commissions, and if the CSA decide to ban trailing commissions, then it would make sense to also ban internal transfer payments that are tied to an investor's purchase of a specific investment fund security. We will defer to the individual responses that our members may choose to submit in response to this Question.
11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.	Yes, this payment method should be allowed, however it is unlikely to mitigate the consequences of a prohibition of embedded commissions for mass-market investors. We have included a discussion of this method of payment in our alternative proposal as a mitigation tool in the event of a prohibition because it would be one way to address the behavioral resistance of consumers to pay up front for advice where the value of that advice cannot be known at the time of purchase. However, there are operational issues to be resolved to implement this method of payment, as well as serious tax consequences that will need to be explained to all clients wishing to use such a payment method.

Questions	Industry Response
	For a more fulsome discussion of these issues, please refer to our response to Question 29.
12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?	No. We believe that the data and evidence provided in this Part do not support prohibition of embedded commissions as the only solution to address the three key investor protection and market efficiency issues discussed. It is a disproportionate and unnecessary regulatory response. As we have cited in our response, the CSA concerns can be addressed in other ways without the negative impact of a prohibition; please refer to our alternative proposal in the submission letter. A key input supporting the CSA's proposal, the research paper by Cumming et al., *A Dissection of Mutual Fund Fees, Flows, and Performance*, was evaluated in three independent academic reviews. These reviews, similar in style to peer reviews that would be undertaken to evaluate work for publication, provide detailed evaluations of the methodology employed in the Cumming et al. work along with assessments of the strength of the research findings and conclusions. The reviews are consistent in finding serious limitations in the Cumming et al. analysis and they suggest that any conclusions should be subject to skepticism due to outstanding methodological issues. All these authors offer constructive suggestions for an improved future iteration. A summary of the academic reviews is provided in Appendix F, Peer Review of Fund Fee Research. Copies of the full academic reviews are annexed to the PwC report at Appendix G to this submission. **Conflicts of interest** As noted in our response to Question 1, PwC's research concludes that there is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour. A prohibition of embedded commissions would likely eliminate some of these influences, but would create new instances of misalignment of interests between investors and advisors via new fee schemes.[18] Potential conflicts exist in any relationship, irrespective of the fee structures, so while the prohibition of embedded commissions might address the conflict of interest inherent in this compensation model, it would substitute for this conflict different, potentially more harmful or less manageable conflicts of interest associated with the other payment models. In general, conflicts of interest in financial advisory

[18] The PwC Report, p. 72

Questions	Industry Response
	relationships can be mitigated by increased financial literacy, increased transparency, and longevity of the relationship between advisor and investor.[19] **Awareness and Understanding of Fees** Investor understanding of fee payments is already high. Today 74% of mutual fund investors say they understand the fees they pay[20] and 73% say they know that the fees they pay are used in part to compensate their advisor[21,22]. In addition, the general level of education of mutual fund investors is relatively high, and while this may not be a perfect proxy for financial literacy, it is a good indicator that investors should be able to easily understand information, provided that it is presented in reader-friendly design and language.[23] On this basis, while the prohibition of embedded commissions would address to a degree the CSA's concerns with investor awareness and understanding of fees, we repeat that a prohibition of such commissions is a disproportionate and unnecessary regulatory response to the concerns raised. The CRM2 requirement that investors be given personalized reports on the fees they paid in the previous year, and the Fund Facts disclosure of the dollar and percentage amount of trailer fees depending on the amount invested at the time of purchase, have already effectively unbundled embedded commissions, and we expect that investor awareness, understanding and control of fees will improve as a result of these reforms. A prohibition of embedded commissions, and requiring clients to individually negotiate their own fees will, however, result in less transparency, less awareness of whether the fees they are paying are fair (no ability to compare with other firms or other investors) and may do nothing to enhance their ability to control fees. It will also make it more difficult for clients to assess their account performance since returns will no longer be expressed net of fees. The PwC research notes that one of the principles of a perfect competitive market is that information on prices should be known to all market participants. Moving away from embedded fees to individually negotiated fees will violate this principle and therefore may actually reduce competition.[24]

[19] The PwC Report, p. 38
[20] Pollara 2016, p. 25
[21] Pollara 2016, p. 27
[22] Appendix C, Effectiveness of Disclosure, on page 1 notes that the BCSC research found that, after receipt of their CRM2 statements, investors' awareness of direct fees rose from 59% to 76% and awareness of indirect fees rose from 48% to 59%.
[23] The PwC Report, p. 38
[24] The PwC Report, p. 48

Questions	Industry Response
	Embedded commissions do not align with the services provided Prohibiting the trailer fee will eliminate misalignment of the trailer fee and the service. However there is no evidence that other fee payment models that would remain available after a prohibition of embedded commissions would better align with the services provided. One example of a simpler and less disruptive approach to aligning the fees and services would be to set out in a service level agreement the services for which each investor is eligible, and the fees for those services, and to encourage the investor to take advantage of all services included for those fees.
13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?	Rather than prohibiting embedded commissions, the CSA should implement IFIC's alternative proposal described in the submission letter to which this document is annexed as Appendix A. The alternative proposal addresses the concerns raised by the CSA without the cost, disruption and unintended consequences that could result from a prohibition. In addition, the market has already moved, and continues to move, to address the concerns raised by the CSA, without regulatory intervention.[25] It is worthwhile to consider the unintended consequences of a prohibition in the two (of three) jurisdictions where a prohibition was implemented (and which were selected as case studies in The PwC Report), as well as the reasons why a prohibition was not implemented in those jurisdictions that considered, but expressly rejected, this approach. In addition, a number of European jurisdictions are domestically applying the MIFiD 2 Directive such that the ban on commissions applies only to independent distributors, which comprise only 11% of the distribution channel for mutual funds throughout Europe. [26]
14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?	A transition to direct-pay arrangements would not necessarily create new conflicts of interest but would highlight the existing conflicts embedded in those types of compensation models. The PwC research confirms that "Financial advisory services belong to the category of credence goods which implies that they are characterized by asymmetric information. As a consequence, potential conflicts exist in any such relationship irrespective of the fee structure."[27]

[25] See Appendix B, A Competitive and Changing Fund Industry.
[26] The PwC Report, p. 59-68, and p. 68-71.
[27] The PwC Report, p. 44

Questions	Industry Response
	The PwC report outlines, in detail, the various conflicts inherent in alternative compensation arrangements to embedded commissions.[28] Existing conflicts in current compensation arrangements have been identified by the CSA in their December 2016 report on firms' compensation practices,[29] and these are all addressed by current CSA and SRO rules. The SRO rules require the firm to put the clients' interests ahead of their own when there is a conflict of interest. There is evidence that there is widespread industry compliance as a result of these SRO rules.[30,31]
15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:	Commenting generally about the data and evidence produced by the CSA, the Paper fails to provide any evidence for the CSA's predictions that a prohibition of embedded commissions would: • reduce fund series by 65% and resulting cost reductions (page 51); • promote the emergence of smaller asset managers (page 53); • cause a decline of MERs by 25 to 50 bps for actively-managed equity funds and 10 to 25 bps for actively-managed fixed income funds (page 53); • drive a shift to lower-cost, passively-managed funds (pages 54,72); • increase index fund market share to 5% - 10% of the market in 5 years after a prohibition (page 55); • promote new market innovations that would ensure that mass-market households still have access to advice (page 57); • promote growth of on-line advice (pages 60, 62); • not deter deposit-taker and insurer-owned dealers to continue to serve mass-market households (page 63); and • have little direct impact on integrated business models (page 63).

[28] The PwC Report, p. 46-48.
[29] CSA Staff Notice 33-318, *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*, (2016), 39 OSCB 10115.
[30] MFDA Bulletin #0705-C, publishing the results of a targeted review of Member compensation and incentive programs. The MFDA identified a small number of Members who provided incentives that favoured proprietary mutual funds or mutual funds of a particular fund family over other mutual funds. These cases were referred to Enforcement and were quickly remedied. Other compensation and incentive practices were identified that, in MFDA's view, increase the risk of mis-selling and unsuitable advice. Firms are expected to properly manage these risks and consider amendments to their compensation structure.
[31] IIROC Notice 16-0297, *Managing Conflicts in the Best Interest of the Client – Status Update*, December 15, 2016; IIROC Notice 17-0093, *Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review*, April 27, 2017.

Questions	Industry Response
	PwC's research, and the experience in other jurisdictions, tells us that any reduction in the availability of advice (whether through a reduction in number of advisors (however caused), or an increase in costs, or both) for all levels of investor, will negatively impact investor outcomes. Most importantly, investors with no further access to advice will have lower levels of assets in retirement than investors who have had the long-term and consistent benefit of an advice relationship throughout their investing lives.[32] The MFDA states that "Advisors may be using the embedded DSC commission paid by the fund company upon purchase to finance the cost of offering advisory services to mass-market clients. If so, a ban of embedded compensation would eliminate the DSC commission and may result in advisors having to charge clients an upfront fee to cover the cost of their services. As mass-market households are less likely to be able to afford direct-pay arrangements and are less likely to be eligible for fee-based programs, they would be the most impacted by a ban of embedded compensation."[33] The importance of effectively measuring investor outcomes and how prohibiting embedded commissions may affect outcomes is explored in greater detail in Appendix D, Measuring Investor Outcomes.
• Will investors receive advice and financial services that are more aligned with the fees they pay?	We do not need to prohibit embedded commissions to align advice and financial services received with fees paid. As noted in our response to Question 12, a simpler and less disruptive approach to align the fees and services would be to set out in a service level agreement the services to which each investor is entitled, and the fees for those services, and to encourage the investor to take advantage of all services included for those fees. This is one of the reforms in IFIC's alternative proposal.
• What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?	We do not know what effect the proposal will have on automated advice, and the Paper does not provide any evidence to support the CSA's prediction that the proposal would promote new market innovations that would ensure that mass-market households will still have access to advice (p.57). Automated advice does not have a sufficient history to assess its ability to overcome investors' behavioural biases and to meet investor expectations, particularly in declining markets, for older investors in the de-cumulation stage and

[32] Montmarquette, C., & Viennot-Briot, N. (2016). The Gamma Factor and the Value of Financial Advice. CIRANO
[33] MFDA Report, p. 15.

Questions	Industry Response
	vulnerable investors. For a discussion of automated advice please refer to the PwC research[34] and to Appendix B, A Competitive and Changing Funds Industry. Effective use of technology provides the opportunity to lower costs and improve the client experience; the increased use of technology for this purpose is already occurring as a result of market competition.
• Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?	We cannot predict whether there may be an increase in discretionary advice. Discretionary advice tends to be at the higher end of the cost spectrum. Accordingly, all things being equal, those who cannot afford this service today will still not be able to afford it after a prohibition. As such, it is not likely to become a realistic alternative to traditional investment advice for many investors.
• What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?	We cannot predict whether there may be an increase in online accounts. The Paper provides no evidence for the CSA's prediction that the proposal would promote growth of on-line advice (p.60, 62). However, it is fair to suggest that more investors facing an advice gap would consider trying to invest on their own. We expect, as today, experiences will be mixed. Anecdotally we understand that many online accounts have been opened and funded, but remain un-invested due to behavioural fear of loss.
• What effect will the proposal have on the cost and scope of advice provided to specific investor segments?	Based on the PwC and MFDA research and the experience in other jurisdictions we expect that the proposal to prohibit embedded commissions will make advice less available, in particular, for the mass market.[35,36] There is a minimum cost for a dealer to administer a client's account, and that minimum is higher for fee-based accounts given the systems required by the dealer to bill and collect the fees on those accounts. Embedded commissions provide a certain assurance of an annual revenue stream that enables a dealer and advisor to receive a reasonable return on their investment in the client over time; however, as fee-based accounts do not provide that assurance, dealers using those arrangements must cover their costs as they are incurred. For this reason, many firms require a

[34] The PwC Report, p. 12 - 14.
[35] The PwC Report, p. 52-53, 55; MFDA Report, p. 15
[36] Appendix D, Measuring Investor Outcomes.

Questions	Industry Response
	minimum account size of $100,000.
16. What types of payment arrangements are likely to result if this proposal is adopted? In particular: • Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?	Payment arrangements offered by dealers today already differ based on investor segment, and this will continue after a prohibition. As is currently the case, payment options will depend on how much the investor has to invest. We have identified the following possible payment arrangements that could be offered in the event of a prohibition on trailer fees: • Discount brokerage – investors can manage their own investments using an online discount broker account. Currently a large number of such accounts have been opened but remain in cash (un-invested). • There may be a return to front-end-load pricing, and possible reversion to previous higher load levels. In the exempt market, which consists mainly of one-time transactional deals rather than long-term advised relationships, front-end loads of 8 to 10% are common. • In a pre-authorized contribution arrangement, investors could have a percentage fee deducted from each installment - investors would not see this as a good deal. • Mutual fund transactions might become like stock transactions where an investor pays a fee or commission for every purchase and sale transaction. We should not forget that DSCs were created to address clients' worries about payment of up-front commissions • Hourly-rate billing for advice • Fee-based accounts, where an annual asset-based percentage fee or charge is remitted or deducted on a monthly or quarterly basis. As noted above these types of accounts are typical only offered to clients with a minimum account size of $100,000.
17. Do you think this proposal will lead to an advice gap? In particular: • Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g.	Our research suggests that prohibiting embedded commissions is likely to result in an advice gap for, at least, the mass-market investor. This has been the experience in other jurisdictions. The PwC report concludes that since the use of embedded commissions is more widespread in Canada than in the UK and Australia, the likelihood of an advice gap would be more pronounced than in those countries.[37] As noted in our submission letter, many

[37] The PwC Report, p. 71; MFDA Report, p. 19

Questions	Industry Response
remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.	countries are addressing conflicts of interest through policy and regulatory reforms, but are not doing so through a prohibition of embedded commissions. Of those, several have explicitly considered a prohibition and have decided against it out of fear of an advice gap. Instead these jurisdictions generally opted for more disclosure as a solution to conflict of interest issues.[38] The MFDA report suggests a slightly different impact on investors, "Given almost all licensed advisors with FA [financial advisory] firms are dually licensed to sell insurance and the CSA proposal to ban embedded compensation would not apply to insurance products (such as segregated funds), clients may not in fact experience any change in their advisory relationship. Rather, advisors may decide to recommend products or services to their clients that are not subject to the same regulatory requirements."[39]
• Do you agree with our definition of an advice gap?	The CSA's definition of advice gap on page 62 of the Paper is premised on three elements - an amount of advice, a price for that advice, and a point in time relative to today. This definition is too narrow. Given the proven value of advice to investors (and to the public policy goal of ensuring sufficient personal retirement savings) an advice gap should be seen as existing whenever personalized advice to the degree expected or needed by an investor is not obtainable by the investor from his or her preferred provider for any reason, not simply price.
• Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?	No. Any reduced access to individual financial advice, resulting in lower savings available at retirement for Canadians, especially Canadians with modest investment accounts, would be a serious and harmful result. It does not matter whether the advice was provided face-to-face or over the phone. It is important that the market be allowed to continue to provide clients with choice as to how they want to access advice. As noted in the PwC research, other countries that have contemplated a prohibition on embedded commissions, but have rejected it, did so mostly for the fear of an advice gap. Instead they generally opted for more disclosure as a solution to conflict of interest issues.[40]

[38] The PwC Report, p. 71
[39] MFDA Report, p. 19.
[40] The PwC Report, p. 71

Questions	Industry Response
• What types of advice or services currently provided today would be most affected by the proposal?	We must be careful to avoid triggering any negative consequences to investors, particularly as there are other ways to address the regulators' concerns without resorting to a prohibition on trailer fees. Research confirms that, in 2016, nine out of ten mutual funds were purchased through a financial advisor, an increase over the last 5 years. It also confirms that 56% of investors would feel "not very confident" or "not confident at all" choosing mutual funds without the help of an advisor, and most investors would not be comfortable buying investment products on-line or through automated advice.[41] As noted in our response to the first bullet of this Question, the availability of advice to the mass-market would be most affected by the proposal.
• Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?	The reforms proposed in CP 81-408 and CP 33-404 will, in combination, significantly increase the cost of providing financial advice and accelerate and expand an already existing advice gap. Even without a regulatory best interest standard, the implementation costs of one or more of the proposed targeted reforms will increase operational costs that investors ultimately pay for.
• How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?	IFIC's alternative proposal addresses the concerns raised by the CSA without the cost, disruption and unintended consequences that could result from a prohibition.
• Do you think that online advice could mitigate an advice gap? If so, how?	Online advice may be of limited utility in mitigating an advice gap. The PwC research notes, "While robo-advice does seem to appeal to growing parts of the investor population, it is apparent that the current technology has limitations that do not enable it to effectively service all clients. While robo-advisors offer some guidance, robo-advisors in Canada currently do not offer complete financial advisory services. This may make them inadequate for investors with more complex financial planning needs, including estate planning and tax planning. Secondly, the questionnaires provided by robo-advisors to assess investors' needs may be too simplistic to provide appropriate advice. Finally, as this technology is fairly new, it is not yet clear whether robo-advisors can provide a substitute for the behavioural coaching that advisors provide."[42]

[41] Pollara 2016, pages 14,15 and 17-19
[42] The PwC Report, p. 14

Questions	Industry Response
• Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?	We defer to the individual responses that may be provided by our members in response to this portion of the Question.
18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular: • Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	As is discussed in Appendix B, A Competitive and Changing Fund Industry, for several years the fund industry has been transitioning away from embedded commissions and to direct-pay fee-based compensation for investors with higher asset levels. This transition will continue. However, because the embedded commission arrangement produces better outcomes for some clients and is preferred by many clients, embedded commissions will not disappear unless prohibited by regulators. The competitive market has driven reductions in trailer fees in addition to reductions in management fees, and this trend is also expected to continue. Canadian investors have seen a steady decline in mutual fund fees over the past decade. At 1.96% at the end of 2015, the asset-weighted MER for long-term mutual funds is at its lowest level—declining 8bps in just one year. The percentage of equity and balanced funds that pay above-average trailer fees (higher than 1%) sits at only 4%. This is less than half (from 10%) the level of just one year ago. All indications are that this trend will continue and that it will be increasingly difficult for funds and fund companies paying higher than average trailers to find shelf space in distribution channels. As shown in Appendix E, Active and Passive Management, one of the most significant market trends in recent years has been the rapid growth of passive ETFs. Sales of passive investment funds, particularly ETFs, are far higher than their relative market share. For example, while ETFs make up just 8% of investment fund assets, net sales in 2016 were 35.4% of investment fund sales. This trend is expected to continue. Currently in Canada, passive products make up 87% of the Canadian-domiciled ETF industry.
19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm	We have no views on the accuracy of Figure 8, other than to note that, as we see it, the portfolio management channel is not a true comparator to fund distribution channels and, therefore, should not be included in the

Questions	Industry Response
type? In particular: • Do you see payment options and business models evolving at present? • How are they likely to change over time if the CSA were to choose not to move forward with the proposal?	comparison. Discretionary portfolio management is a very different service than the options for distribution of funds being considered in the table. There is already underway a significant market-driven evolution of business models. The development of new payment options and new products, and regular announcements of fee reductions and simplification of pricing are all current market trends that are expected to continue. The MFDA observes that since the implementation of CRM2, there has been a rise in fee-based platforms and accounts within MFDA membership.[43]
20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?	The relative differences between jurisdictions in availability or popularity of product types, fee structures or other characteristics are not a result of obstacles but rather market evolution that is unique to each jurisdiction. The barriers to the use of fee-based series are the same everywhere – if there is no payment to the dealer, the client's account assets must be sufficiently large to support the higher costs of operating a fee-based account as opposed to an embedded fee account. For this reason there are minimum account thresholds for these arrangements, which make them practically unavailable to investors with account sizes below $100,000.
21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:	We do not agree with the analysis in Part 4 suggesting the Canadian capital markets and the market for investment management and investment funds are not competitive. In fact, our research notes that the Canadian market has all the indicia of a competitive market. Please refer to Appendix B, A Competitive and Changing Fund Industry.
• Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?	PwC's research concludes that the proposal may accelerate industry consolidation and concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms. Reduced profitability for some players may lead to consolidation of the advisory industry and the risk of increased bias towards funds produced by the same organizations that provide the advice. PwC suggests that banks are generally in the best position to serve less affluent clients who will stop using independent advisors.[44]

[43] MFDA Report, p. 13.
[44] The PwC Report, p. 53

Questions	Industry Response
• What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?	Consolidation of market participants will leave investors with less access to financial advice, less choice of investment products and less competitive prices, producing inferior investor outcomes.
• What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups? ○ Independent dealers? ○ Independent fund manufacturers? ○ Integrated financial service providers? ○ Mutual fund dealers? ○ IIROC dealers? ○ Online/discount brokers?	PwC's research indicates that pricing and distribution pressures will increase for independent dealers and manufacturers. Advisors and dealers who rely significantly on less affluent investors may become economically non-viable or would have to shrink their businesses significantly.
• What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?	Please refer to our response to Question 4.
• What would be the impact on dually-licensed mutual fund dealers and insurance agents?	Please refer to our response to Question 4.
• Will the proposal lead new, lower-cost entrants to the market? Why and how?	The market is already causing fund managers to be announcing, on a regular basis, fee reductions, and this trend is expected to continue with or without new entrants in the marketplace. It is difficult to predict whether the proposal will generate new entrants to the market and whether new entrants would be lower cost. To the extent an entrant sees opportunity to fill a need and can do so at a pricing level that generates profit, it is a fair assumption that such entrants would emerge. However, as noted in our response to Question 12, we do not think the Paper provides any evidence for CSA

Questions	Industry Response
	predictions that a prohibition of embedded commissions would, among other results, lead to new, lower-cost entrants to the market. There are a very small number of large low-cost passive ETF providers in Canada and the US. The ability of new entrants to compete in this space is limited, given the inability to compete with product differentiation and the importance of scale in delivering the lowest-cost offering.
• Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?	CP 81-408 and 33-404 will have the complementary effect of increasing costs and enhancing the advantages of scale and affiliated distribution. As we noted in our response to Q17, bullet 5, the reforms proposed in CP 81-408 and CP 33-404 will, in combination, significantly increase the cost of providing financial advice and accelerate and expand an already existing advice gap. Even without a regulatory best interest standard, the implementation costs of one or more of the proposed targeted reforms will increase operational costs that investors ultimately pay for.
• Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?	A prohibition of embedded commissions will result in elimination of new sales of fund series with embedded commissions. Simplification of fund fee series is already underway in the market, and will continue regardless of regulatory reform. Fee-based models may or may not be more complex and may or may not be simpler for investors to understand. Investors in fee-based arrangements will know what they are paying, but will not have enough comparative information to know whether they are paying more or less than their neighbours.
• Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?	The PwC research suggests that in the face of a regulatory prohibition on embedded commissions Canadian banks are best positioned, in terms of infrastructure and reputation, to serve mass-market investors through robo-advice and hybrid advice models that are affordable to those investors. This is especially relevant for smaller and more remote communities, where a bank or insurer might be the only alternative to a local independent advisor or firm that cannot afford to serve their clients anymore.
• What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?	We refer to our response to Question 17, 7^{th} bullet, which discusses PwC's views on the limitations of robo-advice. PwC finds that notwithstanding the above limitations and any changes in regulations, it appears that the growth in the use of robo-advice will continue to accelerate, driven by

Questions	Industry Response
	evolving technology (i.e. artificial intelligence) and the increasing adoption of such technology by younger generations.[45]
22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular: • Is there any specific operational or technological impact that we should take into consideration?	We cannot underestimate the magnitude of the administrative and client-contact changes that will be necessary for investment fund managers, dealers and advisors to transition away from embedded commission arrangements, and the resulting burden and loss of trust experienced by investors who will not understand why the regulator is forcing a change to their compensation model. Many dealers will need to establish fee-based compensation models and, in addition will be faced with necessary task of meeting with each and every client to transition to alternative account types by the implementation deadline – an enormous task that will yield few benefits other than to bring the industry into compliance with the new rules. This is among the number of disproportionate consequences we can expect to be triggered by a prohibition on embedded commissions.
23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today. • Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight? • To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?	As we have noted in our response to Questions 1 and 12, prohibiting embedded commissions does not eliminate all conflicts of interest, only those inherent in the embedded commission model. Moving to alternative compensation arrangements replaces those conflicts with conflicts that are inherent in the alternative compensation arrangements. For this reason, dealers and investment fund managers will continue to need to have in place controls and oversight of conflicts, with measures to identify and manage them, regardless of the compensation arrangements that are offered to investors.

[45] The PwC Report, p. 14

Questions	Industry Response
24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?	Canada's is a competitive market in which we expect many dealers would be able to establish new pricing models that would enable them to continue to receive the same or similar levels of revenue from their client base, taking into account that they may have fewer clients. It is expected that any new pricing model they adopt would allow them to collect more fees from each of their fewer number of clients. However some dealers that serve the mass market would have difficulty in developing pricing models that would continue to generate sufficient operating revenues for them while allowing them to continue to serve their mass-market clientele. PwC notes that advisors and dealers who rely significantly on mass-market investors may become economically non-viable or would have to shrink their business significantly. As such "reduced profitability for some players may lead to consolidation of the advisory industry and the risk of increased bias towards funds produced by the same organizations that provide the advice".[46] This will lead to an increase in the cost of advice for investors, and a reduction in the number of advice providers, particularly those that are accessible to mass-market clients. Mass-market clients would be forced to go without advice, or choose to invest online without advice, or use a robo-advice solution.
25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?	A prohibition on embedded commissions would have no impact on how advisor performance is assessed and rewarded and, therefore, would have no impact on dealer commission grids and salaries. Dealers would still have to fairly allocate revenues between themselves (for dealership management and administration) and their advisors (compensation).
26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the: • career path; • attractiveness of the job; • typical profile of individuals attracted to the career;	A change in payment arrangements by itself is unlikely to have any impact on the attractiveness of a career for incumbent advisors. Experience has shown that advisors moving to a fee-based model earn as much or more than under the embedded model. Fee-based advisors may serve fewer, but larger investors. However, a prohibition on embedded commissions will make it more difficult for new advisors to enter the market and build their books of business, as they typically begin their careers advising new and smaller investors, for whom fee-based accounts will be uneconomical. This limitation

[46] The PwC Report, p. 53.

Questions	Industry Response
• recruitment; and • relative attractiveness of careers in competing financial service business lines?	will diminish the attractiveness of this career choice for new entrants. The increasing regulatory burden, and significantly increased litigation risk whether for errors, or perceived lack of suitable recommendations, is also adding to reduce the attractiveness of financial advisor as a career choice.
27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring: • access to advice for investors, • choice of payment arrangements for all investor segments, and • a level playing field amongst competing investment products?	In 2016, approximately 79% of all mutual fund assets were purchased using embedded commissions[47]. Prohibiting this distribution channel will have transformational effects on investment fund managers, distributors and most importantly, their investors. The Paper acknowledges that the proposal to prohibit embedded commissions favours some business models over others. Greater concentration of ownership, higher costs, fewer advisors and less access to advice are predictable outcomes[48]. The Paper provides little evidence that any of the mitigation measures proposed would minimize or prevent any of these negative outcomes. These outcomes are disproportionate to the harm the CSA is seeking to mitigate, especially given alternative reforms such as those proposed by IFIC that address the harms raised by the CSA, that are focused on ensuring access to advice and choice of payment arrangements, and that avoid the unintended consequences of a prohibition.
28. What other measures should the CSA consider to mitigate the above unintended consequences?	The regulatory framework should preserve as much choice as possible, consistent with investor protection, and the market should be permitted to address regulators' concerns, as is already occurring. The CSA should consider IFIC's alternative proposal.
29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular: a. Would there be a negative tax impact to investors associated with their payment	We will defer to the individual responses that may be provided by our members in response to the operational impacts portion of this Question. With respect to the tax issues, periodic fund redemptions in a non-registered account, including to pay dealer compensation as proposed, would result in capital gains/losses to the investor. Capital losses, in particular, could increase tax complexity to the extent that an investor has an arrangement to periodically purchase new units of a given fund. For example, a client who has a pre-arranged purchase plan to automatically buy new units of a fund every month could trigger the superficial loss rules to the extent a capital loss is realized on units of the same fund

[47] Strategic Insight, *Insight Report 2016*.
[48] The PwC Report, p. 53

Questions	Industry Response
of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain. b. To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors? c. What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?	disposed of in the same month. Clients would be required to track losses and new purchases to comply with the rules for claiming losses on re-acquired property; to the extent they attempt to claim losses in contravention of the rules, they may be subject to reassessments and penalties. In the case of registered accounts, the situation is less clear, as Canada Revenue Agency is still in the process of finalizing its position on registered plan fees. To the extent such withdrawals are made from RRSPs and RRIFs they would in most cases be taxable to clients. Such withdrawals may also trigger the application of HST in cases where HST did not apply before. Whether there are negative tax consequences because of rationalization of fund series due to a transition to direct-pay arrangements will depend on the fund series. For some funds, there will be rollover treatment, while for other funds, the rationalization of fund series will result in the recognition of a gain or loss.
30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements, a. to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?; b. does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and	We do not have data on the possible cross-subsidization effect of the embedded commission model; however, we note that the potential for cross-subsidization is not unique to embedded commission payment models. To the extent that cross-subsidizations might be considered to exist, they would exist across all financial services compensation models where the revenues generated by one client exceed those generated by another. Eliminating embedded commissions will not eliminate the asymmetry in client fee levels – individual high net worth clients will continue to contribute higher revenues to the dealer than will individual low asset investors. Embedded commissions do benefit smaller investors. As was noted in our response to Question 3, most investors start with small amounts to invest and actually receive advice and services worth more than their account balances would pay for. In an embedded fee relationship, even a first-time investor with $15,000 to invest is likely to receive more than the $75 in advice that his/her trailer fee would cover (assuming a 50/50 split of the trailer fee between the dealer firm and the advisor). Later, as their asset levels increase, these investors contribute higher levels of fees to the dealer's revenues. The high net worth investor is in a position to negotiate a

Questions	Industry Response
c. what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?	fee arrangement – one that s/he perceives as providing value for the services received. Under an embedded commission model, high net worth investors can negotiate better loads and be eligible for reduced trailing commissions. Many choose a fee-based payment model and seek a broader suite of advisory services than those required by a low net worth investor.
31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?	As the UK and Australia experiences have shown, the bulk of remediation required to correct the unintended consequences of a prohibition on embedded commissions will fall to governments and regulators. In the UK, the Financial Conduct Authority has had to establish an Advice Unit to support businesses looking at low-cost automated advice solutions. The government is consulting on a proposal to allow individuals to withdraw up to £500 from their government pensions (potentially more than once) to pay for their pre-retirement financial advice. The embedded commission model originally evolved in order to make mutual funds and financial advice accessible to modest investors in a way that was efficient for the industry. It is the responsibility of regulators to fully analyze the potential impact on Canadian investors of a prohibition of embedded commissions and, if they decide to proceed, to have specific plans in place to ensure that investors are not disadvantaged.
32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs. • Are there unique costs or challenges to specific businesses? • What transition period would be appropriate? • Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is	As we strongly disagree that a prohibition of embedded commissions is an appropriate solution to the issues raised in the Consultation Paper, we disagree with the need to transition away from embedded commissions. However, should the CSA decide to proceed with a prohibition, the transition decisions to be taken by any particular investment fund manager or dealer in response will depend on each firm's business model and its desired strategic business direction. For this reason we defer to the individual responses that may be provided by our members in response to this Question.

Questions	Industry Response
completed, or discontinued at the Transition Date?	
33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?	Please refer to our response to Question 32.
34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?	The CSA should consider capping or standardizing embedded fees as one element of a stand-alone solution, as this will mitigate the financial incentive for an advisor to recommend a fund based only on trailer fee. Consideration would have to be given to transparency of standard rate variability. In Canada, as a practical matter, trailer fees are effectively capped already, given that 96% of all equity and balanced funds are at or below a 1% trailing commission.
35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination: • address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and • address or not address any additional harms or issues that you have identified.	**POS and CRM:** We agree with the CSA's view in the Paper that the Point of Sale and CRM 1 & 2 reforms, now implemented, will improve investors' awareness and understanding of mutual fund costs and performance, and make them more informed and active consumers of investment fund products and advice services: • "increased transparency should better enable investors to compare the costs of investing which should help investors manage the impact of fund costs on returns" (p.87). • performance reports will allow investors to better assess the true costs and value of the services they receive, and, overtime time, may lead to better performing funds (p.87) The addition of IFIC's alternative measures to these disclosure reforms will further address the investor protection and market efficiency issues identified in the Paper. **Compliance reviews:** We agree that compliance reviews may assist in addressing conflict of interest (p.90). Vigorous and coordinated compliance reviews of the current rules combined with the strategic use of enforcement action in appropriate cases has proven to be an effective deterrent to misbehaviour for registrants with ongoing businesses and reputations to

Questions	Industry Response
	protect. **CP33-404 Proposals:** We acknowledge the CSA's view in CP 81-408 that some of the targeted reform proposals in CP 33-404 may: • Lead to better conflict of interest management and mitigation (p.93); and • Cause tied forms of compensation to play less of a role in product recommendations (p.93). Given the CSA's conclusion that the combination of the proposals in CP 33-404 and the POS and CRM initiatives may address the conflicts of interest in embedded commissions (p.93), we question whether a prohibition on embedded commissions needs to be pursued at this time.
36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.	Please see IFIC's alternative to a prohibition which would address many of the CSA concerns but maintain investor choice. The alternative is described beginning on page 6 of IFIC's comment letter to which this document is attached as Appendix A.

APPENDICES B - F

A COMPETITIVE AND CHANGING FUNDS INDUSTRY

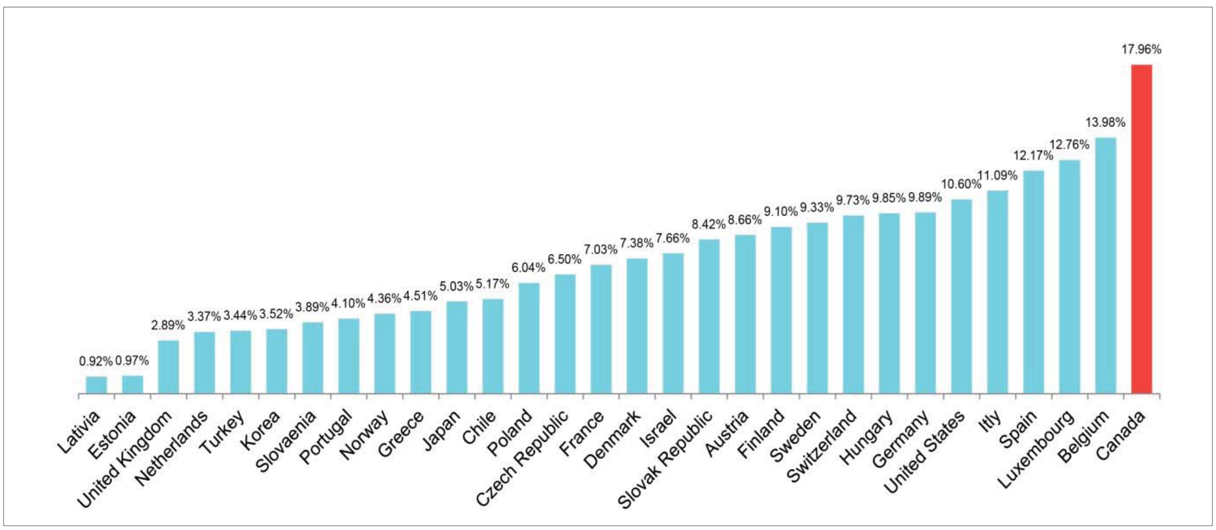
The CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("the Paper") makes a number of observations about the Canadian funds industry and the importance of mutual funds in helping Canadians build wealth. For example, the Paper seems to minimize the importance of mutual funds for less affluent Canadians, observing that "investment funds are less popular than traditional savings vehicles with mass-market households" and that "mass-market households make up the largest share of *those that do not* own investment funds". There are also numerous statements that investors do not receive value for money in actively-managed funds and a concern that Canadians pay "among the highest mutual fund fees in the world". The Paper also presents the view that embedded commissions encourage high fund costs, inhibit competition by creating a barrier to entry and reduce investment fund managers' focus on fund performance.

Standing in contrast to these observations, a preponderance of evidence would suggest that Canadian investors benefit from a highly competitive investment funds industry that sees a continual stream of new entrants to the market and a relentless focus on fees and fund performance.

Importance of Mutual Funds to Canadians

The share of Canadians' financial wealth that is invested in investment funds has been steadily increasing since 1990 and has now overtaken the share of financial wealth in deposits. At the end of 2016, with over $1.3 trillion in assets, mutual funds' share of financial wealth stood at 32.5%.[1] In the US, the figure is 22% (including assets in all US—registered investment companies—mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts).[2] According to the OECD, Canada has the highest level of mutual fund ownership as a percentage of total financial assets.[3]

Figure 1: Mutual Funds as percentage of total financial assets – 2015 – OECD National Accounts



Source: OECD. Household Financial Assets - Mutual fund shares, % of total financial assets, 2015[4]

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[1] Strategic Insight, 2017.

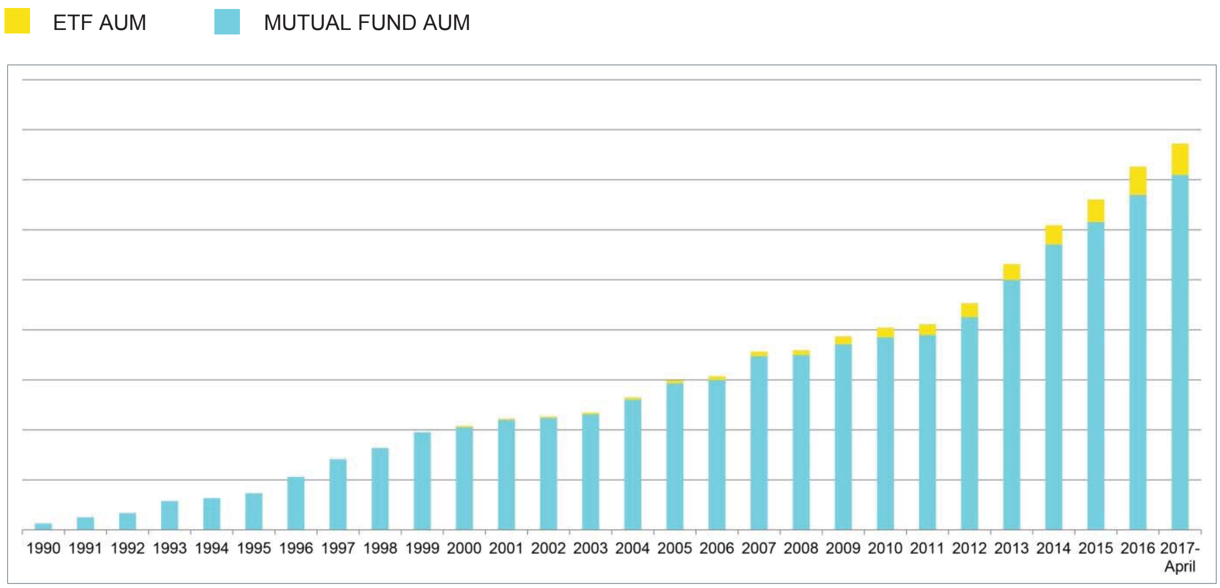
[2] ICI Factbook. 2017

[3] OECD. National Accounts. 2015. The OECD uses a different methodology than either Strategic Insight or ICI producing lower levels of overall ownership for both countries. However, the proportional differences do not change. OECD defines household financial assets as: currency and deposits; securities other than shares; loans; shares and other equity; net equity of households in life insurance reserves; net equity of households in pension funds; prepayments of premiums and reserves against outstanding claims; and other accounts receivable. https://data.oecd.org/chart/4QBe

[4] https://data.oecd.org/hha/household-financial-assets.htm

The mutual funds industry has been a strong promoter of government-sponsored savings initiatives, such as RRSPs, RESPs, RDSPs and TFSAs, which has led to increased participation and savings rates by Canadians in these vehicles. Indeed, mutual funds make up 55% of Canadians' registered assets.

Figure 2: Growth of mutual funds and ETFs in Canada in Billions (source: IFIC)



Mutual funds are also critical savings vehicles for modest investors. Most Canadians are modest investors, or have been at some point in their lifetimes. According to Strategic Insight data, up to 79% of Canadian households with financial assets may fall within this category today.

Recently published data from the Mutual Fund Dealers Association of Canada ("MFDA") finds that financial advisors licensed with the MFDA represent close to nine million households in Canada, or about 56% of all households. Of those households, 83% fall within the mass-market space, defined as those with less than $100,000.

Why should Canadian regulators be concerned about modest investors who have such relatively low levels of assets? The answer is that a significant proportion of these investors are at an early stage of their investing lifetimes and, with advice, over time their assets can grow substantially to serve their lifelong needs. The IFIC-sponsored Pollara investor survey indicates that more than half (55%) of mutual fund investors who began their advisor relationships with assets of less than $100,000 currently report investment assets exceeding $200,000.[5]

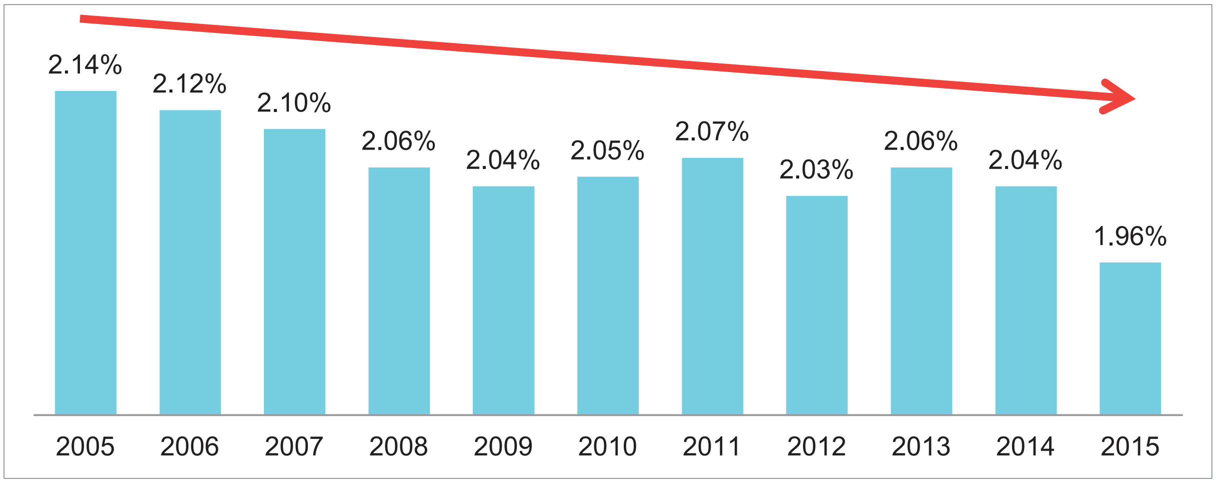
Competition and Price

Canada's investment funds industry has the hallmarks of a highly competitive industry, with over 115 mutual fund providers offering more than 3,300 unique funds and a combined 20,000 mutual fund series. The recent growth and proliferation of ETFs, both Canadian- and US-domiciled, by established players and by more recent entrants is providing an unprecedented degree of choice and competitive pressure. As observed by Strategic Insight in its 2016 review of the industry: "The continual rise in popularity of comparatively lower-cost investment vehicles—at least those populating the passively-managed end of the ETF shelf—in tandem with growing competitive pressures have begun to exert pressure on fund manufacturer revenue formulas."

[55] Pollara Investor Survey - 2016

The Canadian investor has seen a steady decline in mutual fund fees over the past decade. At 1.96% at the end of 2015, the asset-weighted MER for long-term mutual funds is at its lowest level—declining 8 bps in just one year.

Figure 3: Asset-Weighted MER for Long-Term Funds



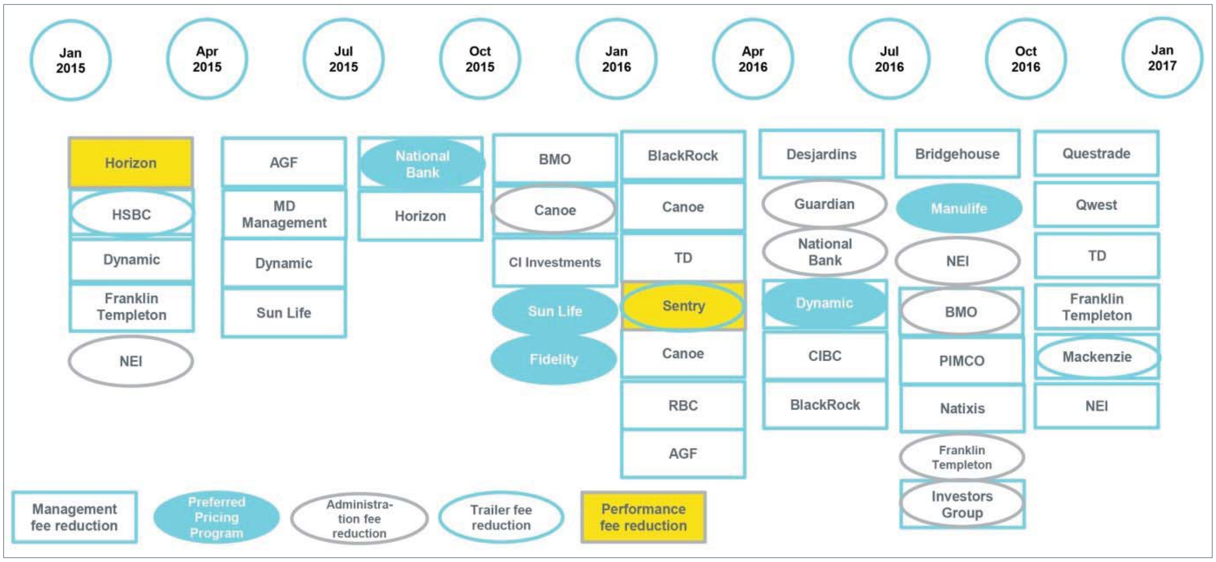
Source: Strategic Insight. *Insight*, January 2016

In 2016, at least 25 firms, including both mutual fund and ETF providers, reduced their fund pricing. And it is not just investment management fees and administration fees that are falling; there is increasing movement to lower trailer fees. The percentage of equity and balanced funds that pay above-average trailers (greater than 1%) sits at 4%. This is dramatically fewer funds than several years ago and a drop of over one half (from 10%) from just one year earlier.

Downward pressure on pricing almost certainly also relates to the lower expected global growth and lower expected returns that guide current thinking. These forces make fees an even more important determinant of future returns.[6] As well, the emergence of a growing array of financial services technologies is decreasing the cost of distribution, especially for the mass market.

[6] McKinsey, 2016 Paper: Diminishing Returns: Why Investors May Need to Lower Their Expectations. http://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-investors-may-need-to-lower-their-sights

Figure 4: Fee Reduction and Re-pricing Initiatives



Source: Strategic Insight. *Insight*, January 2016

The re-pricing trend is accelerating. Since the above chart was published in January, 2017, there has been a rash of fee reduction and re-pricing announcements, including from Scotia Asset Management, BMO Investments, Fiera Capital, Horizons ETFs, Mackenzie, and CI Investments.

Cost of Mutual Funds

The pressure on pricing can best be appreciated when comparing the cost of ownership of mutual funds between Canada and the United States, a market that is more than ten times the size of Canada's. Research commissioned by IFIC from Strategic Insight and referenced in the Paper shows that mutual fund fees in the US and Canada are comparable for advisor-assisted clients. On a tax-adjusted basis (there is no value-added tax in the US) the asset-weighted cost of ownership in Canadian advice channels is estimated to be 2.02% of invested assets compared to the level of approximately 2% in the US And for modest US investors (those with less than $100,000 to invest), the asset-weighted cost of ownership increases to 2.40%.[7]

The persistent statements about Canadian mutual funds being the highest priced in the world can be traced back to a 2011 Morningstar report which became a source for other reports and commentators. However, in 2015, Morningstar published an update that concludes that a more proper comparison would place Canada at: "the top half of lower fee markets" in the 25 countries that were studied.[8]

The flaw in the original analysis was its failure to recognize a key difference in the expense ratios reported in different countries. In Canada, published expense ratios generally include the costs of distribution. In the US and several other countries, most investors pay additional fees for advisor services that are not captured in the reported expense ratio. To properly compare expense ratios with Canada, the advisor fee must be added to expense ratios in other countries, as was done in the Strategic Insight report referenced above.

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[7] 2015 Update - Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios - A Canada – US Perspective - May 2015 Update to the 2012 study by Investor Economics and Strategic Insight

[8] http://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf?INV=82e08cea-55, p. 22

New Fund Company Entrants and Changing Distribution Landscape

The Canadian mutual funds industry continues to attract new players. Over the past ten years (2007-2016), more than 50 firms have entered the segment, ranging from small independent firms to large U.S-based fund providers including PIMCO, BlackRock and Federated Investors.

Since the beginning of 2016, ten firms have begun to offer Canadian-listed ETFs, including several traditional mutual fund companies.

As noted in Appendix E, one of the most significant market trends in recent years, globally and in Canada, has been the rapid growth of passive ETF funds. While active management dominates the funds industry in terms of assets under management, sales of passive investment funds, particularly ETFs, are far higher than their relative market share. For example, while ETFs make up just 8% of investment fund assets, net sales in 2016 were 35.4% of investment fund sales. Currently in Canada, passive products make up 87% of the domiciled ETF industry.[9]

There is consolidation in the distribution side of the fund industry, however, technology is allowing for market innovations that are creating novel approaches to product sales and putting increased pressure on traditional channels.

While the robo-advice segment in Canada is a nascent offering, with likely no more than $1 billion in AUM at the end of December 2016[10], there are 16 firms now operating in this space.

New trading platforms are also disrupting traditional distribution, with platform-traded funds offering the ability for actively-managed mutual funds to be traded and settled in a similar manner as publicly-listed securities and ETFs. With growing assets traded through these platforms and a growing number of dealers utilizing them, they seek to provide a streamlined approach to trading with a lower transaction cost model.

Furthermore, ETFs are beginning to be made available to advisors registered in the MFDA channel. While the MFDA permits ETFs to be sold in that channel, the majority of fund dealers do not currently have access to stock exchanges where ETFs are bought and sold. Through the work of the Canadian ETF Association and others, access to ETFs is being enabled for a growing number of MFDA dealer firms - a trend that is expected to continue.

Another major trend in the market today is the accelerating shift to fee-based accounts for investors with accounts of at least $100,000 in assets. While this trend is certainly dominant in the full-service brokerage business, it is evident too in the independent and life insurance businesses. Today, 20% of mutual fund assets are sold with unbundled compensation, double the amount from 2010. Over the same period there has been a ten-fold increase in discretionary advisor managed programs. In the last year, fee-based mutual fund assets grew by 41.6%, a faster rate of growth than any other fee structure.

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[9] CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

[10] Investor Economics, January 2017.

Figure 5: Assets in fee-based programs have significantly outgrown overall channel assets in the last 10 years

		Full-service Brokerage Growth Multipliers
Full-service brokerage assets	$1,054 Billion	2X
Fee-based program assets (all program)	$448 Billion	5X
Discretionary advisor managed programs	$174 Billion	10X

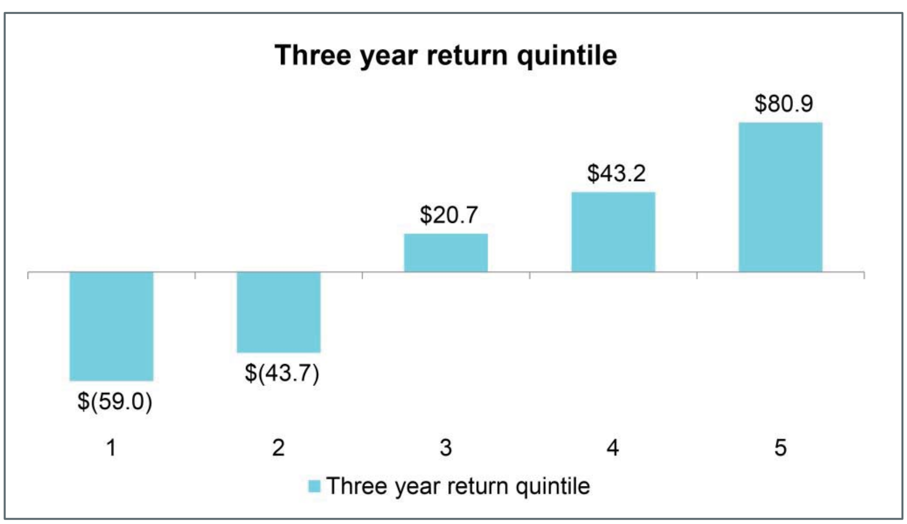
Source: Strategic Insight

Incentives for Performance

While most active portfolio managers' compensation is very directly tied to their ability to generate excess returns, a more fundamental reason that fund companies strive to generate good returns is that performance drives fund sales. One can argue whether investors are well-served by channelling money into funds that have performed better (based on one-month, one-year or even five-or-ten-year past performance) but the data is clear that money follows returns.

For example, the IFIC-commissioned Strategic Insight report, *Analysis of the Factors Influencing Sales, Retention and Redemptions of Mutual Fund Units*, 2015, and referenced in the Paper, identified over 40 factors that explain the sale and retention of mutual funds. The report finds that relative performance is the single biggest driver of flows.

Figure 6: Mutual fund net flows by three-year investment return quintile – all asset classes



Strategic Insight: Analysis of the Factors Influencing Sales, Retention and Redemptions of Mutual Fund Units, 2015

The chart above shows that funds that performed better than their peers by risk-adjusted returns, ranking in the top three quintiles of three-year returns, had positive inflows, while those in the bottom two quintiles experienced net redemptions. Simply put, funds that underperform quickly see their assets shrink. It is for this reason that investment fund companies care about, and are strongly motivated to deliver, returns.

Conclusion

There is no doubt that Canadians and, in fact, all investors are facing serious challenges in their ability to generate investment returns, not least of which are a low-growth global economy and a low natural rate of interest. A strong focus then on fees, competition, and performance in this investment environment is understandable. However, as Rob Carrick recently wrote in observing the trends in the retail marketplace, investors are in a "golden period of price competition".[11] Evidence shows a highly competitive, dynamic marketplace with a growing array of disrupting forces to traditional distribution channels. These forces will no doubt continue to build the value proposition of fund ownership in Canada for investors of all financial means.

[11] G&M. Robo-advisers face new rival as the cheapest place to get investing advice. September 16, 2016

http://www.theglobeandmail.com/globe-investor/investment-ideas/robo-advisers-already-being-challenged-as-the-cheapest-place-to-get-investing-advice/article31935358/

EFFECTIVENESS OF DISCLOSURE

The CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (“the Paper”) notes that while the impact of POS and CRM will take a number of years to fully evaluate, the CSA expects “the reforms to appreciably improve investors’ awareness and understanding of mutual fund costs and performance, and make them more informed consumers of investment fund products and advice services.”

More specifically, with respect to the three investor protection and market efficiency harms which the CSA believe are associated with embedded fees: 1) conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors; 2) embedded commissions limiting investor awareness, understanding and control of dealer compensation, and 3) embedded commissions not aligning with the services provided to investors, the CSA conclude that POS and CRM2 disclosure will better enable investors to compare the costs of investing in one mutual fund over another and will equip investors with better tools to manage the impact of fund costs on their returns. The CSA also note that enhanced disclosure may help investors better evaluate and question the costs and value of the services they receive and that increased awareness may, over time, lead to positive changes in the consistency and level of services provided to investors and to better product choices on the part of investors.

Early Evidence of the Impact of Enhanced Disclosure

Early evidence is encouraging. According to a BCSC study that is surveying a group of BC investors prior to and following receipt of CRM2 statements, investors who received CRM2 statements are more aware of the fees, both direct and indirect, they are paying. Awareness of direct fees rose from 67% to 76% and awareness of indirect fees rose from 48% to 59%. The results also show that after receiving statements, some groups of investors were much more likely to switch advisors.[1]

It is notable too that almost half of investors (48%) reported that they spoke to their adviser about CRM2 prior to receiving their reports and one-third (34%) reported that they have discussed the report with their advisor since receiving it.

These results are consistent with IFIC’s annual Pollara investor survey. While only measuring the lead-up to CRM2, the 2016 survey nevertheless found mutual fund investors reporting increased awareness of the fees and compensation they pay to their advisors. From 2015, clients who recalled discussing fees and commissions with their advisor rose six points, to 62%, clients who recalled discussing compensation rose eight points, and those who recalled discussing MERs rose four points[2].

Academic Research on Disclosure and Conflict of Interest

The Paper notes that there is research suggesting that advisors provide more biased advice when a conflict of interest is disclosed than when it is not, and other research showing that disclosure of a conflict of interest can have the perverse effect of advisees being more likely to follow conflicted advice. However, as even the authors of this research observe, this is not an argument against enhanced disclosure.

This early research on the limits of disclosure uses laboratory settings that do not reflect the full complexity of actual advisor and investor relationships. The much referenced study, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest* (Cain, Loewenstein, and Moore, 2005)[3] had “estimators” attempt to estimate an uncertain quantity of coins in a jar and rewarded them for their accuracy. “Advisors” were provided with more information than estimators and were instructed

[1] BCSC. Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2 (report prepared by INNOVATE Research Group, April 26, 2017, p.8. http://www.bcsc.bc.ca/uploadedFiles/About_Us/Publications/Wave_2_Survey_Report.pdf

[2] Pollara Investor Survey 2016.

[3] The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest (Cain, Loewenstein, and Moore, 2005)

to provide estimators with advice. In a control treatment, advisors, like estimators, were paid more when estimators answered accurately. This alignment of incentives was disclosed. In two conflict-of-interest treatments, advisors were paid more when the estimator responded with a high (relative to actual value) rather than an accurate estimate. The researchers examined the impact of disclosure by disclosing this conflict of interest in one of the conflict of interest treatments but not in the other. The “perverse” finding of this study was that subjects did not discount advice from biased advisors as much as they should have, even when advisors’ conflicts of interest were disclosed. Secondly, disclosure was found to increase the bias in advice because it led advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further.

While a rigorous and illuminating study, there are two important points to consider in evaluating this work. One is that the conflict was set up so that a benefit to the “advisor” was of no benefit to the “estimator” and could even be a detriment to the “estimator”. This is clearly different from a long-term advisory relationship where, using embedded commissions or a fee-based account, advisor compensation grows as the client’s portfolio grows. The mutually beneficial aspect of growing assets cannot be captured in this study, nor does it create any reputational cost of providing bad advice.

To the authors’ credit, these limits are acknowledged in the study: “Disclosure, at least in the context of the admittedly stylized experiment discussed in this paper, benefited the providers of information but not its recipients. We do not believe that this is a general result – that is, that disclosure always benefits providers and hurts **recipients** of advice.”

One of the authors of this research, and today one of the most respected academics on conflicts of interest and disclosure, George Loewenstein, is a strong proponent of disclosure.[4] More recent research by academics who work in this field is seeking to identify those factors that help facilitate effective disclosure, and finds that these factors include the existence of a long-term relationship and the ability of recipients to make decisions about conflict in private. Disclosure is shown to be more effective when it is not made directly by the advisor. These conditions, it should be noted, are all met with CRM2 fee and performance statements, and by the Fund Facts and prospectus disclosure documents that are prepared by investment fund managers.

Also, research on public information disclosure in contexts such as health and safety warnings has generally found that some of the beneficial effects of disclosure are likely to result from the behavior of the “disclosee” (Archon Fung, Mary Graham, and David Weil 2007). Indeed, some observers might suggest that the recent trend of fee cuts and re-pricing programs at mutual fund companies was in part spurred by the impending CRM2 statements.

Disclosure experts also observe that disclosure enables third-parties, researchers, reporters, and advocates, to analyze disclosed data and draw investor and public attention to problems, enabling intermediaries to emerge who can make use of the data and convey it to consumers in ways that often have significant impact.

Conclusion

Disclosure should be viewed as a critical component of effective investor protection and education and a mechanism by which to manage conflicts of interest. There is a strong theoretical justification for enhanced disclosure that is supported by academic research. The early BCSC survey data supports this theory and is demonstrating the effectiveness of POS and CRM2 initiatives in making Canadians more informed and pro-active investors.

[4] In Appendix F of the National Academy report on Conflicts of Interest in Medicine, George Loewenstein (along with two other non-MDs) dissented in support of greater disclosure than the overall committee was ready to endorse.

MEASURING INVESTOR OUTCOMES

The CSA *Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions* ("the Paper") states that part of the goal of any potential regulatory action will be to effect "positive outcomes for Canadian investors". Indeed, a sustainable and growing financial services industry depends upon positive investor outcomes. As such, it is critical to have a full understanding of what defines positive outcomes and to appreciate what contributes to these outcomes.

The goal of most investors is to build wealth over time with a portfolio that delivers favourable returns and that is consistent with their risk profiles and financial objectives. However, throughout the Paper, client outcomes are not defined as long-term savings or wealth accumulation, but rather are associated with investment performance and the cost of investment products and advice. While performance and cost are certainly important determinants of wealth generation, it is misleading to equate these with investor outcomes.

Measuring Harm

Much of the evidence of harm reviewed by the CSA focuses on the interplay of product cost, absence of outperformance and the effects of narrowly-defined conflicts of interest. Indeed, the CSA's selection of research positions "interest" as almost exclusively relating to product cost and compensation for outperformance. Furthermore, the studies often compound the distortion of the "fees pay for performance" view by looking for conflict of interest in the context of a mutual fund, and not in the context of the total client portfolio. While relevant and important, the research reviewed paints an incomplete picture of the total context of the client-advisor relationship. A complete view must include an examination of the total client portfolio, associated compensation, advisor services, a full consideration of client interest, preferences and suitability requirements, and long-term client outcomes in order to evaluate the value of advice, the presence of conflict of interest and potential harm. While the Paper does reference a number of specific studies that measure the value of financial advice, it does not connect this research to the "regulatory impact" analysis section of the Paper nor does it consider what less access to financial advice would mean in economic terms, either at the individual or societal level.

Value of Financial Advice

In the "regulatory impact" section of the Paper, the CSA state that a ban on embedded commissions may impact "mass market" investors' (those with investable assets below $100,000) access to financial advice. The Paper states: "It is fair to say that this group of investors is the group most at risk of falling into the "advice gap" – the group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay". The Paper observes that for these mass market investors, who make up the largest number of households in Canada, the cost of "traditional advice" may rise. The CSA conclude that, "Some investors may be pushed into online advice relationships, other more simplified forms of advice, or the online/discount brokerage channel even though these services may not meet all their needs and even though they [the mass market] may prefer, but can no longer afford face-to-face advice." Client research undertaken by the MFDA finds that of the 15.8 million households in Canada, 8.9 million are within the MFDA client base and 7.4 million are "mass-market" household with $100,000 or less in investible assets.[1]

It is notable that the CSA recognize that banning embedded commissions may limit mass market investors' access to financial advice; however, the economic impact of this possible gap is not explored or measured. There is a substantial and growing body of research that measures the quantitative value of financial advice to investors. These studies include: research by Morningstar economists David Blanchett and Paul D. Caplan demonstrating that planning strategies increase retirement income[2]; research from Vanguard[3] on the quantitative value of coaching and strategic

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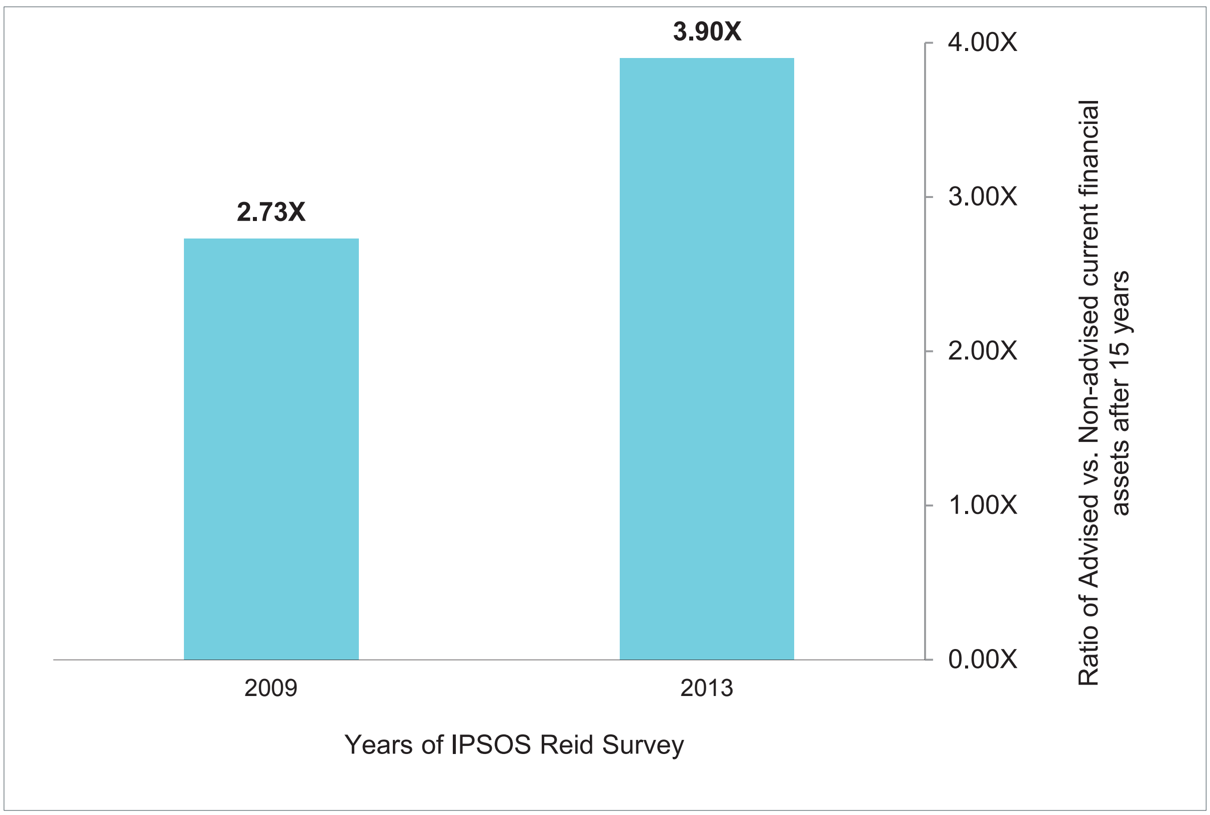
[1] MFDA Client Research. BULLETIN #0721 – C. http://mfda.ca/bulletin/0721-c/

[2] http://www.iijournals.com/doi/full/10.3905/pa.2014.1.4.036

discipline, and two consecutive studies by Claude Montmarquette and Nathalie Viennot-Briot[4], showing that the discipline imposed by a financial advisor on the financial behavior of households and the increased savings of advised households are key to improving asset values of households relative to comparable households with no advisor. While these studies are referenced in the Paper, the Paper wrongly concludes that the benefits of advice are largely "behavioral and thus intangible in nature". While the benefits are largely behavioural, they are measurable. These papers, referenced in greater detail in IFIC's submission to CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients, in fact show the measurable and quantitative value of advice.

For example, the Montmarquette research shows that, after adjusting for nearly 50 socio-economic and attitudinal differences, investors with advice are found to accumulate 290%, or 3.9 times, more assets after 15 years than comparable non-advised investors. These results are shows in Figure 1 below.

Figure 1: Ratio of Current Financial Assets for Advised and Non-Advised Investors after 15 years



A more recent analysis, *Do Human Advisor Fees Offer More Value than Robo-Advisor Fees?,* undertaken by Dave Faulkner, CEO of Razor Logic Systems Inc. and reported in Advisor.ca[5] provides a theoretical analysis of a typical low-cost robo-advice offering compared to a theoretical higher-cost human advisor account. The analysis finds that while the robo offering provides lower cost, the vast majority of Canadians would benefit in actual wealth accumulation through the education, tax, and retirement planning that human advice and coaching provides.

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[3] https://www.vanguardcanada.ca/documents/aa-advisors-alpha-research.pdf

[4] https://www.cirano.qc.ca/files/publications/2016s-35.pdf

[5] http://www.advisor.ca/news/industry-news/do-human-advisor-fees-offer-more-value-than-robo-advisor-fees-225908

There is no evidence to suggest that robo-advice or online channels will deliver to Canadian investors, and in particular, mass affluent Canadian investors, the same benefits that are shown to accrue from human advice. Indeed, most "robo-advice" today involves asset allocation and rebalancing and lacks the fuller dimension of advice usually associated with buying investment fund products. It is noteworthy that "robo-advice" offerings are not designed to capture a view of "outside money" and do not attempt to capture a view of the global picture of a client's investments. As such, "robo-advice" offerings have an inability of looking at both sides of a client's balance sheet. There is also evidence that Canadians are not trusting of robo-advice. According to an HSBC global survey, of the 1,001 Canadians represented, only 7% said they're likely to trust recommendations delivered by a robo-advisor.[6]

The studies on the value of advice are a counterbalance to the preponderance of research that focuses on cost and the rate of return of a portfolio relative to a benchmark ('Alpha') as the ultimate measure of investment success. The latter body of research does not take into account 'Gamma', the additional return over time that can be generated from a portfolio if saving is more regular and if common investment errors are avoided.

Goals-Based Planning

The Paper's focus on cost and relative returns runs contrary to the industry trend in Canada and the US towards holistic goals-based planning. In goals-based planning, an advisor must have a thorough understanding of a client's life goals, as well as a client's assets and investment style. In goals-based planning, a client's goals and liabilities are defined, and a financial advisor works with a client to establish a timeline and risk-budget for each specific goal. This approach is a deliberate move away from measurement of returns relative to benchmarks and market performance and a move towards measuring progress relative to specific end goals.

The touted advantages of goals-based planning include: a greater potential for a long-term relationship with a client based on meeting life goals; fewer redemptions amid market turbulence, and the possibility of consolidating and growing existing clients' assets.

Banning Embedded Fees Will Cause Many Canadians to Pay More for Advice.

Evidence in the US and the UK, where the transition away from embedded commissions is largely complete, shows that costs to investors with lower balance accounts have increased.[7] The higher market price for advice for small accounts has led to advice gaps in both countries[8][9]. In the UK, this advice gap was confirmed by the Chief Executive of the Financial Conduct Authority, Andrew Bailey, who stated at the 2016 Annual General Meeting of the FCA that the Financial Advice Market Review (FAMR) found that, "affordability of advice was a barrier to the less well-off. Full, face-to-face advice can be expensive and not always cost-effective for consumers, particularly those with small amounts of money or simpler needs. Many consumers who want guidance or limited advice cannot find it or end up paying for advice, even if their needs are straightforward. In simple terms the Retail Distribution Review has achieved its objective of removing opaque charging through commissions and improving the training and qualification of advisors, but had– along with a number of other significant

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[6] http://www.hsbc.com/trust-in-technology-report

[7] 2015 Update - Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios - A Canada - US Perspective - May 2015 Update to the 2012 study by Investor Economics and Strategic Insight

[8] Accounting and consulting firm Grant Thornton quarterly survey of wealth managers representing approximately 80% of industry (evaluating advice charge, platform charge, and fund change) finds that investors with £100,000 pay on average 2.56% annually in fees (10% less than before RDR, at 2.86%). Advisor service firm True Potential, tracking 4,000 advisors calculates that the average retail investor pays 3.1% in first year of their relationship with an advisor, up from 2.99% 2012, before RDR. *UK retail investing fees stay above 2.5% annually.* Financial Times. August 26, 2016. *https://www.ft.com/content/ba0ae18c-6a98-11e6-a0b1-d87a9fea034f* (requires subscription)

[9] ICI Submission Letter, Re: RIN 1210-AB79; Proposed Rule; Re-examination of Fiduciary Rule, April, 2017. *https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf*

developments – contributed to an advice gap opening up for the less well-off and those in need of single event type advice." In the US, the growing advice gap is documented by the Investment Company Institute's submission to the Department of Labor during its consultation on the proposed Fiduciary Duty Rule. The letter states that, "…some investors who had been in commission-based accounts are being moved to fee-based accounts. While both compensation models (fee-based and commission-based) have their advantages, the commission-based model can be a more cost-effective means to receive advice, particularly for buy-and-hold investors, which is the case for many investors with modest-sized accounts…in many instances, our members have been informed by their intermediary partners that they will no longer service certain account holders in light of the [proposed fiduciary] rule. These so-called "orphaned" account holders already number in the hundreds of thousands…"

Using existing data, the rising cost of advice that would result from a ban on embedded commissions can be projected using existing data. As an illustration, Figure 2 compares the account balances for a $10,000 initial investment in a typical Global Neutral Balanced Fund placed in a commission-based account as compared to a fee-based account. In the commission-based account, the typical cost, or MER, of an embedded A-series fund is 2.08%. For a typical fee-based account, the typical cost, or MER, of an F-series fund is 1%. Using published data from Pricemetrix[10], the typical advisory fee for accounts less than $250,000 is 1.43%, resulting in a total cost of 2.43% under the fee-based account. As can be seen in the chart below, modest investors are expected to pay more for advice and this will impact investment returns. As in the UK and the US, it may also lead to lower levels of advice.

Figure 2: Account Balances for $10,000 Initial Investment in Commission-Based versus Fee-Based Investment in typical Global Neutral Balanced Fund.

IFIC Analysis.

[10] https://www.theglobeandmail.com/globe-investor/investment-ideas/fee-based-accounts-dont-advertise-prices-but-its-good-for-business/article25043240/

Impact on Seniors and Vulnerable Investors

Increasingly, regulators are concerned about protection of vulnerable investors and seniors. Senior investors are no longer in the wealth accumulation stage of their investment strategy but are in the decumulation stage. This stage requires significant behavioural coaching and advice concerning tax implications. Vulnerable investors benefit from the assistance of advisors who know them and can identify if the client is making unusual or imprudent investment decisions, even in extreme cases of undue influence or abuse. It is not clear that robo-advisors will be able to provide this advice and oversight to protect vulnerable investors.

Conclusion

There are less tangible outcomes that are critical to the concept of investor outcomes. Indeed, there are things besides money that investors want from advice, including peace of mind. However, it is also clear that access to advice is critical to investor outcomes and that any future policy proposal must be measured against the degree to which it promotes or hinders access to advice. The embedded fee model provides access to advice to modest investors and this advice has positive and measurable outcomes.

ACTIVE AND PASSIVE MANAGEMENT

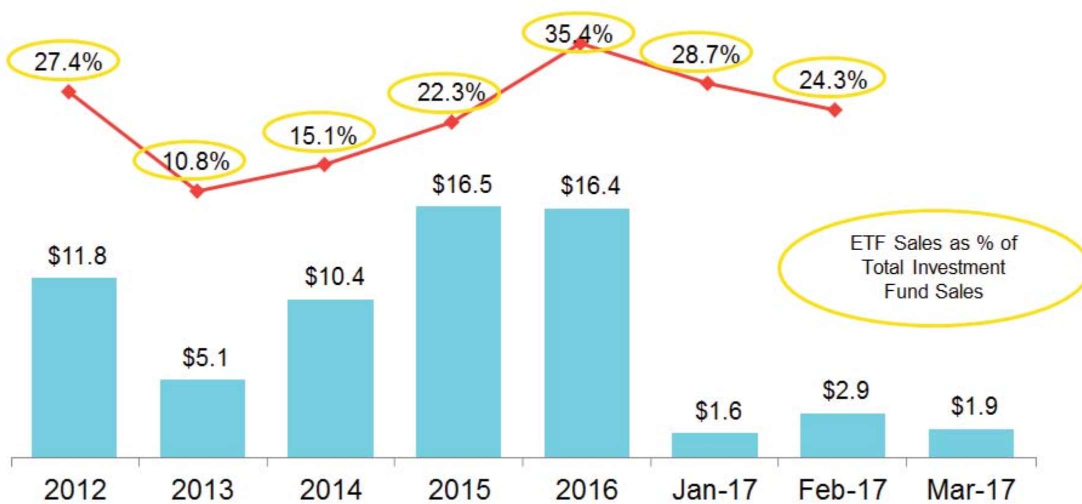
The CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("the Paper") asserts that research shows that actively managed funds do not perform sufficiently well to justify their fees and that actively managed funds can impair investor outcomes. The Paper also suggests that there is a lack of availability of low-cost funds in Canada.

The goal of most investors is to build wealth over time with a portfolio that delivers favourable returns and that is consistent with their risk profiles and financial objectives. Canadians currently have the full spectrum of investment strategies available in the marketplace: pure passive, one-factor smart beta, multi-factor smart beta, active management with low tracking error, and highly differentiated active management strategies with minimum constraints. These strategies, pursued by mutual funds and ETFs, are all used in Canadian investment accounts and openly compete in the retail marketplace.

Growth and Availability of Passive Funds

One of the most significant market trends in recent years, globally and in Canada, has been the rapid growth of passive ETF funds. While active management dominates the fund industry in terms of assets under management, sales of passive investment funds, particularly ETFs, are far higher than their relative market share. For example, while ETFs make up just 8% of investment fund assets, net sales in 2016 were 35.4% of investment fund sales. Currently in Canada, passive products make up 87% of the Canadian-domiciled ETF industry.[1]

CETFA Monthly ETF Report and Strategic Insight. Net Creations in $ billions and % of total investment fund sales.



Source: Strategic Insight with data from Canadian ETF Association (CETFA).

The ETF market is not a perfect proxy for the size of passive investment in any jurisdiction; however, Canada does have a well-established ETF market compared to other countries, when measured as a percentage of the total funds industry. In the US, which is by far the strongest market for passive investing, ETFs make up just 9.8% of investment fund assets.[2] Globally, ETFs make up 7.5% of the total fund industry.[3]

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[1] Strategic Insight with data from Canadian ETF Association (CETFA).

[2] It should be noted that the US has a very large passive mutual fund industry as well as a large passive ETF industry.

[3] ETFGI report for November 2016 and IIFA Global Statistics

Comparisons of Active and Passive Investing

The Paper suggests that actively managed funds might not be delivering “value for money”. While this position is partly based on the presumption that the primary goal of most investors is to “beat a benchmark” at the least possible cost, it is also based on research comparing active and passive strategies. Despite an ample supply of commercial and academic literature that purports to show that passive strategies are superior to active strategies, all of this research faces serious methodological challenges and analytical weaknesses.[4]

One of the most common weaknesses of studies evaluating active and passive strategies is comparing the performance of the active investment to an index rather than to an investment tracking the index. The two are not the same. Investors cannot purchase an index. They can only purchase an investment that attempts to perform like an index. Returns on passive investments will differ from their underlying index due to a number of factors, including transaction costs, bid/ask spreads and tracking error. Just focussing on tracking error as an example, when looking at a largely used ETF like XIN (iShares MSCI EAFE ETF CAD Hedge), with fees of 0.50% and a 10 year annual tracking error of 0.38% this generates an average annual impact of -0.88 bps/year over the last 10 years.[5]

One common misperception that is evident in a great deal of commercial research concerns the relative costs of active and passive instruments and this arises from the direct comparison of Management Expense Ratios (MERs) of actively-managed mutual funds with those of passively-managed ETFs. These direct comparisons are invalid cost comparisons as they fail to adjust for differences in services provided. For example, the mutual fund MER typically embeds the cost of advice, whereas the ETF MER has no advice component.[6]

Almost without exception, studies of relative returns of active investment strategies have been subject to the improper use of benchmarks. Researchers writing these reports typically assign broad market benchmarks to all managers after the fact rather than using the actual benchmark for each fund. As a result, active manager performance is frequently compared against the wrong benchmark, and the conclusions drawn from the analysis are consequently of limited value to investors. As a case in point, the S&P Dow Jones Indices SPIVA Canada Scorecard compares the performance of funds within very broad categories against single benchmarks.[7]

More fundamentally though, by definition, the average active manager cannot outperform the benchmark because the benchmark is a culmination, or a manifestation, of the sum of activity carried out by both active and passive managers. However, passive managers do not influence the direction of the benchmark. As stated by industry innovator Yves Choueifaty, “It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers.”[8]

Market Efficiency

Proponents of passive investing often cite the Efficient Markets Hypothesis as a theoretical rationale for their preference for passive over active strategies. Developed by Eugene Fama in the mid-1960s, and later popularized by Burton Malkeil in the 1970s, the Efficient Markets Hypothesis views markets as efficient processors of all available information relevant to stock pricing and concludes that markets therefore cannot be reliably and systematically beaten by stock pickers. While efficient markets

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[4] Active and Passive Investing. IFIC. https://www.ific.ca/wp-content/uploads/2013/08/IFIC-Active-and-Passive-Investing-Report-July-2011.pdf/1659/

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Financial Times. Active managers can’t beat a benchmark, they are the benchmark. January 2, 2016

theorists would accept that active investors can at times beat markets, they would say that on average their performance will be equal to, or lower than, that of the index (due to fees, transaction costs, wages, etc.). As noted above, there is a vast amount of literature demonstrating that passive management, on average, does outperform active management.

However, there is a growing concern, particularly in the US where approximately 30% of domiciled funds are now passive, that passive investing may make markets less efficient.[9] The respected investor Seth Klarman wrote in a recent note to clients of his Baupost Group, "The inherent irony of the efficient market theory is that the more people believe in it and correspondingly shun active management, the more inefficient the market is likely to become."[10] At the root of this observation is that passive investors are not engaged in decisions about where to allocate capital but merely track the decisions of active managers.

Risk

There is also a growing concern, expressed by academics, investment professionals, and policy-makers about the risks associated with larger and larger pools of passively-managed funds. One concern relates to the growing popularity of large market-cap weighted indices that are dominated by the largest companies. As noted in an October 2016 research note by J.P. Morgan, "The shift towards passive funds has the potential to concentrate investments to a few large products. This concentration potentially increases systemic risk making markets more susceptible to the flows of a few large passive products."

Conclusion

The issues described above relating to active and passive investing are not presented to suggest that either of the active or passive strategies is superior to the other. Problems of measurement, concerns over market efficiency and issues of risk are certainly associated with active management strategies too. However, the market should be the culmination of individual investor decisions, made according to their own needs and interests, and balanced by the risks and opportunities of each product.

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[9] Flows & Liquidity Implications from the shift towards passive investing. J.P. Morgan. October 2016

[10] New York Times. A Quiet Giant of Investing Weighs In. February, 2017.
https://www.nytimes.com/2017/02/06/business/dealbook/sorkin-seth-klarman-trump-investors.html?_r=0

PEER REVIEW OF FUND FEE RESEARCH

The research paper, *A Dissection of Mutual Fund Fees, Flows, and Performance* by Douglas Cumming et al. was evaluated in three independent academic reviews. These reviews, similar in style to peer reviews that would be undertaken to evaluate work for publication, provide detailed evaluations of the methodology employed in the work along with assessments of the strength of the research findings and conclusions. The reviews are consistent in finding serious methodological weaknesses sufficient to put in jeopardy the conclusions put forward by Cumming and his fellow researchers.

In the first review, Allan Timmermann, Atkinson/Epstein Endowed Chair, Professor of Finance, Co-Director, Master of Finance Program, Rady School of Management, University of California, observes that for the most part Cumming et al. uses only one year (12 monthly observations) of monthly return data to estimate future performance, a practice out of step with the bulk of financial literature. A more common choice would be to use 24, 36, or 60 months of returns data. Mr. Timmermann also notes that the particular measurement of alpha used by Cumming et al. is “inappropriate” in that it uses the same set of factors regardless of the funds’ asset class (i.e. bond vs. equity funds) and investment objective. Another major criticism of Timmermann’s is that differences in alpha associated with different purchase options are very small in statistical terms and there are no associated calculations showing the economic effects of these. Specifically, “what is the estimated reduction in investment performance associated with higher trailer fees or various charges in basis points per year? How large are the effects both gross and net of fees?”

In the second review, Benoit Perron, Professor of Economics, Département de sciences économiques, Université de Montréal, expresses concern consistent with Timmermann about how alpha is used, and notes limited or missing observations. Perron’s larger criticism relates to Cumming *et al.*’s interpretation of the results. Specifically, he observes that the “work does not seem to answer at all the question of whether fee-based or commission-based remuneration is better for individual investors. It is not clear at all what objective investors are assumed to be trying to achieve.”

In their review, Oliver Linton, Professor of Political Economy and Econometrics at Cambridge University and a Fellow of Trinity College and student researcher Ondrej Tobek of the University of Cambridge, find that the conclusions put forward by Cumming et al. are “simply too strong to be justified by the analysis.” They note that there is “…fragility in the results across time period and in other dimensions and that the economic magnitude of the effects they claim is open to different interpretations.” Given a number of methodological issues and weak statistical relationships detailed in the Cumming et.al. analysis, the authors conclude that [the] “…causal interpretation that the authors are pushing is simply not defensible. At most they can claim some weak association in the data.” In particular, they find that Cumming et al. has not sufficiently separated out the effects of past alpha on future alpha in the equations, resulting in a problem of endogeneity that is not addressed.

These academic reviews highlight serious limitations in the Cumming et al. analysis and suggest that any conclusions should be subject to skepticism due to outstanding methodological issues. All these authors offer constructive suggestions for an improved future iteration.

The full texts of the three reviews are published as appendices to a research report produced by PricewaterhouseCoopers LLP.[1]

[1] PricewaterhouseCoopers LLP, Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds, May 2017, attached as Appendix G.

ECONOMIC IMPACT ASSESSMENT OF BANNING EMBEDDED COMMISSIONS IN THE SALE OF MUTUAL FUNDS

ECONOMIC IMPACT ASSESSMENT OF BANNING EMBEDDED COMMISSIONS IN THE SALE OF MUTUAL FUNDS

INCLUDES COMMENT LETTERS

Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds

June, 2017

Table of Contents

Executive summary

PwC has been retained by The Investment Funds Institute of Canada ("IFIC") to provide an independent economic assessment of the likely impacts that would result from a ban on embedded commissions in the sale of mutual funds in Canada through financial advisors. To that end, we have engaged in the following major steps:

1. Assessed the benefits of the use of financial advisors;
2. Studied the current evidence of a conflict of interest between financial advisors and clients in Canada;
3. Analysed the current impact of embedded commissions on the sale of mutual funds in Canada;
4. Assessed the overall cost of financial advice in Canada;
5. Based on the above, developed hypotheses on how a ban on embedded commissions will impact the market for mutual funds in Canada and the Canadian economy;
6. Conducted a jurisdictional review of countries that have contemplated and/or implemented a ban on embedded commissions; and
7. Concluded on the likely impacts of a ban on embedded commissions on the market for mutual funds in Canada and on the Canadian economy.

The Value of Financial Advice

Taken together, the academic empirical research shows that while financial advisors are not able in their investment choices to consistently beat relevant market benchmarks after fees, their advice generates significant net benefits to investors in terms of a more disciplined savings behaviour, overall higher asset values, more efficient tax planning, and retirement confidence. In addition, survey results indicate that Canadian mutual fund investors seeking financial advice place high trust in their advisor and believe that the use of a financial advisor helps them to achieve their financial goals. Moreover, since the high level of trust that Canadian investors have in their advisors is likely driven by long term relationships, the academic literature suggests that such trust is generally justified, as investors' benefits tends to increase with the longevity of their relationship with their advisor.

The main reason that empirical studies show significant net benefits from the use of advisors is founded in behavioural economics. According to research from this field, investors tend to suffer from behavioural biases such as loss aversion, short-termism, and overconfidence. Sound financial advice helps to mitigate these biases and, as a consequence, helps investors to achieve higher savings. In an ageing society, assisting people in saving sufficiently for a comfortable retirement is a critical public policy issue. As financial advisors help investors in generating overall higher savings for their old age, financial advice is an important component in a policy strategy to achieve this goal.

Conflict of Interest

Financial advisory services are characterized by asymmetric information between advisors and clients. Potential conflicts exist in any such relationship irrespective of the fee structure. Moreover, financial advice is a "credence good," meaning that many investors are unable to confidently assess the quality of services provided.

In general, conflicts of interest in financial advice can be mitigated by increased financial literacy, increased disclosure and transparency, and longevity of relationship between advisor and investor.

The general level of education of Canadian mutual fund investors is relatively high, however this may not be a good proxy for financial literacy. The increased transparency rules that were fully implemented in Canada in 2016 are capable of mitigating the fee information gap that existed prior to this legislation. We do not have yet empirical data to test the validity of the effectiveness of these rules in conveying fee information to investors. However, the relatively high education profile of Canadian investors and the fact that currently the majority of Canadian investors in mutual funds are informed support the hypothesis that Canadian investors would be able to understand information disclosed about their investments, even upon a cursory review of the statements sent to them. Moreover, the current share of informed mutual investors and the heavy reliance of financial advisors and their firms on reputation and long term relationship with investors suggest that a critical mass of informed investors does exist which effectively discourages widespread misconduct by financial advisors.

In general, Canadian investors appear to have long-term relationships with their advisors and overwhelmingly trust their advisors. The following suggests that this trust is positive and mutual in nature and that advisors in Canada generally align their interests with those of their investors:

- a majority of investors evaluate the performance of their investment portfolios in some form or another;
- investors do punish their advisors when they perceive sub-performance;
- academic research shows that long term relationships between advisors and investors lead to significantly better outcomes for the investor; and
- a recent academic study in Canada shows that the portfolio of advisors who invest for themselves does not differ significantly from the portfolio they recommend to their clients.

Cost of Advice

Canada has higher average fund management fees than most developed countries. However, in many of those countries compensation for advisors is paid through direct payments rather than included in fund management fees. Since, unlike embedded commissions, data on direct fees is not easily available, it is not possible to ascertain whether the overall cost of advice in Canada is higher than in those countries. However, a detailed study done in this regard suggests that the overall cost of advice in Canada and the US is similar even though the US boasts the lowest fund management fees in the world.

The average advisor compensation in Canada is lower than in the US, UK and Australia. Thus, it is doubtful that advisor compensation is the main driver of the higher fund management fees in Canada. Embedded commissions do not appear to be inflating advisor compensation above international norms.

Hypotheses

The following hypotheses represent our predictions of what would happen following a ban on embedded commissions. They are based on the evidence and theory reviewed in this Report, but are not directly testable.

Hypothesis 1 – A ban will reduce the demand for advisor services as well as the supply of advice, both of which will act to reduce the use of or access to advisors by mass-market[1] investors. Mass-market investors who would continue to use an advisor will likely see an increase in the cost of advice.

Hypothesis 2 – A ban on embedded commissions will likely eliminate some existing misalignments between advisors' and investors' interests, but may give rise to new misalignments.

Hypothesis 3 - Reduced profitability for some players may lead to consolidation of the advisory industry and a risk of increased bias towards funds produced by the same organizations that provides the advice. Banks are generally in the best position to serve mass-market clients who stop using independent advisors.

[1] Mass-market investors have less than $100,000 of investable assets.

Jurisdictional Review

Current transparency rules in Canada are significantly stronger than in the UK and Australia both prior to their respective bans on embedded commissions and currently. Thus, given that transparency is one of the means to mitigate the risks inherent in agent-principal relationships, these risks should be significantly less acute in Canada.

There is no strong evidence from the UK or Australia that cost of advice has decreased as a result of the ban on embedded commissions. The shift to lower cost products such as ETFs following the ban is a continuation of a trend that has been evident in many countries including Canada and it is difficult to ascertain to what extent, if any, banning embedded commissions accelerated this process.

On the other hand, it is not clear whether an advice gap was created in these countries following the ban on embedded commissions. In this regard, we note that in Canada the use of embedded commissions is more wide spread and thus the likelihood of an advice gap would be more pronounced than in those countries. We further note that bans on embedded commissions in UK and Australia followed evidence of major mis-selling of investment products in those countries,[2,3,4] but that Canada has not seen mis-selling on this scale.

Other countries have contemplated a ban on embedded commissions and have rejected it, generally for the fear of an advice gap. Instead they generally opted for more disclosure as a solution to conflict of interest issues.

Conclusions and Quantification of Economic Impacts

Based on our assessment and subject to the scope of review and limitations of this report we conclude the following:

1. Transparency, financial literacy and long term relationships between advisors and investors are the ultimate assurance for a well-functioning financial advisory market, where interests of advisors and investors are aligned.
2. Canadian investors who use advisors are generally well educated and have trust in their advisors that has developed through long term relationships.
3. Current transparency rules in Canada are at a level that creates a critical mass of informed Canadian investors which acts as an effective deterrence against the possibility of misconduct by financial advisors.
4. There is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour. A ban on embedded commissions would likely eliminate some of these influences, but would create new instances of misalignment of interests between investors and advisors via new fee schemes.
5. Banning embedded commissions in Canada would likely lead to negative consequences for the mass-market investors in the form of:
    a. Less access to financial advice;
    b. Lower savings available at retirement; and
    c. Higher cost of advice for those who would want to continue receiving financial advice.
6. Robo-advice is a viable alternative solution for some investors who would stop using an advisor but not for all.
7. Banning embedded commissions may lead to industry concentration that would create other forms of biases such as those created by greater vertical integration.
8. The estimated economic footprint of Canada's investment advisory industry amounts to around $25 billion in total output, $12 billion in total GDP, $8 billion in labour income and 116,000 full-time equivalent jobs. These figures include the direct, indirect and induced impacts on Canada's economy.

[2] Ferguson & Vedelago, 2013
[3] Money Marketing, 2009
[4] Hyde, 2013

9. In the absence of embedded commissions, the potential imposition of a $100,000 minimum investment threshold for providing advice[5] would have a significant negative impact on the economic footprint of the investment advisory industry in Canada. For example, if no new advice models were introduced, the contribution to GDP from the industry would shrink by between approximately $2.8 and $3.3 billion.

10. The move from an advisor to DIY[6] investing is expected to reduce the amount of savings available to those Canadians at retirement. On an order of magnitude basis, those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice.

[5] The common threshold in Canada for fee-based service is $100,000 to $250,000.
[6] DIY investors do not use the services of a financial advisor. They may research investment products themselves and purchase them using an intermediary such as a bank or online brokerage.

Introduction

On January 10, 2017, the Canadian Securities Administrators ("CSA") released CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("CSA Paper"), which contemplates the banning of embedded commissions in investment fund products.

The CSA Paper hypothesises that embedded commissions raise three main investor protection and market efficiency issues:

1. Embedded commissions result in conflicts of interest that misalign the interests of investment fund managers, dealers and advisors against those of their clients (investors);

2. Embedded commissions limit investor awareness, understanding, and control of dealer compensation costs; and

3. Embedded commissions generally do not align with the services provided to investors.

The concerns raised in the CSA Paper led the CSA to conclude that a change to a different compensation model must be considered, but the CSA emphasizes that it has not made a decision to discontinue embedded commissions. The CSA will reach its final decision in this regard following a consultation process.

As part of this consultation process, PwC (or "we") have been engaged by the Investment Funds Institute of Canada ("IFIC") in order to independently assess the likely economic outcomes if Canada were to ban embedded commissions (our "Assessment").

This report (the "Report") presents the findings of our assessment, the scope of our review, the data collected, as well as our analysis.

The following PwC staff contributed to this study:

Michael Dobner – Partner, Leader of PwC Economics Practice
Matthias Oschinski, PhD – Senior Economist
Gemma Stanton-Hagan – Economist
Michal Staszewski – Economist

Scope of Review

To prepare this assessment, we have reviewed and, where appropriate, relied upon various documents and sources of information.

By general classification, these sources include:

- Data Sources on Advisors and Investors
    - PwC Survey
    - Interviews with market participants
    - Strategic Insight
    - Pollara Survey
    - Innovative Canada Survey
    - Morningstar
    - Financial Conduct Authority (FCA) UK
    - Academic Studies
- Data Sources on Regulatory Environment
    - Fundscape
    - Strategic Insight
    - Europe Economics
    - Financial Services Council
    - Investment Management Association
    - Financial Conduct Authority (FCA) UK
    - Australian Bureau of Statistics

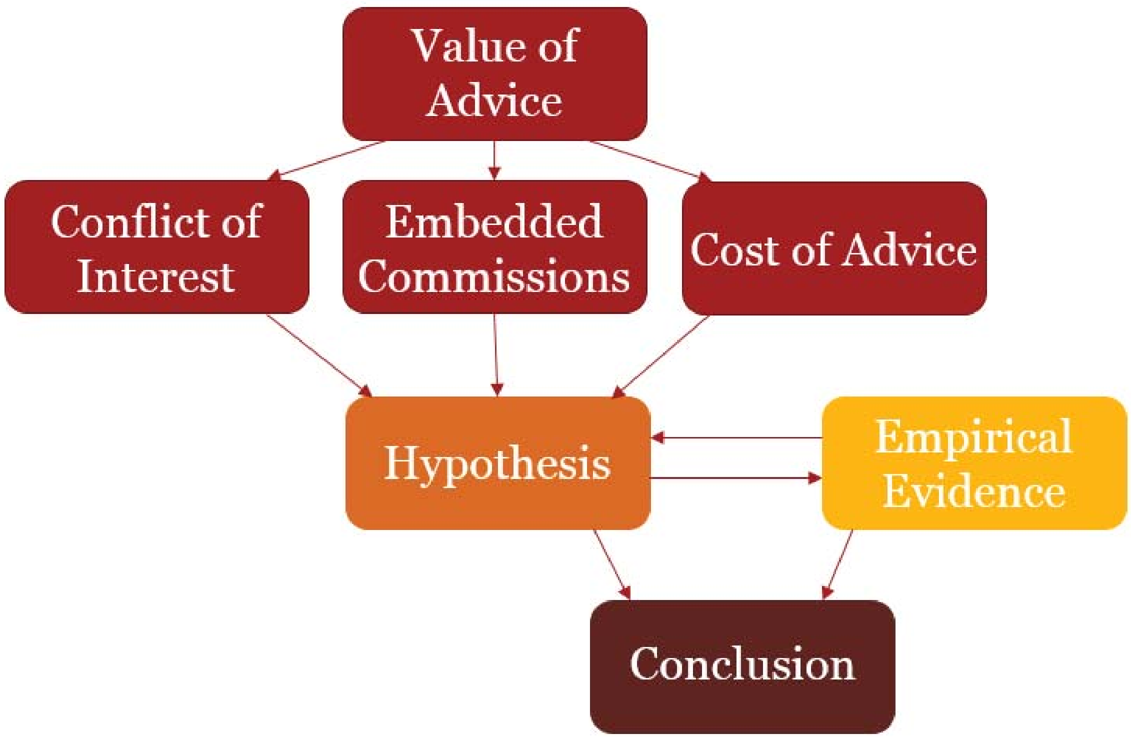
A list of sources and articles used for the purpose of this assessment is available in Appendix B.

We note that PwC relied upon the completeness, accuracy, and fair presentation of all information, data, advice, opinions or representations obtained from various sources, which were not audited or otherwise verified by us.

Approach and Methodology

At the core of our approach is the value of financial advice. It is through this lens that we approach the question of embedded commissions and their impact on the mutual fund industry. We examine how the value of advice is related to conflicts of interest, embedded commissions, and to the overall cost of advice to the investor. Based on these theoretical and empirical underpinnings, we developed our hypotheses, which further evolved based on findings from empirical evidence in other countries.

Figure 1: Approach



Assessing the likely economic impacts of a contemplated change in legislation is a complicated process and does not lend itself to a "black and white" analysis. One of the more common mistakes made in such assessments is the use of a static analysis that ignores likely chain reaction effects and longer term responses by market participants to such change. This type of mistake often leads to an assessment that does not consider unintended consequences and does not enable a proper cost benefit analysis of the likely positive impacts against the likely negative impacts of the contemplated change in legislation.

In our assessment, a deliberate effort was made to avoid the situation described above. To this end, our approach to this assessment was holistic in nature. It involved an identification of the players involved in the mutual fund market in Canada, and an understanding of their interests in light of the current structure of advisor compensation and the current regulatory environment. This was achieved through the collection of data, market surveys, and through interviews. We have also conducted a broad literature review regarding issues relevant to our assessment in order to incorporate relevant theoretical and empirical studies into our analysis. Finally we conducted a jurisdictional review of a sample of countries where a ban on embedded commissions was contemplated. This was done with the aim of understanding why some of these countries decided not to implement the ban while others did. For two of the countries that did implement the ban (Australia and the UK), we have examined the impacts following the implementation of the ban.

The above process enabled us to develop informed hypotheses regarding the likely impacts of a ban and to test these hypotheses against the findings of our jurisdictional review.

Our conclusions therefore represent the culmination of an informed and holistic review. Our conclusions are not meant to serve as a recommendation to policy makers, rather they intend to serve as a framework for an informed decision making. In other words, our conclusions intend to provide policy makers a balanced view of the likely impacts of a ban on embedded commissions.

Given our approach, our methodology included the following major steps:

8. Assessed the benefits of the use of financial advisors;

9. Studied the current evidence of a conflict of interest between financial advisors and clients in Canada;

10. Analysed the current impact of embedded commissions on the sale of mutual funds in Canada;

11. Assessed the overall cost of financial advice in Canada;

12. Based on the above, developed hypotheses on how a ban on embedded commissions will impact the market for mutual funds in Canada and the Canadian economy;

13. Conducted a jurisdictional review of countries that have contemplated and/or implemented a ban on embedded commissions; and

14. Concluded on the likely impacts of a ban on embedded commissions on the market for mutual funds in Canada and on the Canadian economy.

The Mutual Funds Market in Canada

In order to contextualize the policy discussion about embedded commissions, the following section provides background on the mutual funds market in Canada. It reviews the role of financial advisors, distribution channels for mutual funds, and current models of advisor compensation. It then discusses investor profiles, and recent changes in the investment industry. Finally, we review the current regulatory environment in Canada along with proposed changes.

Mutual funds in Canada are manufactured by dedicated mutual fund manufacturers, investment management firms, as well as financial institutions such as banks that offer diverse savings products and financial services to their clients in addition to investments.

In 2016, Canada had around 115 fund companies offering more than 3,500 unique mutual fund products. Long-term investment fund assets amounted to $1.4 trillion. Banks accounted for roughly 48 per cent of investment fund assets, followed by independents (such as Fidelity Investments and Investors Group) with a combined share of 38 per cent of investment fund assets, and life insurers and ETF firms with a 5 percentage share each.[7]

Table 1 depicts the largest 20 Canadian mutual fund manufacturers by market share as of December 2016. As the table shows, the top ten companies had a combined market share of around 66 per cent, and the top 20 companies a combined market share of roughly 80 per cent.

Table 1: Asset Market Share of All Mutual Funds (Dec. 2016 assets)[8]

Manager	Share of All Mutual Funds
RBC Global Asset Management	14.1%
TD Asset Management	8.9%
Fidelity	7.4%
BMO Investments	6.6%
Scotia Global Asset Management	6.5%
CIBC Asset Management	6.4%
Investors Group	5.7%
BlackRock Canada	3.8%
Mackenzie	3.5%
Manulife Mutual Funds	3.5%
Top 10 (as of Dec. 2016)	66.3%
MD Financial	2.2%
Desjardins Investments	1.9%
National Bank	1.8%
Franklin Templeton	1.4%
Sentry Investments	1.3%
AGF Investments	1.2%
IA Clarington	1.0%
Beutel Goodman	1.0%
SEI Investments Canada	0.9%
Top 20 (as of Dec. 2016)	80.2%

[7] Strategic Insight, Investor Economics Insight, January 2017.
[8] Strategic Insight, Investor Economics Insight, January 2017.

The largest manufacturers of mutual funds in Canada are banks, which constitute the top four fund managers by assets under management (AUM). Other significant manufacturers include multinational investment management firms such as Fidelity and Franklin Templeton, as well as Canadian firms including Investors Group, Mackenzie and Manulife Mutual Funds.

In addition to being the largest fund manufacturers, banks also manage the majority of the twenty largest Canadian funds.

Mutual Fund Distribution Channels

Mutual funds are distributed through both independent and exclusive channels. An exclusive firm primarily offers its own funds, with a few external fund managers possibly catering to niche markets.

An independent mutual fund dealer typically offers funds from several, if not all, major mutual fund manufacturers, and this model is referred to as an “open shelf” concept. A significant number of financial advisors working with independent mutual fund dealer firms also deal with one or more managing general agents (MGAs) for insurance product offerings, as they also carry an insurance license. Unlike life insurance licensed advisors, who can work through multiple channels or distributors, financial advisors who are licensed for mutual funds may only be a representative of one mutual fund dealer.

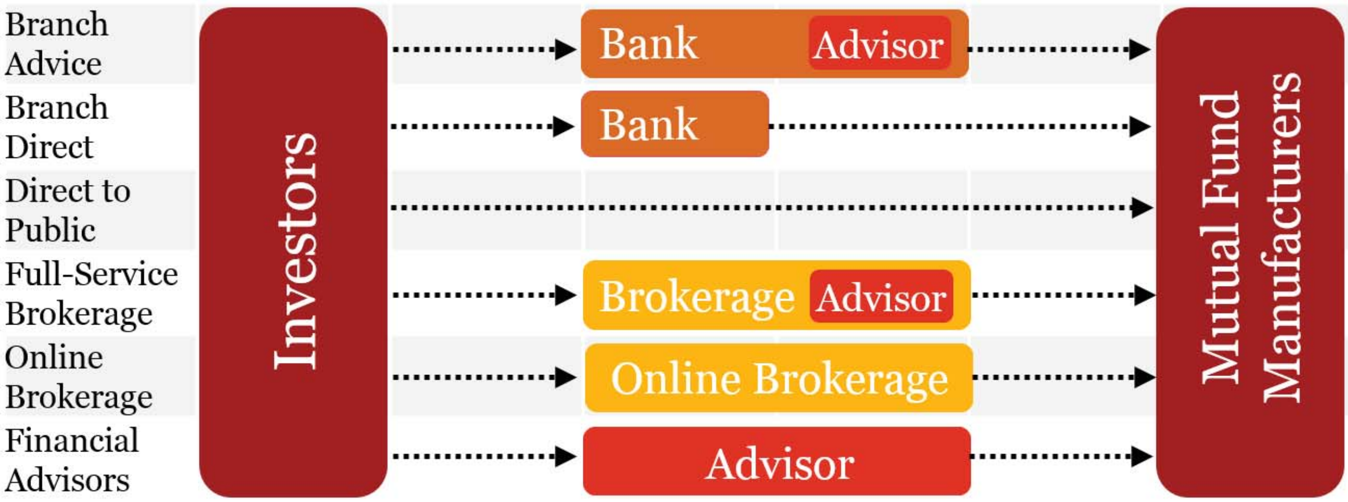
Two main dealer-based Self-regulatory organizations (SROs) oversee the sale of mutual funds and securities to Canada’s investors: the Mutual Fund Dealers Association (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC). These organizations are overseen by the CSA. The Ontario Securities Commission defines an SRO as, “an entity that is organized for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest.”[9]

Mutual fund dealers regulated by the MFDA include 111 firms, 81,894 sales persons and $502.6 billion of collective assets under administration (AUA).[10] .

Securities dealers regulated by IIROC represent 180 firms, and 28,704 dealers.[11] IIROC’s regulatory focus is directed specifically at member firms and their registered employees who sell a wider range of products, including mutual funds and exchange traded funds (ETFs), guaranteed investment certificates, stocks, bonds, derivatives and alternative investments including hedge funds. In Quebec, the Chambre de la sécurité financière (CSF) and the Autorité des marchés financiers (AMF) also regulate securities and mutual fund markets.

[9] Refer to “Regulatory Environment” for further information on SROs.
[10] MFDA Membership Statistics
[11] IIROC, 2016

Figure 2: Mutual Fund Distribution Channels



Mutual funds in Canada can be purchased through one of the following distribution channels:

- **Branch advice** – distribution channel that offers financial planning and investment products through branches of deposit-taking institutions such as major banks and credit unions. The channel is made up of in-branch advisors who typically hold MFDA licensing, although some are also registered through IIROC.

- **Branch direct** – distribution channel made up of banking and other employees available to "walk-in" clients, who provide limited financial advice and initiate mutual fund transactions. Branch direct clients may move to the branch advice channel to receive more complete financial advice. The dealers operating through the branch direct channel are registered as mutual fund dealers with the provincial securities regulators. Within this channel, the majority of advisors are not paid a portion of the trailing commission. Rather, they are paid on a base and bonus structure. The branch direct channel is one of the fastest growing segments of the market.

- **Direct-to-public** – distribution channel that offers the sale of mutual funds directly to the investor. The channel includes registered mutual fund dealers such as private investment counsellors and specialist firms.[12] The services provided through this channel are primarily transaction focused.

- **Full-service brokerage** – this distribution channel offers full range of investment services to investors, including equity and fixed income securities, mutual funds, ETFs and other securities. The channel includes those IIROC member firms that have client-facing advisors with a retail offering of directly-held securities and fee-based managed asset solutions.

- **Online brokerage** – distribution channel delivering a wide range of investment products to do-it-yourself investors. Investment advice is typically not offered through this channel and products are delivered through centrally managed platforms. The online channel has been growing significantly in recent years, both in terms of the number of investors and assets under management. However, it remains small as a share of total AUM.

- **Financial advisors** – distribution channel made up of various firms, including dealer firms that offer a comprehensive range of investment services, as well as unregistered fee-only planning firms. These business models have varying degrees of independence and different product shelf capabilities.

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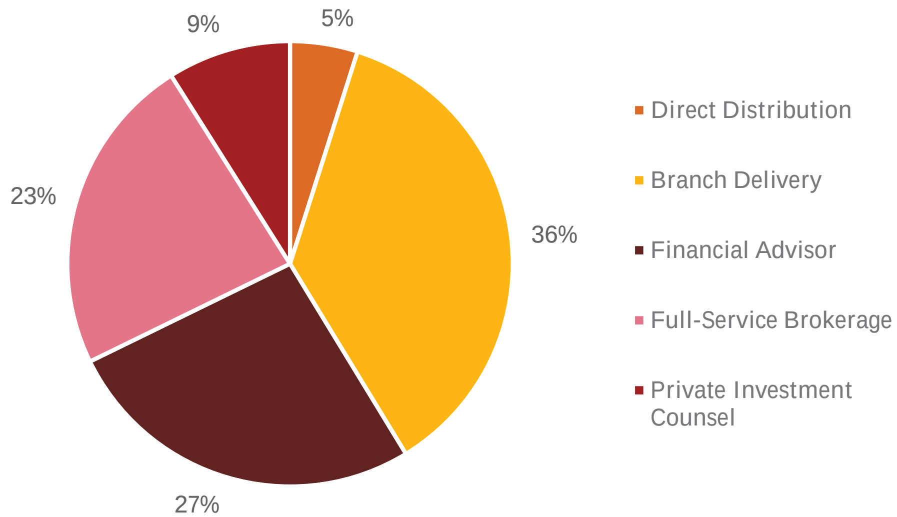
[12] Investor Economics & Strategic Insight, 2012

The Role of Financial Advisors in the Sale of Mutual Funds

The following figure shows each distribution channel's share of total AUM as of 2016. In reference to the classification in Figure 2, Financial Advisors and Private Investment Counsel would both be considered "Financial Advisors." Branch delivery refers to both branch advice and branch direct channels. Direct distribution includes online brokerages.

Figure 3: Mutual Fund Assets by Distribution Channel, June 2016[13,]



Advisor Compensation

Advisors are paid for the sale of mutual funds in a variety of ways, which can often be selected by the consumer in conjunction with their advisor. Some advisors only offer funds with specific fee structure, such as no-load funds. Mutual fund manufacturers pay embedded commissions to the mutual fund dealer, who in turn typically have a commission sharing agreement with their advisors.

Table 2: Compensation Models for Financial Advisors

	Time Paid	**To Whom**	**Embedded**	**Accessible to Mass Market (<100K)[14] Investors**
Front End Load (Sales Commission)	Time of purchase	Dealer	No	Yes
Back End Load (DSC)	When fund is redeemed (if within 5-7 years)	Fund Manager pays the Dealer	Yes, commission is paid to the dealer at the time of purchase	Yes

[13] SI Investor Economics Insight, 2017
[14] Mass-market investors have less than $100,000 in investable assets.

Low Load DSC	When fund is redeemed (if sold within 1-3 years)	Fund Manager pays the Dealer	Yes, commission is paid to the dealer at the time of purchase	Yes
Trailer Commission	Ongoing	Fund Manager pays the Dealer	Yes, commission is paid to dealer on an ongoing basis	Yes
Fee-Based	Ongoing	Dealer	No	No[15]
Hourly Fee	At time of purchase	Dealer or Advisor	No	No[16]

The most common structures for compensation include:

1. **Fees Paid at Time of Purchase or Sale**

   - **Front End Load:** A set percentage of the investment is paid by the customer to the advisor's firm at time of purchase – resulting in a lower net investment of funds by the client. This commission is usually negotiable up front, and often ranges from 0% to 5%. We note that for funds with this fee structure, the load charge is often waived.

   - **Back End Load:** Commission is paid by the fund company to the advisor's firm at the time of purchase (i.e. no commission is paid by the investor. Hence, the amount of the commission is not deducted from the initial investment made by the customer.

     Instead, a redemption schedule is established outlining the amount of time the customer is required to stay invested in the fund in order for the fund company to recover its costs associated with the upfront commission payment. If the customer decides to redeem the mutual fund prior to the expiration of the redemption period, a redemption fee is charged.

     There are 2 types of Back End Load fund structures:
     - *Deferred Sales Charge (DSC)*: The commission rate paid to the advisor's firm is typically 5%. The redemption fee rate is set on a sliding scale, starting at up to 7%, which diminishes to 0% over a 5 to 7 year period.
     - *Low Load*: Similar to DSC, but with a lower, negotiable commission rate (i.e. typically 1% to 3%), lower redemption rate and shorter schedule (typically 1 to 3 years).

   - **No load:** No sales commission is charged or paid when a fund is purchased or redeemed. This structure is normally offered only by direct sellers/manufacturers.

2. **Ongoing Fees based on Cumulative Assets Held**

   - **Fee-Based:** Similar to No Load, but sold by a financial advisor who may charge a fee percentage based on the total of the assets or for other services.

   - **Trailer fees:** In addition to the sales charges described above, advisors may also receive a trailer commission from their dealer, which is an annual service commission, based on the percentage of assets held by the client, paid to the dealer by the mutual fund manufacturer for as long as the customer maintains their investment in the mutual fund. The financial advisor who receives a portion of this service commission is expected to provide the customer with ongoing services, such as answering questions regarding fund performance, account details and tax issues.

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[15] In the United States, some institutions now offer fee-based services to mass-market investors, but these services are not yet available in Canada. Robo-advisors are not considered financial advisors for the purpose of this comparison.
[16] Hourly advice is accessible to mass-market investors, but given of the relatively small portfolio size, it is not practical for most.

An advisor's compensation is paid pursuant to a commission grid. For mutual fund dealers, the firm will pay between 60 per cent and 80 per cent of the trailer fee to the advisor depending on their volume of business and their relationship with the firm. These advisors operate independently and pay many of the expenses related to their financial advice practice themselves. Full service brokerage firms typically provide more services to their advisors, therefore pay out a smaller percentage of the commissions, ranging from 25 to 55 per cent.

Fee-based platforms

Advisors at IIROC-licensed full service brokerage firms and mutual fund dealers may also offer their clients a fee-based investment program. This platform has become more popular in recent years: Investor Economics estimates that in 2015 37 per cent of all assets in the full-service brokerages of the big six banks were held in fee-based accounts, compared to 16 per cent in 2005. In 2015 26 per cent of assets in independent full-service brokerages were in fee-based accounts, compared to 16 per cent in 2005.[17]

At traditional fee-based retail brokerages, clients are charged a straightforward percentage of the money they invest – typically about 1-2 per cent of the assets under their watch – and they forgo mutual fund trailer fees and commissions on stock trades.[18] Advisors receive a share of this fee. However, fee-based platforms typically have a minimum investment level of at least $100,000, thereby making them inaccessible to mass-market investors.

Hourly Rates for Advice

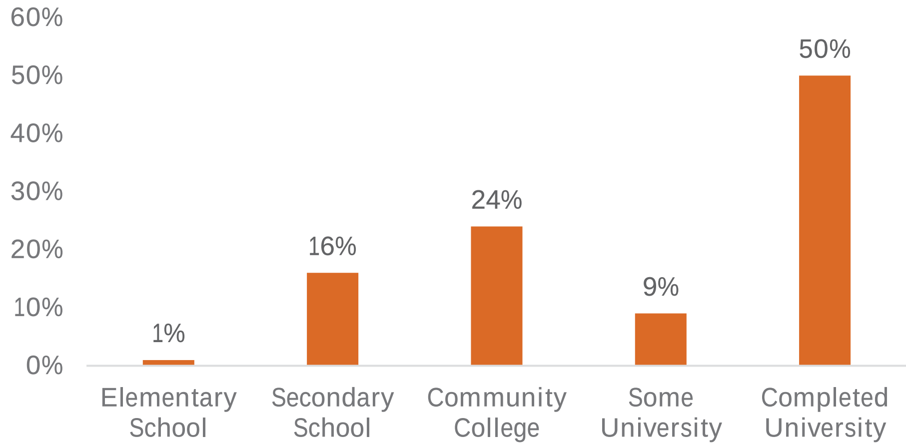
Investors may also hire financial advisors on a per-hour basis. Advisors in Canada typically charge between $100 and $300 dollars per hour, or between $1,000 and $5,000 for a full financial plan.[19] These fee levels make hourly advice impractical for mass-market and even some mass-affluent investors.

Profile of Investors

According to the Pollara survey on Canada's mutual fund investors, over 80 per cent have a post-secondary degree (see Figure 4). Approximately half of all investors graduated from university, approximately 10 per cent received some university education and approximately one quarter graduated from a community college.

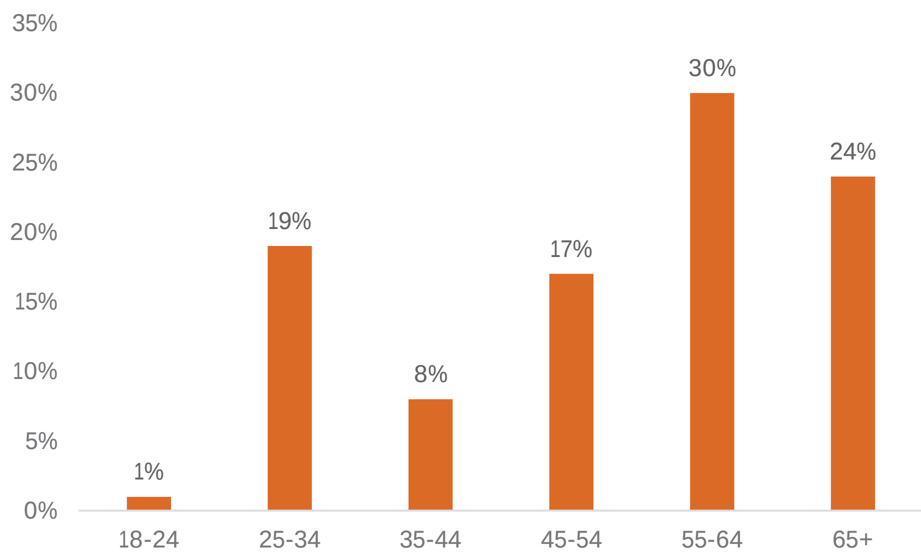
[17] Collie, 2015
[18] Kiladze, 2013
[19] Macleans, 2015

Figure 4: Educational Level of Mutual Fund Investors in Canada[20]



The vast majority, roughly 70 per cent, of mutual fund investors in Canada are over the age of 45 (see Figure 6). In fact, around 30 per cent are in the age cohort of 55 to 64 years and almost one quarter are in the age cohort of 65 years and over. Investors between ages 25 and 34 make up approximately 18 per cent.

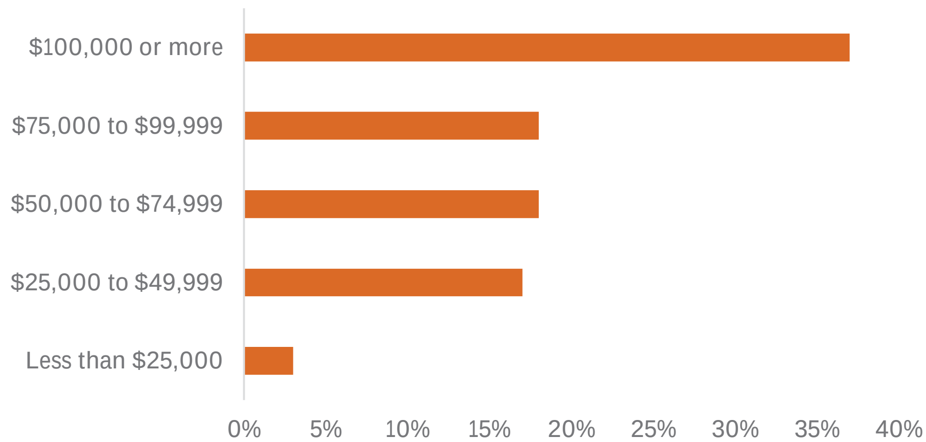
Figure 5: Mutual Fund Investors by Age[21]



Around 37 per cent of households have total household income of $100,000 or more. Around 36 per cent of households have total household income ranging from $50,000 to $99,999. Finally, around 20 per cent of households have a total household income below $50,000 (Figure 6).

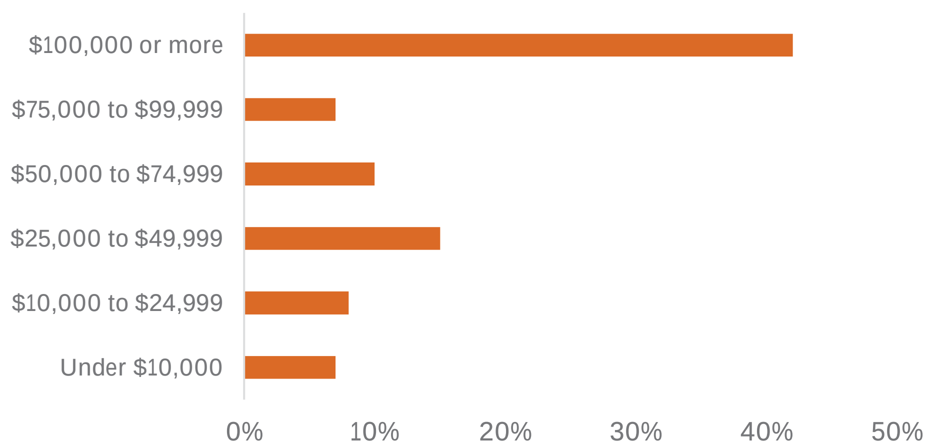
[20] Pollara, 2016
[21] Pollara, 2016

Figure 6: Household Income of Canadian Mutual Fund Investors[22]



Among Canadian households who own mutual funds, over 40 per cent own more than $100,000 of mutual funds (Figure 7). Around 7 per cent of households hold between $75,000 and $99,999 in mutual funds and 10 per cent of households have current investments in mutual funds between $50,000 and $74,999.

Figure 7: Household's current investment value in mutual funds[23]



Investors are grouped into three categories based on their net worth. Mass-market investors have under $100,000 in investable assets. Mass-affluent investors have between $100,000 and $500,000. Affluent investors have over $500,000.

Robo-Advisors

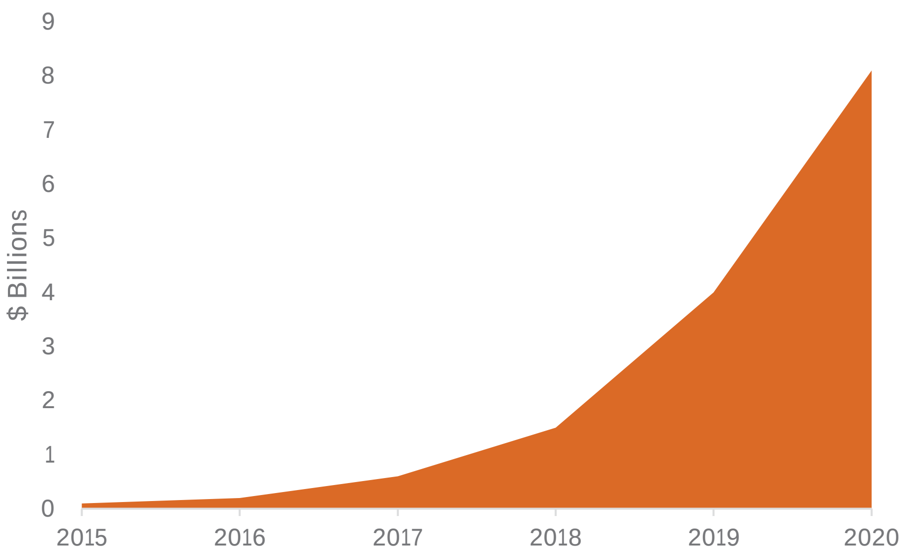
Traditional distribution channels are now faced with the rise of the "digital advice" channel, otherwise known as "robo-advice." The global advent of robo-advice started less than 10 years ago when firms launched a digital user interface that utilized sophisticated algorithms to develop automated asset allocation / portfolio models and create

[22] Pollara, 2016
[23] Pollara, 2016

specific investment recommendations tailored to meet investors' needs. Robo-advisors typically provide these solutions at considerably lower costs when compared to traditional investment fund distribution channels. In Canada most robo-advisors charge an "advice fee" or direct fee in the range of 0.25 to 0.65 per cent, which is paid in addition to the MER of investment funds.

Consequently, global growth of robo-advisors has experienced substantial growth with assets under management totalling approximately $60 billion USD at the end of 2016.[24] Global robo-advice assets are projected to grow to over $8 trillion USD by the end of 2020.[25] The Canadian investment fund distribution landscape began evolving with the launch of almost half a dozen robo-advisors in 2014. Since then, Canada's robo-advisor industry has experienced fast growth with a currently estimated $1 billion in assets under management.[26] The market leader in Canada, WealthSimple, currently serves over 15,000 clients and has over $750 million in assets under management, and anticipates to have over $1 billion by the end of 2017.[27] In January 2016, Canada's first bank owned robo-advisor (BMO Smartfolio) launched, signalling the entry of Canada's big banks into the robo-advice space.

Figure 8: Global AUM by Robo-Advisors[28]



While it is common for robo-advisors to primarily sell ETFs, some also sell mutual funds.

Robo-advisor channels tend to be marketed towards millennial investors, but in a 2016 survey the average investor age was 43, similar to the average investor age for traditional channels.[29] Robo-advisors tend to target smaller investors and generally have no minimum investment, or a low minimum such as $5,000. Most robo-advisors in Canada offer model portfolios based on investor profiles rather than customized options.

The main function of robo-advisors is to select a portfolio, invest and rebalance automatically based on algorithms. However, some robo-advisors in Canada offer guidance on account choice and written financial plans that go

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[24] Moyer, 2015
[25] Kocianski, 2016
[26] BMO Global Asset Management research, 2016
[27] Ho, 2017
[28] Kocianski, 2016
[29] Carrick, 2016

beyond portfolio design.[30] Wealthbar is the only firm to include an annual review with an advisor. The costs of these services are included in the direct fee paid as a share of assets or fixed a monthly charge.

Some robo-advisors in the US such as Personal Capital and Vanguard Personal Advisor Services offer more extensive financial advice from humans along with automated investment services. These hybrid advice services may also have portfolio minimums, meaning that they are not accessible to all mass-market investors. For example, Personal Capital has a $25,000 USD minimum and Vanguard Personal Advisor Services has a $50,000 USD minimum. As far as we are aware, no such hybrid services are offered in Canada at this time.

While robo-advice does seem to appeal to growing parts of the investor population, it is apparent that the current technology has limitations that do not enable it to effectively service all clients. While robo-advisors offer some guidance, robo-advisors in Canada currently do not offer complete financial advisory services. This may make them inadequate for investors with more complex financial planning needs such as estate planning and tax planning. Secondly, the questionnaires provided by robo-advisors to assess investors' needs may be too simplistic to provide appropriate advice. For example, many do not ask about assets outside of what the investor would like to invest with the firm, and therefore do not take into account factors like debt and real estate holdings. Additionally, many investors are still uncomfortable with the idea of robo-advice. Finally, as this technology is fairly new, it is not yet clear whether robo-advisors can provide a substitute for the behavioural coaching that advisors provide. As discussed later in this Report, human financial advisors have been shown to help investors to save more and counter investor biases in investing strategy.

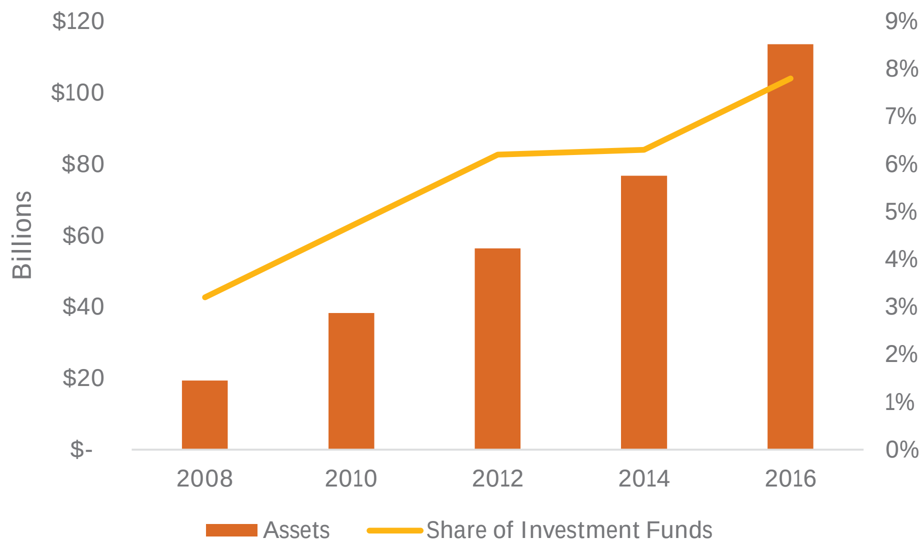
Generally speaking, robo-advice is a platform that offers a lower cost alternative to mass-market investors. Notwithstanding the above limitations and any changes in regulations, it appears that the growth in the use of robo-advice will continue to accelerate, driven by evolving technology such as artificial intelligence, and the increasing adoption of such technology by younger generations.

Growth in ETFs

Another important change in the investment industry is the recent growth of exchange-traded funds (ETFs). ETFs are investment funds that trade on the stock exchange. Most ETFs track indices of other stocks such as the S&P 500, but there are ETFs for many smaller market segments and for funds of funds including mutual funds. ETFs tend to have lower fees than mutual funds because they passively track an index of stocks rather than actively managing the fund. Since 2008, the ETF market in Canada has grown significantly, totalling 478 funds and $122.9 billion in assets, as of March 2017. Figure 9 shows the increase in assets in ETFs and in these assets as a share of total investments.

[30] Carrick, 2016

Figure 9: Assets in ETFs as of December of Each Year[31]



As described in PwC's "A Roadmap to Growth" publication in 2016, the manner in which ETFs across the globe continue to evolve. Based on that survey, financial advisors, online platforms, and retail investors are expected to be the top three segments driving global demand for ETFs over the next five years. Almost 86 per cent of North American respondents expect that financial advisors will continue to create significant demand for ETFs over the next five years, contrasted with approximately 43 per cent for Europe and Asia.

Regulatory Environment

The regulatory system for Canada's investment fund industry focuses on achieving a balance of promoting investor protection, confidence and fairness, while also attempting to improve regulatory "harmonization" through the development of uniform rules to be applied to all investment funds sold to retail investors including mutual funds, exchange traded funds, closed-ended funds and scholarship plans.

In Canada, the manufacturing and distribution of investment funds and other securities is regulated under provincial securities legislation and through rules and guidance set by provincial securities commissions. The main rules and guidelines that govern investment funds, dealers and investment fund managers are incorporated into national and multi-lateral instruments and related guidance. These rules and guidelines were created and are managed by Canada's provincial and territorial securities regulators, also known as the Canadian Securities Administrators (CSA). The provincial and territorial regulators work together to coordinate and harmonize the regulation of Canadian capital markets through the CSA. Key activities of the CSA include:

- Developing uniform rules and guidelines for securities market participants;
- Coordinating approval processes;
- Developing national electronic systems through which regulatory filings can be made and processed by all jurisdictions; and
- Coordinating compliance and enforcement activities.

The main rules that govern mutual funds and investment fund managers are created and harmonized by the CSA and adopted by each provincial and territorial securities regulatory authority. These unified rules, also known as

[31] Canadian ETF Association, 2017

National Instruments[32] (or in the case of rules not harmonized across all provinces, multi-lateral instruments), cover the governance, disclosure, custody of assets, investment restrictions, sales practices, calculation of net asset value and operations of investment funds and the regulation of investment fund managers themselves.

The key regulatory instruments that apply to investment funds are provided below:

- National Instrument 81-102 Investment Funds: sets out core investment restrictions and fundamental operational requirements including investment activities and the sale and redemption of its securities.
- National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations: sets out registration requirements and the activities of registrants, including the harmonization, optimization and modernization of registration requirements across Canada for firms and individuals who sell securities, offer investment advice or manage investment funds. The instrument also addresses internal controls and systems and financial requirements for registrants, along with requirements for dealing with clients, and managing conflicts of interest.
- National Instrument 81-101 Mutual Funds Prospectus Disclosure: establishes requirements for mutual funds with respect to the preparation, filing and delivery of prospectuses and annual information forms such as the Fund Facts document.
- National Instrument 81-105 Mutual Fund Sales Practices: regulates Mutual Fund sales practices including compensation, sales incentives, marketing and educational practices for conferences, business promotional activities, and related disclosure requirements.
- National Instrument 81-106 Investment Fund Continuous Disclosure: regulates the financial and other information that mutual funds must disclose, including financial statement requirements.
- National Instrument 81-107 Independent Review Committee for Investment Funds: requires mutual funds to have independent review committees to help manage and oversee all decisions involving perceived or actual conflicts of interest faced by the investment fund manager as it pertains to any operational aspects of the fund.

In addition to the CSA and the provincial/territorial securities regulators, there are three regulatory organizations made up of investment dealer firms that monitor and enforce their own members' compliance with applicable securities laws pertaining to the sale of mutual funds and securities to Canada's investors. These SROs are subject to the authority of the securities commissions and include:

- The Mutual Fund Dealers Association of Canada (MFDA), which oversees the operations, standards of practice and business conduct of mutual fund dealers, and
- The Investment Industry Regulatory Organization of Canada (IIROC), which provides oversight of the trading activity on debt and equity marketplaces of all investment dealers in Canada. IIROC sets and enforces rules regarding the proficiency, business and financial conduct of dealer firms and their registered employees. It also sets and enforces market integrity rules regarding trading activity on Canadian equity markets.
- The Chambre de sécurité financière (CSF) oversees the training and ethics of financial planners and other investment professionals.

Additionally, these organizations maintain investor protection funds that will reimburse investors, up to specific limits, if a member firm becomes insolvent or goes bankrupt.

Representative licensing and registration regulation involves both securities regulators and SROs. To qualify and act as a representative selling mutual funds in Canada, individuals must meet proficiency, dealer sponsorship and securities registration requirements established by the securities regulatory authority in each jurisdiction in which

[32] Further information on CSA's regulatory framework for mutual funds (National Instruments) can be found on the Ontario Security Commission's website (http://www.osc.gov.on.ca/en/6449.htm).

they operate. The individuals sponsored by a dealer are also regulated by the MFDA or IIROC or, in the case of Quebec, the CSF or IIROC. Furthermore, any organization seeking to distribute or sell mutual funds in Canada, other than Quebec, must apply and obtain approval for membership with the MFDA or IIROC, in addition to being registered with the appropriate securities regulatory authority. In Quebec, the organization must apply and obtain approval for membership with IIROC or the provincial securities regulator.

Conflict of Interest and Suitability

Against a backdrop of global concerns regarding investor conflict of interest and suitability, securities regulators, the MFDA, the CSF and IIROC continue to develop legislation to address conflicts of interest, fee transparency and disclosure.

The current statutory standard of care for registrants is the duty to deal with clients fairly, honestly and in good faith. Investment recommendations must be suitable for a client's investment knowledge, risk tolerance, and investment goals. This process is guided by "Know Your Client" (KYC) rules.

In addition to the KYC Rule, regulators also require both registered firms and advisors to comply with the "Know Your Product" ("KYP"), which requires the advisor to fully understand any investment product they recommend and properly determine product suitability or fit for a client. Additionally, firms are expected to have processes in place for new product reviews and/or changes, and these firms must also have the resources with skills and experience necessary to conduct these reviews on their own.

In assessing new or updated investment products, there are several key steps that firms and advisors need to perform, including:

- General Structure – understand product complexity and transparency, basis of return, any conflicts of interest that may arise due to its return structure, and any unique features that may introduce unusual risks.
- Risks – identify product related risks, including liquidity, price volatility, derivative or structured product related risks, and default risks – with a lens of the possibility / likelihood and extent of the investment loss a client may experience.
- Costs – determine investment costs for the client, includes sales charges, commissions, referral fees, early redemption fees, embedded costs and other charges.
- Identifying parties involved – obtain the history and financial position, qualifications, reputation of the issuer including fund managers, portfolio managers, product manufacturers and guarantors involved with the product or transaction.
- Legal Framework – provide frequent and comprehensive disclosure in order to obtain an accurate view of a firm's general structure and risk.
- Policies and Procedures – maintain written policies and procedures to ensure that they are satisfying the KYP requirement.

Enhanced Transparency and Disclosure: CRM2 and POS

Regulatory changes to increase transparency and disclosure were implemented as part of the Point of Sale framework, which requires mutual fund and insurance companies to provide an additional disclosure document ("Fund Facts"). This disclosure document has been designed to provide investors with timely and relevant mutual fund or segregated fund information in a simple and concise manner. Information listed on the Fund Facts statement includes fund investment composition, performance, benefits, risks and costs, and advisor fees. The intent of this regulatory change was to better enable the investor to properly research and compare different fund options to make effective buying decisions. The Funds Facts disclosure document is required to be provided to the client prior to the decision to buy, and replaces the simplified prospectus that was previously required.

Introduced in July 2013, CRM2 intends to improve the transparency and disclosure of advisor compensation including embedded fees, and specific fund performance information to clients. Changes to the client reporting vehicles including trade confirmations, client statements and annual reports involving disclosure of charges, advisor compensation, fund cost information, update fund market value, fund performance and other forms of compensation were implemented over a 3 year, 3 phase timeline from 2014 to 2016.[33] New disclosure documents must be delivered to clients by July 2017. The most recent and final phase of CRM2 relates to the implementation of two annual statements: Charges and Compensation Report and Investment Performance Report. The Charges and Compensation Report includes charges an investor pays in relation to their account including trailing commissions in dollar terms. The Investment Performance Report provides the annual percentage performance on a money weighted basis, net of fees. It is still too early to fully understand the impact these changes will have with respect to transparency and client understanding. Further study will be required in the coming years.

We note that in 2015, prior to the full implementation of CRM 2 and POS, disclosure laws in Canada were considered to be investor-friendly: Morningstar's bi-annual Global Fund Investor Experience Study rated Canada "A-" on a grade scale for disclosure, the third best disclosure rating in the survey.[34]

Accountability

In comparison to other developed capital markets Canada has a strong regulatory framework which increases the likelihood that financial advisors are following best practices in performing their professional activities. For example, the CSA and the SROs investigate and prosecute in appropriate cases, allegations of misconduct in financial services. Penalties range from license suspension to financial penalties and jail time. The CSA also issues investor warnings and alerts based on complaints they receive.

SROs can also investigate wrongdoing and deliver disciplinary action against advisors. In 2015/2016, IIROC received 42,271 reports on advisors.[35] In addition, all MFDA and IIROC members must be subject to the Ombudsman for Banking Services and Investments (OBSI). This body carries out investigations of misconduct and can recommend advisors to provide financial or non-financial compensation to clients.[36] In all, there is a robust complaints system for investors who would like to report misconduct.

Proposed Changes to Regulation

In December 2012 and January 2017, the CSA published consultation papers presenting evidence that they have gathered on the effects of embedded commissions. The purpose of these papers was to provide evidence for their assertion that embedded commissions distort behaviour in the mutual funds market in an undesirable way, and to seek input from stakeholders on any issues that they may not have considered.

Based on the CSA's consultation papers, their position is that there are three main problems with embedded commissions:

1. "Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;
2. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and
3. Embedded commissions paid generally do not align with the services provided to investors."

The 2017 paper (CSA Paper) claims that the existence of embedded commissions leads to undesirable behaviours including the following:

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33 OSC, 2017
34 Morningstar, 2015
35 IIROC, 2016
36 OBSI, 2017

1. Investment fund managers rely more on payments to dealers than on performance to raise and preserve assets;
2. Dealers recommend funds to clients based on the highest embedded commissions; Investors have no ability to manage or negotiate their dealer compensation costs; and Dealer compensation may not reflect the level of service the investor receives.

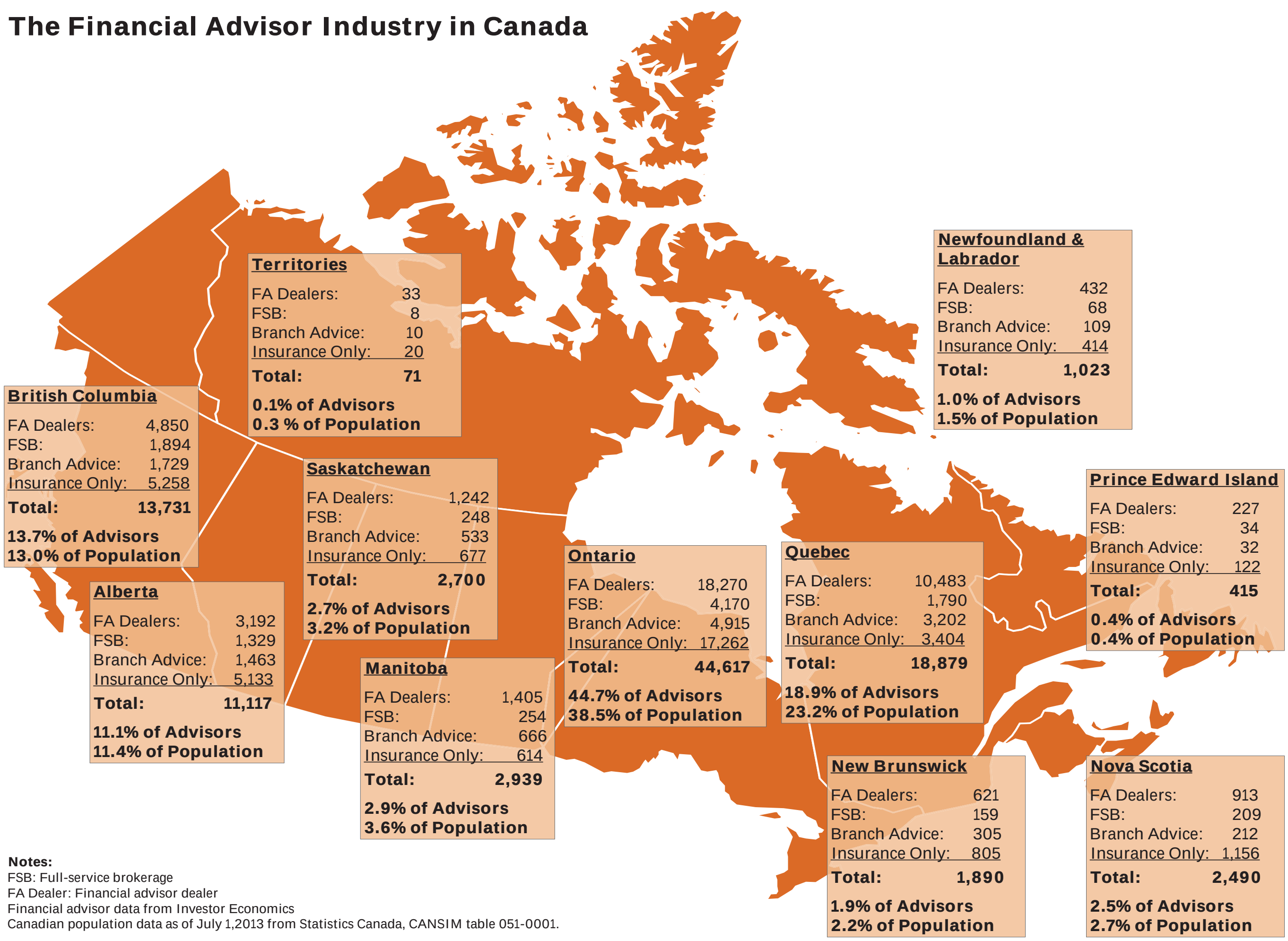
The above concerns have led the CSA to conclude that a change to a different compensation model must be considered, but the CSA emphasizes that it has not made a decision to discontinue embedded commissions. The CSA will reach its final decision in this regard following a consultation process.

The Financial Advisory Sector

This section provides an overview of employment and asset levels and distributions in the financial advisory sector in Canada, and overviews the distribution of assets of Canadian households. It outlines the number of financial advisors by province and reviews the services offered by different types of financial advisors. We also note recent trends in the number of advisors and in household wealth allocation.

The following figure provides an overview of the provincial breakdown of financial advisors across each segment and a comparison of relative advisor coverage by province[37]. The percentage of advisors in each province or territory generally mirrors their population share, with the exception of Ontario which has a higher percentage share of advisors relative to population share (45 per cent of advisors versus 39 per cent population) and Quebec, which has a lower percentage share of advisors relative to population share (19 per cent of advisors versus 24 per cent population).

Figure 10: The Financial Advisor Industry in Canada



[37] Investor Economics, 2014

Under Canada's various regulatory regimes, financial advisors typically fall into 4 broad segments: Full Service Brokerage, Branch Advice, Insurance-based and Financial Advisor Dealer. The focus of these advisors depends on both their licensing and the orientation of the channel through which they do business.

The following is a description of each segment:[38]

- **Full Service Brokerage:** Advisors working through full service brokerage firms that provide financial advice and a wide range of discretionary and non-discretionary investment services based on funds, individual securities and insurance. Over two-thirds of these advisors work for full-service brokerage firms that are owned by deposit-taking (e.g. bank owned) firms, while the remaining advisors work in non-bank owned or independent organizations.
- **Branch Advice:** Advisors that offer a limited range of financial planning and investment products and services through branches of deposit-taking institutions such as banks and credit unions.
- **Insurance-based:** These advisors are only licensed to sell insurance products.
- **Financial Advisor Dealer:** Advisors operating outside of deposit-taking branch network who provide access to a wide range of services including planning, investment and insurance services. These advisors fall into two categories:

  - **Independent Advisors:** These advisors are typically small and medium-sized business owner-operators (i.e. single person or small advisory firms with more than one advisor). They are independently-contracted to distribute life and health insurance and wealth products (e.g. mutual funds, securities) and services through multiple financial services manufacturers (e.g. life insurance companies, fund managers).
  - **Career Exclusive Advisors**: These advisors are affiliated exclusively with a major insurance company or investment firm to sell specific products but are independently contracted. As a result, they are considered to be small businesses i.e. their contract is not based on an employee-employer relationship. However, some product offerings distributed by this segment are also available from third-party financial services providers.

Industry Structure by Financial Advisor Segment

Over 98,000 individuals in Canada carry one or more financial service licenses and fall into one of the four financial advisor segments.

The table and graph below provide a breakdown of the number of financial advisors in each segment, along with the market share of each segment in 2016.

Table 3: Number of Advisors by Industry Segment, 2016[39]

Industry Segment	Number of Advisors	% of Industry
Full Service Brokerage	9,950	10%
Branch Advice	13,600	13%
Insurance-based	40,700	35%
Financial Advisor Dealer	33,900	41%
Total	**98,150**	**100%**

[38] Investor Economics, 2014; Advocis, 2012
[39] Investor Economics, 2016

Dual Licensing

Many MFDA and IIROC firms have sister companies offering Life Insurance products. These companies and are most often set up as Managing General Agents (MGAs) or National Accounts under the IIROC channel. It is estimated that as many as 80 per cent of MFDA advisors are dual-licensed and are holding an insurance license. Life insurance agents working with an MGA may have multiple MGA relationships and even direct-to-insurance-company contracts, thus in the absence of actual source data, reporting of their total income is difficult to estimate and runs the risk of double counting. However, repeated research studies going back as far as the early 2000s consistently have shown that advisor's incomes are highly weighted to their "primary" license. This means that if they were initial licenced as mutual fund representatives, then the activities in this licensing category make up 60 per cent or more of their income, with life insurance making up 17 per cent and Individual Variable Insurance Contracts (IVICs), 10 per cent. In contrast, those starting in the advisory business as life insurance agents would have the reverse income ratios with IVICs having a larger share. Dual-licensed advisors are able to sell segregated funds, which are mutual funds whose value is insured. Unlike traditional mutual funds, segregated funds are not regulated by the CSA. It is important to note that advisors licensed and employed by bank-owned dealers are precluded from obtaining a life insurance licence due to restrictions in the Bank Act.

Growth Trends

The total number of licensed advisors has grown by 2,658, or 2.8 per cent, over the past six years. During this time, most advisor segments have shown a slightly upward trend with the exception of the full service brokerage segment, which shrank by 342 advisors, or 3.3 per cent. Note that relative to 2013, the aggregate number of advisors declined in 2016, from 99,871 to 98,150, a 1.7 per cent decline.

The following table provides a comparison of industry participants per sector between 2010, 2013 and 2016.

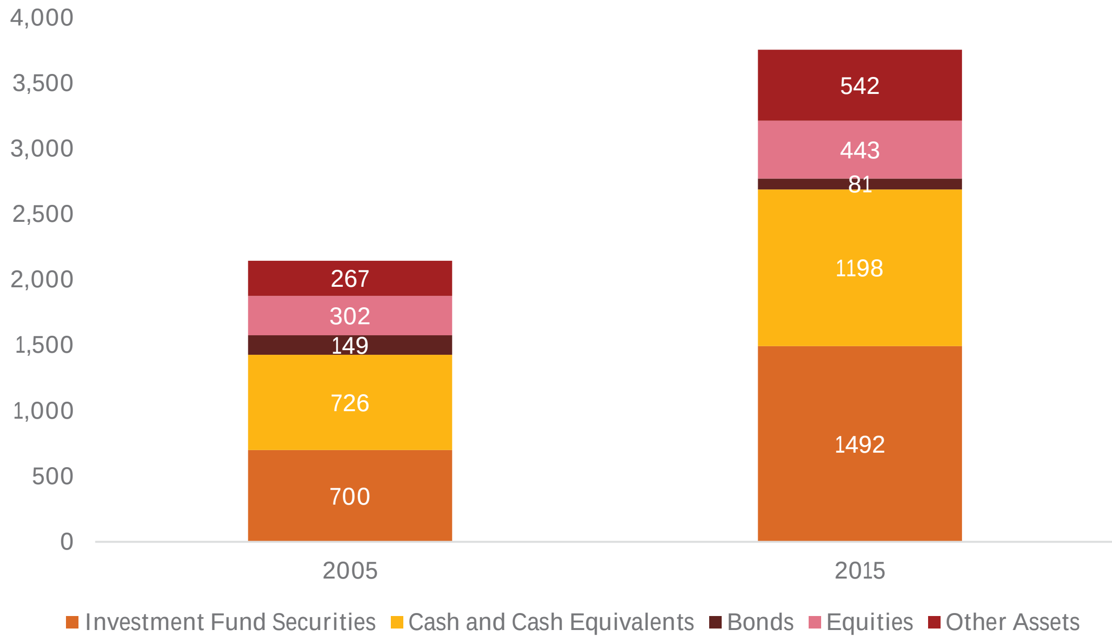
Table 4: Financial Advisor Population in 2010, 2013 and 2016[40]

Industry Segment	2010	2013	2016	Growth rate 2010-2016
Full Service Brokerage	10,292	10,162	9,950	-3.3%
Branch Advice	13,000	13,177	13,600	4.6%
Insurance-based	39,437	44,074	40,700	3.2%
Financial Advisor Dealer	32,763	32,458	33,900	3.5%
Total	**95,492**	**99,871**	**98,150**	**2.8%**

Canadian households' wealth has increased considerably over the last decade, and so did their holdings of investment fund securities including mutual funds, ETFs, and other types of funds. Between 2005 and 2015, households' wealth has increased from $2.1 trillion to $3.8 trillion, an annual average rate of 6.1 per cent increase. At the end of 2015, Canadian households held $1.5 trillion or 40 per cent of their aggregate financial wealth in investment fund securities and 32 per cent in cash and cash equivalents. By contrast, securities such as stocks and bonds made up only 14 per cent of aggregate financial wealth in that year. Figure 11 shows these allocations:

[40] Investor Economics, 2016

Figure 11: Canadian Household Assets in 2005 and 2015, $billion[41]



Households by Investable Assets and Fund Ownership

The majority of Canadian households do not own investment funds,[42] as illustrated in the table below:

Table 5: Canadian Household Assets in 2005 and 2015, $billion[43]

Household Investable Assets	Own investment funds	Do not own investment funds	% of total households
Less than $100,000	22%	78%	67%
$100,000 to $500,000	67%	33%	27%
Over $500,000	76%	24%	6%
% of total households	**37%**	**63%**	**100%**

The figures in Table 5 also suggest that those with higher level of investable assets are more likely to hold investment funds than those with lower levels of wealth.

At the end of March 2017, mutual fund asset under management were $1,392 billion.[44] According to the Pollara 2016 survey the overwhelming majority of mutual funds – nine out of ten - were purchased through a financial advisor.[45] On that basis, advisors handle an overall mutual funds portfolio of $1,253 billion.

[41] CSA 81-408
[42] Investment funds include mutual funds, ETFs, pooled funds and other types of funds.
[43] CSA 81-408

The Value of Financial Advisors

This section outlines the theory and evidence on the value provided by financial advisors. We outline relevant principles from behavioural economics that help to explain this value, and review academic literature on the subject.

The Economic Theory

From an economic point of view, using a financial advisor has a net positive value to an investor if the opportunity cost of spending that investor's resources on the tasks performed by the financial advisor are higher than the cost of financial advice, provided that the outcome in both is identical. The opportunity cost to the investor is a function of the time they would otherwise spend on such tasks as well as the value of a time unit to them. Since in many instances advisors have expertise that investors generally do not have, in theory the use of an advisor should provide the investor a superior outcome compared to DIY-investing. Moreover, the emotional stress that may accompany managing of such tasks alone could further increase the opportunity cost and thus increase the net value of using a financial advisor.

Financial advisors perform a variety of tasks for investors including:

- Evaluating the client's total financial situation;
- Making recommendations on the allocation of financial assets;
- Assessing alternative investment options; and
- Determining whether the client's current rate of savings is sufficient for a comfortable retirement.

Research conducted in behavioural economics shows that, contrary to classic economic theory, people suffer from behavioural biases and do not always act rationally. With regard to investors, research conducted by Richard Thaler and others indicates three main behavioural biases: loss aversion, a tendency toward short-term thinking, and overconfidence.[46]

As the work of Richard Thaler shows, financial losses have about twice the emotional impact on investors as equivalent gains. As a consequence, investors might overreact to short-term negative financial news that would prevent them from taking advantage of long-term gains. The behavioural bias towards short-term thinking can lead investors to under-save for retirement. Overconfidence, may lead investors to under-diversify and over-trade, thus unwisely increasing risk and transactions costs.

Financial advisors can play an important role in this regard for several reasons. First, they can help counteract investors' short-term bias and encourage the discipline to save for the longer term. Second, they can help in addressing investors' loss aversion by advising against panic sales. Finally, advisors can play a crucial role in providing better quality information to investors which is shown to improve financial decision-making.[47] As Robert Shiller points out:

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[44] IFIC, 2017
[45] POLLARA, 2016
[46] See for example: Benartzi & Thaler, 2007; Thaler, 2005; Shiller, 2003; Barberis et al., 1998); Benartzi & Thaler, 1995
[47] Gaudecker, 2015

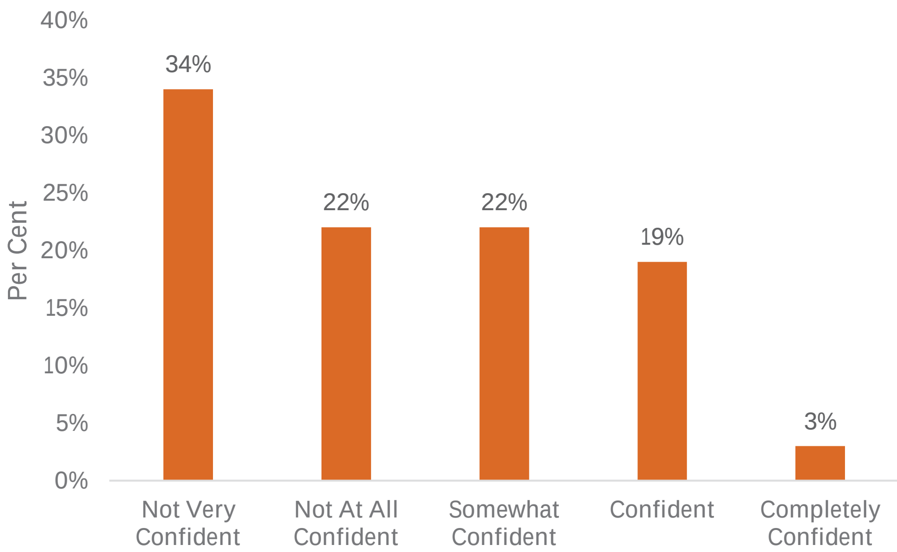
> *"Financial advice is in some respects like medical advice: we need both on an ongoing basis and failure to obtain either can impose costs on society when our health—physical or financial—suffers. There's a strong case to be made that the government should subsidize comprehensive financial advice … to help prevent bubbly thinking and financial overextension."* [48]

Investors Attitudes to Advisors in Canada

In 2016, Pollara conducted a survey among mutual funds investors. This survey (hereafter the "Pollara Survey") is based on telephone interviews among 1,000 mutual fund holders eighteen years of age or older, who make all or some of the decisions regarding mutual fund purchases in their household. Interviews were conducted across all provinces and the national results are representative of mutual fund holders by region and gender. In this section we present the results of this survey as they pertain to the issue of "value of advice."

In 2016, nine out of ten mutual funds were purchased through a financial advisor. According to the Pollara Survey 56 per cent of mutual fund investors do not "feel at all confident" (22 per cent) or "not very confident" (34 per cent) buying mutual funds without an advisor (see Figure 12).

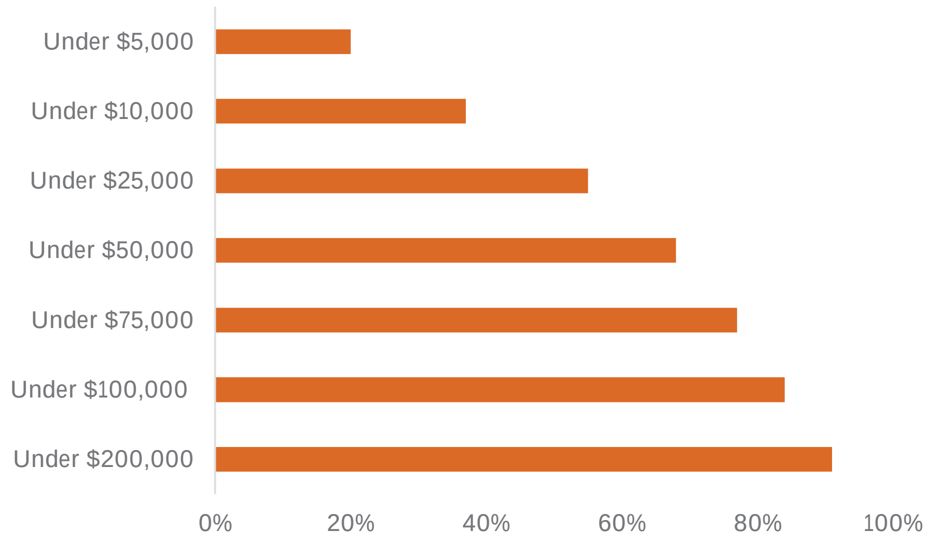
Figure 12: Answers to the Question "How confident would you be in selecting and purchasing mutual funds on your own, without the help of an advisor?"[49]



Approximately 37 per cent of mutual fund investors had less than $10,000 in total savings when they first approached a financial advisor – 20 per cent of which had total savings below $5,000. In fact, almost 70 per cent of mutual fund investors had total savings below $50,000 when they first used a financial advisor (Figure 13).

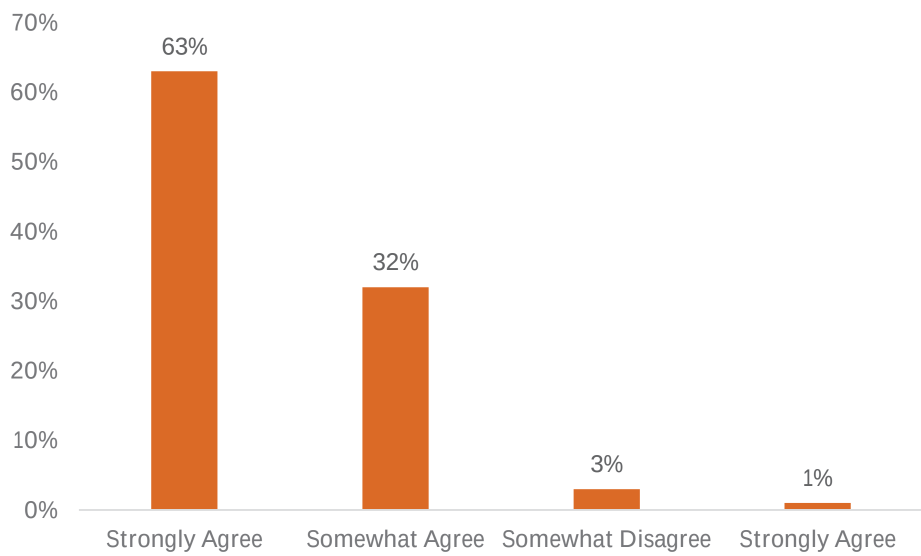
[48] Shiller, 2009
[49] Pollara, 2016

Figure 13: Total Value of Savings and Investments When Started Using a Financial Advisor[50]



The vast majority of investors, 95 per cent, state that they have some or high level of trust in their advisor to give them sound advice (see Figure 14).

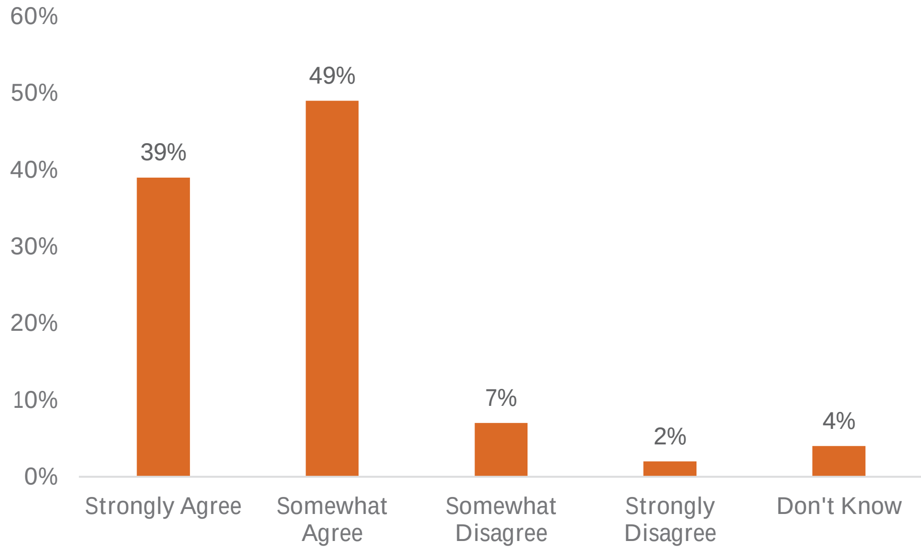
Figure 14: Answers to the Question "I can trust my advisor to give me sound advice"[51]



In addition, a majority of investors, 88 per cent, believe that they get better results when using a financial advisor (Figure 15).

50 Pollara, 2016
51 Pollara, 2016

Figure 15: Answers to the Question "Overall I get better return on my investments because of the advice of my advisor."[52]



Finally, the Pollara Survey also reveals that some 82 per cent of investors are in agreement that they have better savings and investment habits because of their financial advisor, and that 38 per cent strongly agree.

The results of the Pollara Survey suggest that a significant majority of Canadian investors in mutual funds are relatively small investors who believe that they get a net benefit from using an advisor. The large majority of this group uses an advisor.

Empirical Evidence on the Value of Advisors

As noted previously, a majority of Canadian mutual fund investor's trust the ability of their advisors to help them select the right investment vehicles, to generate better returns and to develop better savings habits. This perception is supportive of the notion that financial advisors provide net benefit to Canadian investors in mutual funds and implies that the use of an advisor makes the process of investing less stressful. However, this perception, on its own, is not sufficient evidence to demonstrate the objective value of financial advice. For one, investors lack knowledge of the counterfactual, i.e. how their investments would have performed without the assistance of a financial advisor. Secondly, there is the possibility of self-selection process with regard to financial advice. Put differently, there is a possibility that those investors who seek the help of financial advisors have better savings habits to begin with and thus it appears that investors using a financial advisor perform better than those who do not. Thus, in order to obtain an objective assessment of the value of financial advice, we need to turn to empirical research that meets high academic standards.

A considerable portion of the academic literature has focused on the question of whether financial advisors help investors select outperforming funds i.e. funds that provide a higher return than the market as a whole.[53] The majority of these studies do not find evidence that financial advisors are able to pick outperforming funds for their clients. This finding is consistent with the predictions of financial theory. However, as most academics now recognize, this type of research does not answer the question of whether a financial advisor is providing overall net benefits to an investor. For one, using this as evidence that financial advisors do not provide net benefits to investors, implies that individual investors who do not use financial advisors are on average achieving returns that

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52 Pollara, 2016

53 See for example, Bergstresser et al., 2009; Chalmers & Reuter, 2012; Del Guercio & Reuter 2014; Hackethal et al., 2012

are commensurate with market returns. This implied assumption is not likely reflective of reality and thus benchmarking advisor driven returns to the market is not relevant to the issue of the value of financial advice. Second, it is rather simplistic to assess the value of advice based on one parameter, in this case gross return. As noted above, investors seek various services to help them meet their financial targets, which requires skills they may not have. Thirdly, investors pay income tax on their returns and without an advisor may invest in tax-inefficient instruments that reduce their net return. Finally, there is an opportunity cost to DIY investing that includes time and emotional stress.

We have conducted a literature review aiming to identify studies conducted by reputable researchers who have specifically looked at the issue of the value of financial advice in a broad context. From our review, it appears that the majority of such studies support the notion that financial advisors do provide net benefits to investors.

Our literature review suggests that more recently, empirical studies have moved away from assessing financial advice purely on a “beat-the-market” perspective. Instead, they tend to focus on the overall benefits generated through wealth management practices by advisors. This is especially important since around 64 per cent of mutual fund investors in Canada state that their motivation for investing is to fund retirement or have supplementary income for retirement (Pollara, 2016).

In this context, Blanchett and Kaplan (2013) aim to quantify the value of financial advice that goes beyond the goal of higher returns by beating the market, i.e. “alpha decisions,” and pure asset allocation, i.e. ‘beta decisions’. The authors coin the term “gamma decisions” to describe their approach. This approach takes a more holistic view towards financial investments assuming that most investors pursue broader objectives than short-term high returns with a “beat-the-market-strategy.” More specifically, the authors assumptions with regard to a financial planning strategy focuses on optimal asset allocation, a dynamic withdrawal strategy, tax-efficient allocation decisions, and a portfolio optimization that takes into account investors’ liabilities. Using historical data on returns for different asset classes, the authors conduct a statistical analysis to determine the additional value generated by following a broader investment strategy. Blanchett’s and Kaplan’s results suggest that investors following the broader investment strategy outlined in their paper generates a 1.82 per cent higher net return per year compared to other investors. As a consequence, the authors conclude that the value of financial advice should be measured in terms of these more complex goals.

Similarly, a recent study by Hermansson and Song (2016), shows that the use of a financial advisor has a significantly positive effect on investors’ savings behaviour. Studying the impact on savings generated by a group of Swedish investors that received advice compared to a control group that invested without the aid of a financial advisor, the study finds that the group receiving advice generated 22 per cent higher savings.

Research conducted in Australia presents similar results. A study by KPMG EconTech on the savings behaviour of investors with and without financial advice finds that individuals using a financial advisor save an additional $1,590 per year compared to individuals without a financial advisor. Importantly, their regression analysis controls for other factors that may influence saving behavior, such as an individual’s level of wealth, employment status, and salary. Extending their analysis to the overall economy, the authors establish that as financial advice increases individual household’s savings, overall national savings increase in turn.

A study by Marsden et al. (2011) on retirement planning in the United States delivers similar findings. The authors examine the differences in retirement planning for individuals who use the help of a financial advisor compared to individuals who do not use an advisor. Applying propensity score matching, a statistical technique applied to ensure comparability between the two groups, the study shows that using a financial advisor improves an individual’s savings behaviour due to the positive impact on their overall financial planning, such as awareness of retirement needs and diversification of retirement savings. In addition, the results indicate that individuals who received financial advice demonstrated some positive behavioural changes in response to the financial crisis that had hit the United States in 2008. Individuals who used a financial advisor reported that they spent more time learning about financial topics, saved more or postponed retirement.

Analyzing the impact of financial advice on the savings behaviour of investors in Canada, Montmarquette and Viennot-Briot (2017) conducted a regression analysis to test whether investors who use an advisor are subsequently better off compared to those who don't.[54] Their findings confirm the results of studies conducted in other jurisdictions showing that individuals who receive financial advice display better savings behaviour compared to those who don't. In addition, the authors point out that dropping (or losing) financial advice diminishes returns to investors. Their results indicate that individuals who dropped an advisor in 2010 experienced asset growth of 1.7 per cent by 2014 compared to 16.4 per cent for those who kept their advisor. The findings suggest that the tenure in receiving advice is a decisive factor. A household receiving long-tenured advice (15 years plus) displays 3.9 times the value of assets of a non-advised household.

A study by Cici et al. (2016) on mutual fund investors in the United States found that advisors produce tangible results for their clients by helping them to reduce the tax burden of investments.

Summary of Findings

Taken together, the academic empirical research shows that while financial advisors are not able in their investment choices to consistently beat relevant market benchmarks after fees, their advice generates significant net benefits to investors in terms of a more disciplined savings behaviour, overall higher asset values, more efficient tax planning, and retirement confidence. In addition, survey results indicate that mutual fund investors seeking financial advice place high trust in their advisor and believe that the use of a financial advisor helps them to achieve their financial goals. Moreover, since the high level of trust that Canadian investors have in their advisors is likely driven by long term relationships, the academic literature suggests that such trust is generally justified, as investors' benefits tends to increase with the longevity of their relationship with their advisor.

The main reason that empirical studies show significant net benefits from the use of advisors is founded in behavioural economics. According to research from this field, investors tend to suffer from behavioural biases such as loss aversion, short-termism, and overconfidence. Sound financial advice helps to mitigate these biases and, as a consequence, helps investors to achieve higher savings. In an ageing society, assisting people in saving sufficiently for a comfortable retirement is a critical public policy issue. As financial advisors help investors in generating overall higher savings for their old age, financial advice is an important component in a policy strategy to achieve this goal.

[54] The authors apply an instrument variable regression to control for endogeneity, i.e. to ensure that causality runs in the right direction.

Conflict of Interest

This section outlines the potential for conflicts of interest in the relationship between financial advisors and their clients. First, it describes the economic theory behind conflicts of interest in the investor-advisor relationship, and how this conflict might be mitigated. It then assesses the potential for conflicts of interest of this type in Canada, given empirical evidence on investor characteristics and attitudes toward financial advisor as well as the existing regulatory environment. Finally it reviews the empirical literature on the existence of conflicts of interest.

Economic Theory

Potential conflicts of interest are a common phenomenon in service industries. Providers of advice in auto repair, tradespersons, real estate, the health sector and financial services, to name a few, commonly have substantial expert knowledge that their clients do not possess. As a consequence, expert service industries are often characterized by asymmetric information between the service provider and the client. Darby and Karni (1973) have introduced the term credence goods to classify these markets and added it to Nelson's (1970) classification of ordinary, search and experience goods.[55] Credence goods have the characteristic that the consumer cannot judge ex-post whether the type or quality of good or service she received was what was needed ex-ante. In addition, she may also be unable to judge ex-post which type or quality she actually received.

In economic theory, the principal-agent problem also applies to the relationship between investor and advisor. In a principal-agent framework, the agent acts on behalf of the principal due to the agent's comparative advantage in some activities. The fact that financial advice is a credence good exacerbates the misalignment that may be caused by the principal-agent character of the investor-advisor relationship.

The principal-agent problem arises when two factors come into play. The first is conflicting incentives between the principal and the agent. The second is private or asymmetric information such that the agent possesses more information about a specific issue than the principal. If incentives between principal and agent are aligned, the principal can be confident that the agent will act in his best interest. Similarly, without asymmetric information the principal is able to judge whether the agent's action or advice are in the best interest of the principal's goals. In cases where incentives between principal and agent differ and the agent possesses private information, there exists a potential conflict of interest as the potential exists for the agent to act against the principal's interests.

As mentioned above, the principal-agent problem can arise in a variety of service industries – from the real estate sector to auto repairs. Levitt and Syverson (2008), for example, find that real estate agents invest more effort and secure a higher price for the sale of their own property, relative to their customers' homes. They also find that the difference between agent-owned and non-agent-owned sale prices is increasing with the degree of asymmetric information about property values.

With regard to health care, Gruber et al. (1999) find that relative frequency of Caesarean deliveries compared to regular child births is strongly correlated with the fee differentials of health insurance providers. In another instance, audits of German hospitals have shown that decisions for surgeries on patients are made too fast and too often – especially in cases where profit margins were highest.[56] Emons (1997) provides an example showing that the average person's probability of receiving one of seven major surgical interventions is one third above that of a physician or a member of a physician's family.

[55] Ordinary goods, such as petrol, have well-known characteristics, and subjects know where to get them. Search goods, e.g. like clothes, can be inspected before buying to observe their characteristics. Experience goods, like wine, have unknown characteristics, but they are revealed after buying or consuming them.
[56] Deutsche Presse-Agentur, 2012

With regard to auto repair in the US, Wolinsky (1993, 1995) presents survey results provided by the Department of Transportation that indicate that more than half of all auto repairs are unnecessary.

In sum, conflicts of interest are inherent to many business relationships in the services sector. The degree of misalignment of incentives between the principal and the agent and the extent of information asymmetry between the two parties influence the likelihood and severity of a conflict of interest.

Mitigation of Conflict of Interest

As indicated previously, the principal-agent problem arises when the principal and the agent have different incentives and/or when the principal is unable to fully monitor the agent's actions. As a consequence, mitigating the conflict of interest arising in a principal-agent setting can be achieved either by better monitoring of an agent's action or by better aligning the incentives of the principal and the agent.

For example, a typical policy used by publicly listed companies in order to better align the incentives of principal and agent is performance-based pay. Year-end bonuses are a common form of offering performance-based pay and in trying to mitigate the conflict of interest arising from different incentive structures between principal and agent. An alternative form of performance-based pay is paying a "piece rate" where employees are compensated per unit of work.

As outlined above, one approach to mitigate the conflict of interest between principal and agent is to improve monitoring of the agent's efforts and actions. Monitoring can take the form of increased transparency rules or the principal's own efforts to observe the agents actions. An individual in need of the services of a tradesperson such as an electrician or a roofer, or a lawyer, for example, can use the Internet to educate herself about the particular problem at hand which would reduce the degree of asymmetric information between principal and agent. In addition, she might be able to find information and ratings on specific companies in her region, providing her with greater transparency. Thus, technology assists in increasing transparency and knowledge for a prospective client thereby mitigating the problem of asymmetric information. While increased knowledge and transparency help mitigate a potential conflict of interest, it is important to keep in mind that this comes at a cost. Rules for more transparency can increase bureaucracy both within a firm and outside, thus increasing the cost of doing business and lowering productivity.[57]

Another important factor in the context of mitigating conflicts of interest between principal and agent is the time frame of the relationship between the two. In a short-term relationship, e.g. a one-time visit to a doctor, car mechanic or lawyer, the risk for the agent to be exposed and subsequently "punished" for their actions is lower than in a long-term relationship. In economic game-theory parlance, long-term relationships between principal and agent are called "repeated games." It has been shown that the risk of a conflict of interest is lower in a repeated principal-agent game as there is an increased opportunity for the principal to observe the results generated by the agent and to evaluate whether the agent is taking the appropriate actions.[58] Provided that the principal is able to judge the agent's actions due to information on past behaviour, the agent risks a loss of reputation and, as a consequence, repeated business.[59] In long-term relationships between principal and agent, then, the conflict of interest between the two parties is mitigated by the fact that the principal is able to "punish" the agent for not taking the appropriate actions in pursuing the principal's goals.

[57] See Enriques and Volpin, 2007; Luez and Verrecchia, 2000
[58] See, for example, Sannikov, 2008; Pearce and Stacchetti, 1998; Radner, 1985
[59] Fudenberg and Levine, 1989

The Drivers of Conflict of Interest in the Sale of Mutual Funds

In the mutual fund industry, the advisor takes the role of the agent and the investor the role of the principal. The investor compensates the advisor for her expertise and believes that, taking into account the buyer's needs and characteristics, the agent would over time achieve better financial outcomes than the alternative of DIY-investing.

Investors typically pay for financial advice directly in the form of fees, and/or indirectly through embedded commissions paid by product providers (such as mutual fund manufacturers) to brokers, and other intermediaries.[60] According to regulatory changes that came into full effect in July 2016 (CRM2), investment dealers are required to report in dollars their compensation earned, such as trailing commissions, as well as other earnings such as deferred sales charges or referral fees. In addition, it requires a disclosure of payments from fund companies to brokers. The statement to the client also includes annual administration and transaction fees. As these transparency requirements are fairly recent, it might be too early to draw firm conclusions on potential behavioural changes among mutual fund investors. However, suffice it to say that for those investors who are interested in knowing what they pay for advice the information provided under Canadian legislation is sufficient at least for raising questions with their advisor. There is evidence that most investors are aware of what is in investment fund documents: according to a survey by the British Columbia Securities Commission, 77 per cent of investors regularly review their portfolio holdings and 74 per cent review account documents provided by the advisor.[61] . Since there is no data on whether Canadian investors review their statements, it is difficult to make any reasonable assessment as to the efficacy of these rules.

In the context of the sale of mutual funds, it is in the investor's interest to make sound, sensible investments that have a high probability of paying off with a small chance of suffering a large loss. From the perspective of the advisor, the incentive is to attract as much money into funds as possible as they are paid a percentage of assets under management.

A potential conflict of interest exists between investor and advisor, as the advisor has an incentive to recommend those funds that generate the largest commissions, rather than those most aligned with the investors' overall preferences and interests. Thus, the likelihood of a conflict of interest is larger if there is a high variance in commissions between different funds. In the next section of this report, we address this issue specifically in relation to embedded commissions.

A number of factors can act to mitigate the potential for conflict of interest in the sale of mutual funds. First, higher financial literacy among investors is likely to mitigate the conflict of interest, as it alleviates the problem of asymmetric information between advisor and investor. Second, higher transparency will lower the likelihood of a conflict of interest as it allows the investor to better monitor the actions of the advisor. In addition, we note that there is an element of performance-based pay involved in trailing commissions that could act to further align the interests of advisors and investors vis a vis maximizing portfolio value.

We note that one of the key conditions for high transparency is for prices to be easily available to the public. In the case of mutual funds, for example, an investor is able to conduct an Internet search to check for typical fees associated with specific mutual fund products enabling her to better judge the recommendations provided to her by the advisor. This particular option does not exist under fee-based platforms, however. Where investors are able to negotiate individual fees directly with an advisor, transparency on standard fees for specific products is more limited.

Finally, as the previous section has indicated, the potential for a conflict of interest is lower in long-term relationships between investors and advisors, as it allows the investor to observe the results of the advisor's actions

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[60] See section "Advisor Compensation" under "The Mutual Funds Market in Canada" for more information.
[61] BCSC, 2016

and to "punish" him (e.g. by changing advisors) if these results are not aligned with the investors interests. Accordingly, assuming that a sufficient number[62] of clients are able and willing to evaluate advisors' actions, advisors and their firms risk losing their reputation if they do not act in their clients' best interest.

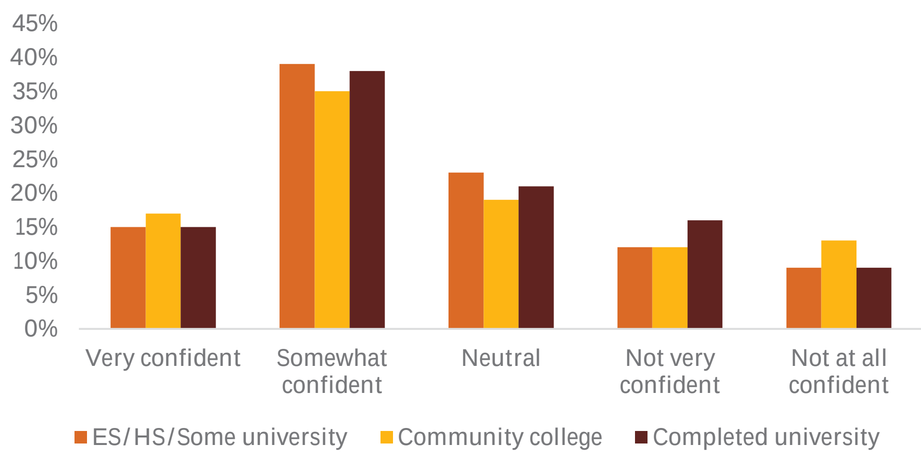
In the next two sub-sections we explore the existence of these last three mitigating factors (i.e. financial literacy, transparency and long term relationship) in the financial advisory market in Canada, as they relate to mutual funds.

The Profile of Mutual Fund Investors in Canada

As discussed earlier in this Report,[63] according to the Pollara survey, Canada's mutual fund investors are fairly well educated (see Figure 16). Half of all investors graduated from university, and around 80 per cent received some post-graduate education. Only a small fraction do not have a secondary school diploma.

The evidence collected through the Pollara survey suggests that mutual fund investors in Canada are overall rather well-educated. Interestingly, though, the self-reported knowledge of fees paid in the mutual fund industry does not vary much by education, as Figure 16 shows. It appears that, irrespective of the level of education, just over 50 per cent of mutual fund investors state that they are 'very confident' or 'somewhat confident' about the fee structure in the mutual fund industry (Figure 17).

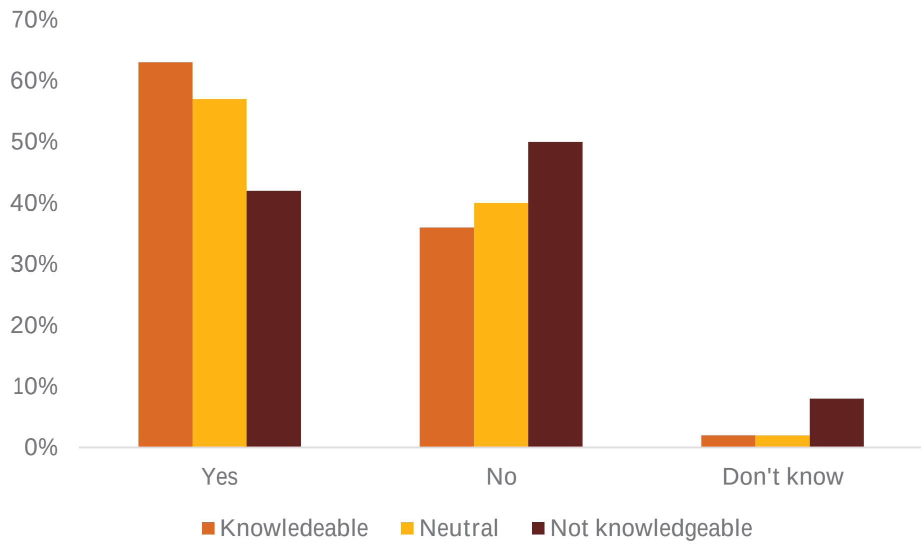
Figure 16: Knowledge of Fees Paid in Mutual Funds by Educational Attainment[64]



A more decisive factor with respect to awareness of the fee structure within the mutual fund industry is knowledge of the mutual fund industry itself. As Figure 17 illustrates, over 60 per cent of investors with self-reported knowledge of the mutual fund industry state that they are aware of fees paid. In contrast, only 42 per cent of investors "not knowledgeable" on mutual funds, claim to be aware of the industry's fee structure, whereas 50 per cent of investors with no knowledge of the mutual fund industry state that they are not aware of how their advisor is compensated. This suggests that the level of formal education is not a good proxy for financial literacy.

62 See section below for an illustration of this process.
63 See Section "The Mutual Funds Market in Canada" for more information.
64 Pollara, 2016

Figure 17: Answers to the Question "Did your advisor make you aware of how he/she compensated?" by knowledge of Mutual Funds[65]



That said, a majority of mutual fund investors appear to have some understanding that portions of their fees paid are used to compensate their advisor. According to Pollara's survey results, more than a quarter of mutual fund investors state that this is definitely the case, and an additional 45 per cent of investors assume that this is the case. In contrast, only around 20 per cent of investors answer this question in the negative. It is also important to note that these results do not fully reflect the new transparency regulation (CRM2) that was fully implemented in 2016.[66] It is reasonable to assume that, given the level of education of Canadian investors, the increased transparency and simplicity of investor statements will actually inform Canadian investors who previously were not informed.

A sign of financial literacy among Canadian investors is the fact that the majority of them evaluate the performance of their investment portfolios in some form or other. As Figure 18 shows, the most popular method of evaluating investment performance is the direct comparison of the rate of return (ROR) to zero, as indicated by 80 per cent of mutual fund investors. Approximately three-quarters of investors compare the ROR of their investments to the overall market performance, while two-thirds evaluate ROR in relation to their investment goals.

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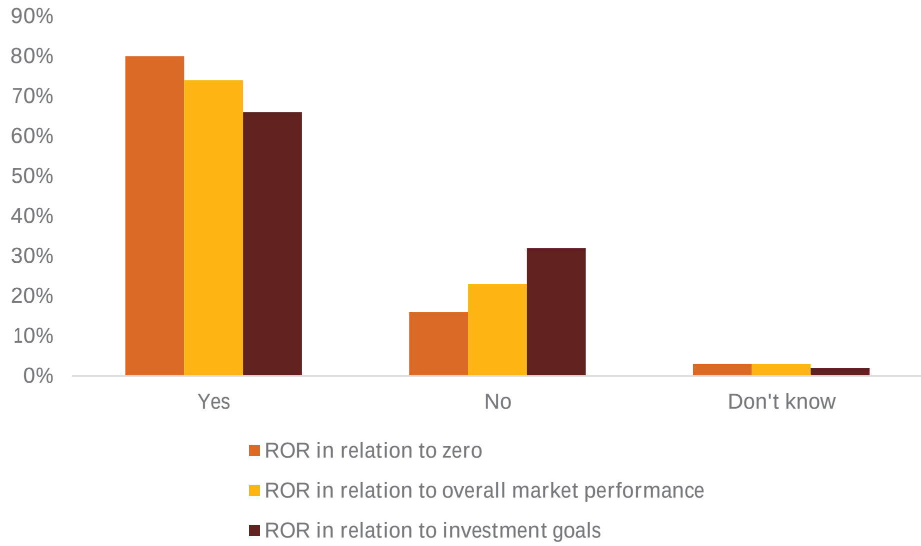
[65] Pollara, 2016
[66] See "Regulatory Environment" under "The Mutual Funds Market in Canada" for more information.

Figure 18: Methods Applied to Evaluate Investment Performance[67]



The above evidence appears to suggest that a large majority of investors would take advantage of the transparency brought by CRM2. Moreover, we note that according to economic theory, where a certain market is characterized by asymmetrical information, there is no need for all consumers to be informed in order to effectively discourage misconduct by service providers. The rationale is that the service provider who is intent on taking advantage of a consumer will weigh the benefit of taking advantage against the cost of being exposed and losing a client and reputation. Thus the higher the percentage of informed consumers, the higher the risk of being exposed.[68] It is therefore likely that a critical mass of informed consumers that is below 100 per cent does exist, where the cost to the agent will outweigh the benefit to him of taking advantage of the uninformed principal. In the financial advisory industry, where advisors depend heavily on their reputation, their firm reputation, and long-term relationship with investors, it is reasonable to assume that the critical mass required is relatively low compared to other markets of credence goods, where relationships are more ad-hoc. Given the fact that even before the full implementation of CRM2, the majority of investors in mutual funds were already fairly informed, it appears that current transparency rules do act as an effective deterrent against misconduct by mutual funds and advisors. This argument is consistent with academic research.[69]

Longevity of Relationship between Advisor and Client in Canada

As has been discussed previously, the longevity of the relationship between advisor and investor can mitigate conflict of interest. As we showed, academic research shows that a longer relationship between advisor and investor leads to better results for the investor. Thus longevity of relationship is associated with positive trust. For positive trust to exist, advisors need to know that they can be punished by investors.

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[67] Pollara, 2016

[68] We assume that that the service provider has no perfect mechanism to identify and isolate uninformed consumers, which is reasonable in the circumstances.

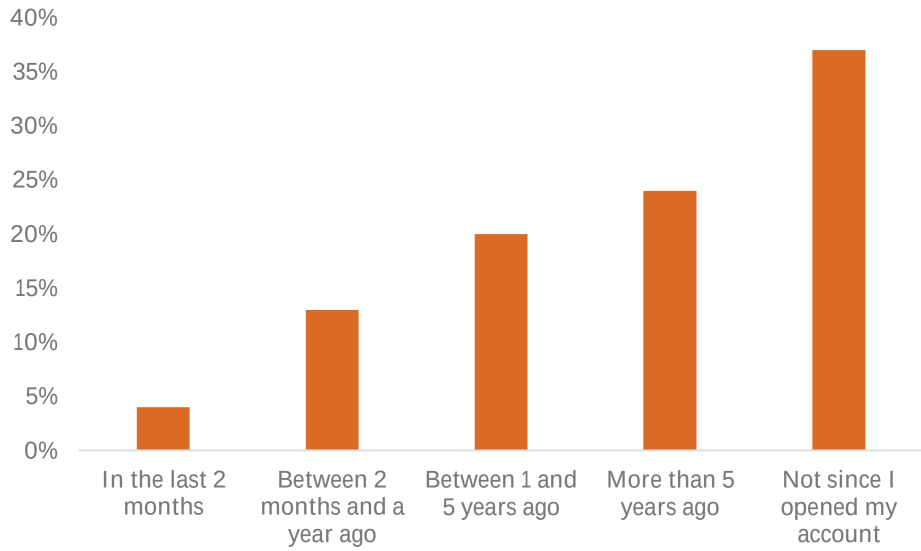
[69] For example Dulleck et al., 2011 show that repeated interaction decreases the incentive to overcharge, as experts find it optimal to forgo short-term profits from overcharging because they benefit more from higher profits due to reputation in the future. Wolinsky, 1993 and Park, 2005 have consistent findings. Henze et al., 2015 show that by informing only a portion of consumers creates positive informational externalities for those who remain uninformed and the outcomes could be very close to situation where all consumers have full information.

One indication of the tendency of the Canadian investor to punish advisors is given by the Pollara survey. When asked how often information given on their financial statements have caused them to make changes to their portfolios or contact their advisor for more information, 27 per cent stated “never,” and 43 per cent answer “rarely.” Only 3 per cent of investors state that they do this frequently.

More direct evidence of a change of advisors is presented in a survey conducted by Innovative Research Group in British Columbia. In 2016, an online survey was conducted among 800 mutual fund investors in BC who use the services of an advisor. It must be noted that the survey was not random and, as such, no margins of error could be calculated.[70] Among other issues, the survey enquires about the frequency of advisor change. According to the results, 17 per cent of investors state that they changed their advisor within the past year. In contrast, more than one third of respondents did not change their advisor since opening an investment account (Figure 19). This result suggests that Canadian investors do “punish” advisors when they perceive them not be effective agents for them. The fact that punishment exists acts as a deterrent to other advisors. As indicated above, punishment does not need to be widespread for it to act as an effective deterrent, because the cost of being punished may go well beyond one disgruntled client, as it will likely affect the reputation of the advisor and his firm in the market.

[70] The BCSC Investor survey was conducted by Innovative Research Group in 2016. Respondents to this online survey have come from INNOVATIVE’s Canada 20/20 panel with additional respondents from Survey Sampling International (SSI), a leading provider of online samples. INNOVATIVE provides each panelist with a unique URL via an email invitation so that only invited panel members are able to complete the survey and panel members can only complete a particular survey once. Only respondents who hold securities and invest through an advisor were eligible for the study. The sample was weighted according to Statistics Canada census data by age, gender, and region. Of the total 2,021 respondents to the survey invitation, 840 were eligible investors with advisors, 804 completed the entire survey, and the final sample is weighted to N=800. Note that the survey suffers from the sample selection biased, as the sample of survey respondents was non-random. In particular, the sample was drawn from the population of mutual fund investors using the Internet. As such, their characteristics may be different that those of the general population, thus resulting in a biased responses. In addition, the sample was based solely on INNOVATIVE’S Canada 20/20 panel and SSI, although we do not know the proportions of each source of respondents. Therefore, the entire population of mutual funds investors who did not participate in the panel and were not selected by SSI were ignored in the survey. This would not cause bias as long as relevant characteristics of survey participants were on average identical to those of non-participants. However, we do expect internet users to possess different characteristics than non-users that would in turn impact their responses to particular questions and cause the sample bias. Note that selection bias is a problem with virtually any survey. While it can be partially overcome by ensuring sample representativeness by presenting respondents’ demographics (as done in the Pollara survey), survey results should nevertheless be interpreted with a grain of salt and caution should be applied when drawing far-reaching conclusions from such survey data.

Figure 19: Change of advisor by mutual fund investor[71]



Evidence on Existence of Conflict of Interest

Having understood the factors that can influence conflict of interest between an advisor and an investor, we have conducted a literature review to identify evidence regarding the actual behaviours of advisors given the potential of such conflicts.

With regard to Canadian retail investment, Foerster et al. (2015) and Linnainmaa et al. (2016) found that the portfolio of advisors who invest for themselves does not differ significantly from the portfolio they recommend to their clients. This provides a strong indication that the advice provided by Canadian financial advisors is not influenced by their potential personal gain from recommending mutual funds that provide them a higher commission. This finding is consistent with the observation made earlier in this Report regarding the overwhelming trust that Canadian investors have developed in their advisors, which we conclude is driven by the fact that most Canadian investors who use an advisor have a long term relationship with that advisor. As noted previously, academic research found that long term relationship leads to positive trust and superior outcomes for investors.

[71] Innovation Research Group, 2016

Summary of Findings

Financial advisory services are characterized by asymmetric information between advisors and clients. Potential conflicts exist in any such relationship irrespective of the fee structure. Moreover, financial advice is a “credence good,” meaning that many investors are unable to confidently assess the quality of services provided.

In general, conflicts of interest in financial advice can be mitigated by increased financial literacy, increased disclosure and transparency, and longevity of relationship between advisor and investor.

The general level of education of mutual fund investors is relatively high, however this may not be a good proxy for financial literacy. The increased transparency rules that were fully implemented in Canada in 2016 are capable of mitigating the fee information gap that existed prior to this legislation. We do not have yet empirical data to test the validity of the effectiveness of these rules in conveying fee information to investors. However, the relatively high education profile of Canadian investors and the fact that currently the majority of Canadian investors in mutual funds are informed support the hypothesis that Canadian investors would be able to understand information disclosed about their investments, even upon a cursory review of the statements sent to them. Moreover, the current share of informed mutual investors and the heavy reliance of financial advisors and their firms on reputation and long term relationship with investors suggest that a critical mass of informed investors does exist which effectively discourages widespread misconduct by financial advisors..

In general, Canadian investors appear to have long-term relationships with their advisors and overwhelmingly trust their advisors. The following suggests that this trust is positive and mutual in nature and that advisors in Canada generally align their interests with those of their investors:

- a majority of investors evaluate the performance of their investment portfolios in some form or another;
- investors do punish their advisors when they perceive sub-performance;
- academic research shows that long term relationships between advisors and investors lead to significantly better outcomes for the investor; and
- a recent academic study in Canada shows that the portfolio of advisors who invest for themselves does not differ significantly from the portfolio they recommend to their clients.

Embedded Commissions

The following section weighs the evidence regarding the effects of embedded commissions on the mutual fund market in Canada. It first describes the economic theory of how the way that fees are charged can impact demand. We then review the forms of embedded commissions in Canada and the ways that they impact the market for mutual funds. We assess evidence on these effects in the Canadian context, and describe the potential for further conflicts of interest that could be created under alternative compensation schemes.

Economic Theory

Embedded costs are a fairly common feature in various parts of economic life. Embedded fees are paid in the real estate industry and the insurance sector. Travel agents also might receive commissions from a tour operator and mobile phone shops that facilitate contracts between consumers and mobile phone operators may receive commission payments from the mobile phone operator. In some instances, embedded costs can be regarded as payments for the distribution of products or services.

Similarly, embedded costs exist in the financial services industry – especially with respect to financial intermediaries who facilitate transactions between consumers and the providers of financial products. The nature of these services ranges from simply providing access to specific products to providing advice on which products best suits the customers' preferences.

The form of payment in each of these industries can have an impact on consumer demand. From a traditional economics perspective, which assumes that consumers act in a rational manner, consumer behaviour should not be affected by the way fees are charged. Yet, behavioural economics shows that traditional assumptions of rationality in consumer behaviour often do not hold in reality, thus the way fees are charged can have a significant impact on demand for goods and services. One reason for this is an individual's loss aversion.

An example from the retail industry illustrates this point. To reduce the amount of plastic bags used by consumers, Washington, D. C. introduced a tax of 5-cent per bag on disposable plastic and paper bags. A neighbouring jurisdiction, Montgomery County in Maryland, meanwhile, introduced a 5-cent bonus for consumers using a reusable bag.[72] Behavioural economics suggests that consumers would react more strongly to a 5-cent tax due to loss aversion and this study among consumers in the Washington D. C. area confirmed just that. The tax on disposable bags reduced the use of plastic bags by over 40 per cent. In contrast, the 5-cent bonus for reusable bags had virtually no effect on consumer behaviour.

Similarly, in a study on consumer behaviour, Chetty et al. (2009), conducted an experiment at a grocery store to test how customers react to tax-inclusive pricing versus pricing where sales taxes are added at the cash register. Traditional economic theory posits that consumer behaviour would not be affected by this, as a rational individual would be aware that they have to pay taxes on the products they buy either way. Yet, the experiment shows that consumption drops significantly when taxes are included in the shelf price and hence more salient to the consumer.

In an example from the mutual funds industry, Barber, Odean and Zhang (2005) find that demand for mutual funds is responsive to changes in load fees, but not responsive to changes in the expense ratio. Their explanation is that load fees are highly salient, as they are negotiated and paid upfront, but the expense ratio is not salient because it is deducted before returns are reported. This finding suggests that if trailer fees, which are part of the expense ratio, were charged directly by the advisor, they would be more salient to investors and investors would subsequently reduce their demand for advisors.

[72] Homonoff, 2015

Public policy makers have long understood the principles of behavioural economics and thus have used embedded costs to encourage individual behaviour that they believe to be beneficial to society as a whole. For example, policy makers who believe in the benefits of education or health care almost exclusively facilitate the use of these services by embedding the cost of such services in the taxes that people pay without providing them the choice to pay directly for such services. The alternative policy open to public policy makers of using the taxation and transfer systems to enable all individuals to have sufficient funds in order to afford those essential services and be free to make the choice to consume them is usually rejected. The underlying rationale for the rejection of individual choice is deeply rooted in behavioural economics that predicts that given the choice, many individuals will not make the optimal decision from a society's standpoint, especially when the benefits are not fully understood and will mostly materialize over the long term.

The above shows that embedded costs are prevalent throughout the economy and when costs are made salient to individuals, they would opt to change their demand in a manner that may or may not be consistent with public policy objectives. Thus, from the overall society's standpoint, allowing or disallowing embedded costs should be a function of the behaviours that this society wants to encourage as opposed to focusing on arguments of consumer empowerment.

The Effects of Embedded Commissions in the Sale of Mutual Funds

Advocates for the elimination of embedded fees argue that differences in trailing commissions among many Canadian funds present a conflict of interest, as financial advisors may decide to favour certain funds that offer higher commissions. Other industry stakeholders agree that the potential for conflict of interest exists, but strongly feel that investor access and choice would be significantly compromised with the elimination of embedded fees. Some suggest that conflicts of interest could be better mitigated if commissions were standardized or capped.

An embedded commission is defined as any payment from a mutual fund manager to dealers. There are two common forms in Canada: trailer commissions and commissions associated with deferred sales charges (DSCs). Trailer fees are charged on an ongoing basis, i.e. the commissions are paid as long as an investor owns the fund. The commission on the DSC is paid to the dealer by the fund manager at the time of purchase, but the redemption charge is not paid by the investor unless and until the investor redeems the fund within a certain number of years from the date of the purchase.[73] Embedded commissions are paid by the mutual fund manufacturer to the mutual fund dealer, and are intended to cover costs for services and advice by the representatives of the dealer's firm. Trailing commissions are paid annually to the dealer and are linked to the sales charge option selected. For example, if the client chooses a front end load sales charge or a low-load sales charge, the trailing commission would typically be 1% of the value of the investment. For a deferred sales charge (redemption charge option) the trailing commission would normally by 0.5% of the fund value.

The embedded commission as a share of funds does not generally vary with size of investment. There are economies of scale in advising clients because the time and effort spent on advice and related administration as a share of investment decreases with the size of the investment. This suggests that mass-market investors are in effect subsidized by wealthier investors who are on the same fee arrangement and purchase similar products.

Data on embedded commissions is disclosed in detail in the simplified prospectus and the fund facts which under point of sale (POS) regulations must be provided to the investor before the actual purchase. In this respect, embedded commissions are actually more transparent than advisor fees based on individual arrangements between client and advisor, as the price negotiated is not available to other market participants. Thus one of the tenets of competitive market conditions, full price information to all market participants, is actually violated by fee schemes that require individual negotiation.

[73] See "Advisor Compensation" in "The Mutual Funds Market in Canada" for more information.

There is limited Canadian evidence on the effects of embedded commissions on the mutual funds market. Research by Douglas Cumming et al. (2015) analyses Canadian mutual fund data with regard to fee structures, fund flows and fund performance. The authors claim to show that funds with strong past performance generally attract more flows. Yet, this relationship weakens when funds are sold through affiliated dealership and weakens further when funds are sold with trailer fees.

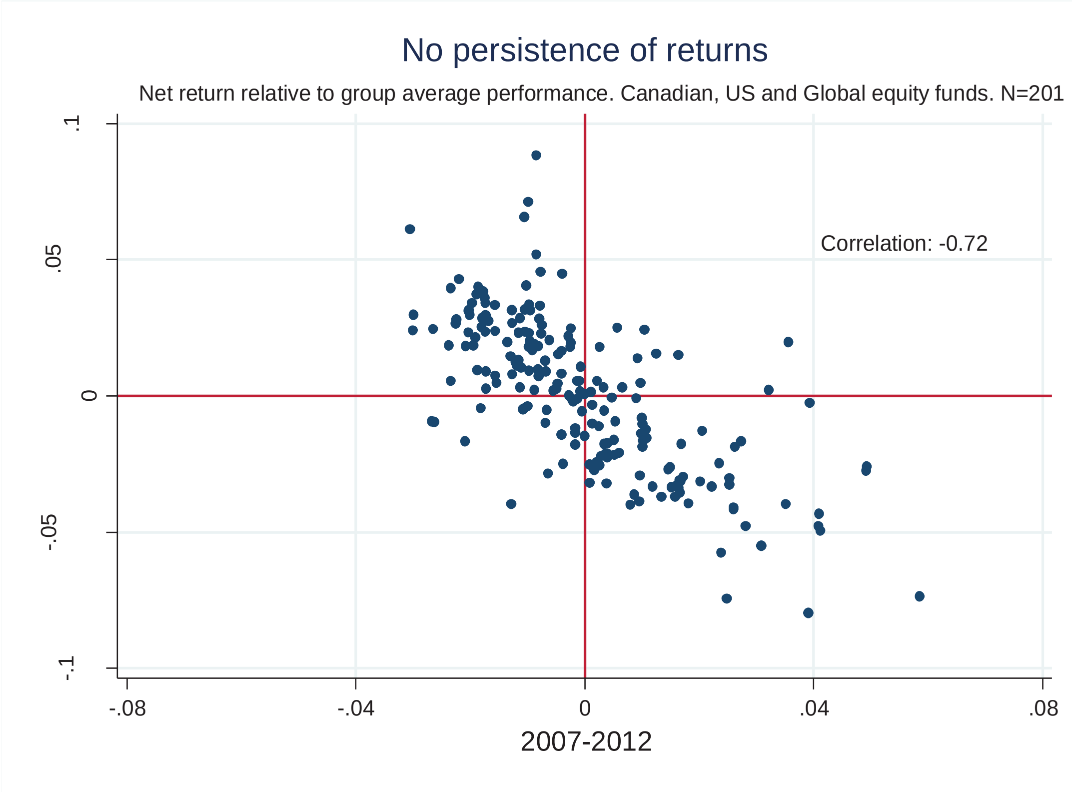
There are several issues with the methodology of Cumming's paper. As both Timmerman, and Linton and Tobek point out, while future alpha (risk-adjusted returns) are assumed to depend on past alpha, past values of alpha are not included in Cumming's analysis, an omission which may bias the results.[74]

In addition, there are problems with the conclusions drawn by this report. Firstly, as Perron notes, the report is not clear about what objective investors are trying to achieve. Therefore, it does not have a metric on which to clearly compare embedded commissions and other forms of compensation. Without such a metric, one cannot answer whether fee-based or commission-based remuneration is better for individual investors.[75] See Appendix E for the full text of the three papers mentioned here, which were funded by IFIC.

Moreover, we note that Cumming's results depend on the assumption that past fund performance is a good predictor of future performance, and therefore that it is good for investors when advisors' choices depend on past results. Were this not the case, his conclusions that embedded commissions reduce sensitivity of flows to past performance would not act as an argument against embedded fees. However, much research suggests that past fund performance is a poor predictor of future performance.[76] Our own analysis of Canadian funds also supports this conclusion. Using data on annualized average performance in two consecutive 5 year periods, we find no evidence of persistency in funds' annualized net return relative to group average for Canadian Equity, US Equity and Global Equity mutual funds. Moreover, we find a strong negative correlation between the net performances in the two periods, indicating that funds that over perform relative to their group in one period tend to underperform in the next period. The following figure illustrates the point:

[74] Timmerman, 2016; Linton and Tobek, 2016
[75] Perron, 2016
[76] For example, see Carhart, 1997

Figure 20: Persistence of Mutual Fund Returns



Further, Cumming's results are inconsistent with evidence from studies presented in this Report that suggests:

1. Advisors provide significant value to investors;
2. Advisors in Canada invest in the same products they recommend to their clients;
3. Canadian trust their advisors but also punish them; and
4. Trust is created through a long term relationship and studies show that long term relationships significantly reduce the risks inherent to conflict of interest situations and lead to superior results.

Variation of trailing commissions across mutual funds in Canada

Any variation in trailing commissions across mutual funds can in principle incentivize financial advisors to recommend funds that pay higher commissions. This, in turn, could lead to advisors recommending funds not purely based on the suitability for investors' needs and preferences.

To investigate the degree of variation of trailing commissions paid by mutual funds in Canada, we have gathered data on trailing commissions paid by lead retail series of Canadian Equity, Global Equity and U.S. Equity funds sold on a no-load basis. These funds represent Series A and Investor Series funds manufactured mainly by Canadian banks. We did not include funds sold through fee-based platforms, funds with front-end load and back-end load, because different compensation arrangements between mutual fund manufacturers and financial advisors in each of those fund types do not enable a proper comparison. No-load funds that we used in the comparison do not pay sales commissions and the only compensation for the dealer is the trailing commissions paid by the fund manufacturers.

In a sample of 82 mutual funds,[77] we find an average trailer fee of 1.03%, with a standard deviation as a ratio of average equal to 14.8%:

Table 6: Trailing Commissions for No Load Funds, A Series Only[78]

Trailing Commissions for No Load Funds, A series only			
Funds Type	**Average Trailer**	**Trailer Standard Deviation as a Share of Average Trailer**	**Number of observations**
Canadian Equity	1.03%	10.1%	14
US Equity	0.99%	9.4%	36
Global Equity	1.00%	11.1%	32
Combined	**1.00%**	**10.2%**	**82**

We found the average and the standard deviation as a share of average trailing commission to be similar across the three types of mutual funds fund the sample. Overall, we find some degree of variation in trailing commissions across mutual funds in the sample, which suggests a potential for conflicts of interest.

The following table shows the trailers for no-load money market and fixed income mutual funds.

Table 7: Trailing Commissions for No Load Funds, A Series Only

Trailing Commissions for No Load Funds, A series only			
Funds Type	**Average Trailer**	**Trailer Standard Deviation as a share of average**	**Number of observations**
Canadian Money Market	0.23%	64.5%	17
Canadian Fixed Income	0.53%	12.2%	17
Global Fixed Income	0.65%	24.3%	13

The above table suggests a greater level of relative variation in trailers on money market and fixed income funds compared to equity funds.

[77] The sample was collected through fundlibrary.com and represents all no load, A series funds with assets of at least $10 million for which trailer information was available.
[78] Fundlibrary.com, 2017

Relationship between fund performance and trailing commission

In this section we investigate the relationships between the level of trailing commission and a fund's performance. If financial advisors recommended mutual funds based on trailer fees rather than maximization of investors' returns, we would expect a negative relationship between funds' return and trailing commissions. Conversely, a lack of significant relationship would indicate that the variation in trailing commissions does not lead to adverse outcomes for investors.

For the same sample of no-load Canadian Equity, US Equity and Global Equity mutual funds that pay trailing commissions, and separately for money market and fixed income funds, we find no statistically significant relationship between 5 year net fund performance and the level of trailing commission at a conventional statistical significance level of 5 per cent. The lack of relationship is illustrated in the figure below, which plots funds' average annualized 5 year net performance against the level of trailing commissions, and separately for bond funds.

Figure 21: Fund Performance and Trailing Commissions, Canadian, US, and Global A-Series

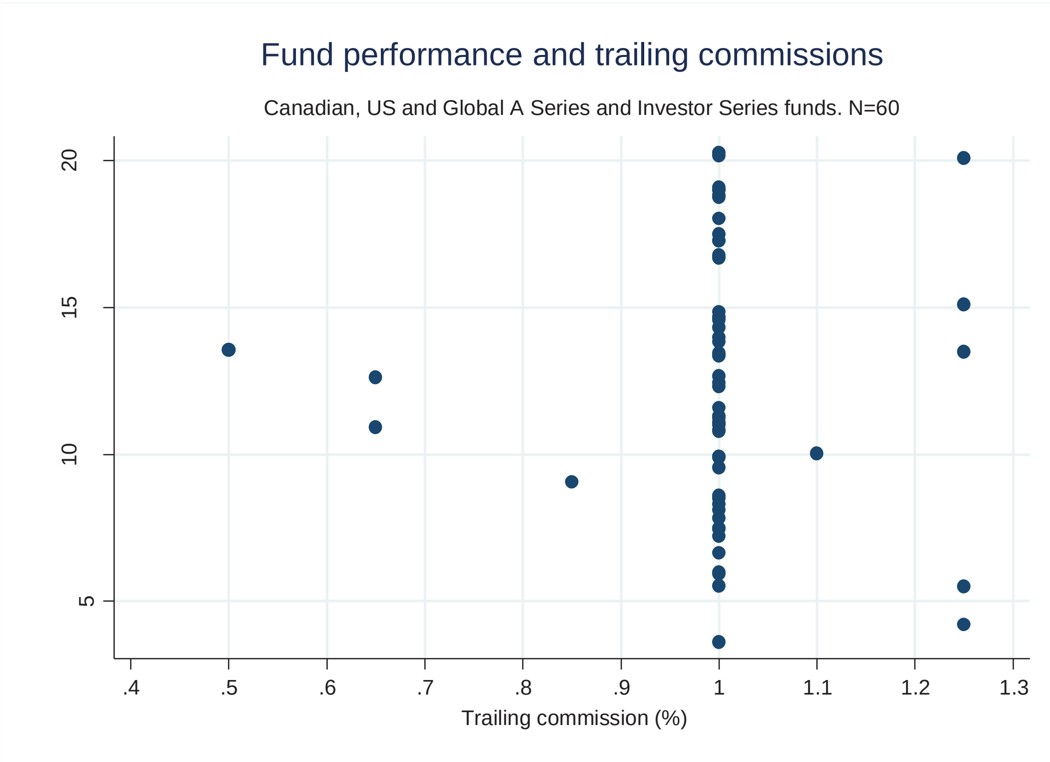


Figure 22: Fund Performance and Trailing Commissions, Canadian and Global Fixed Income A-Series and Investor Series

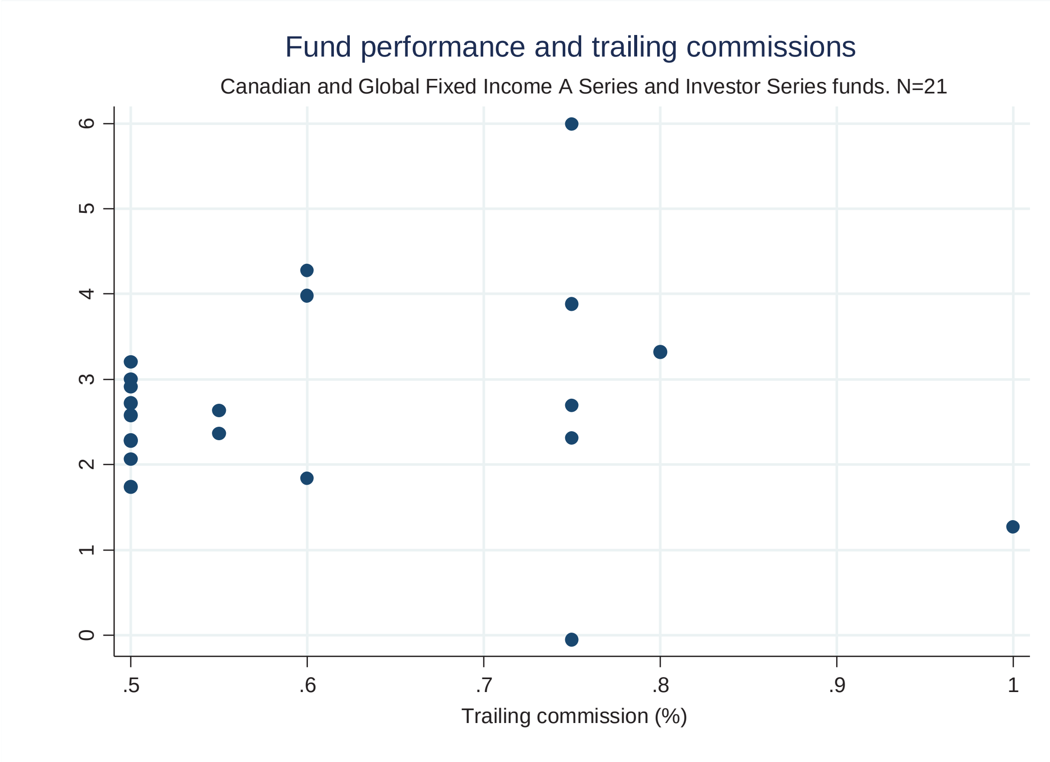
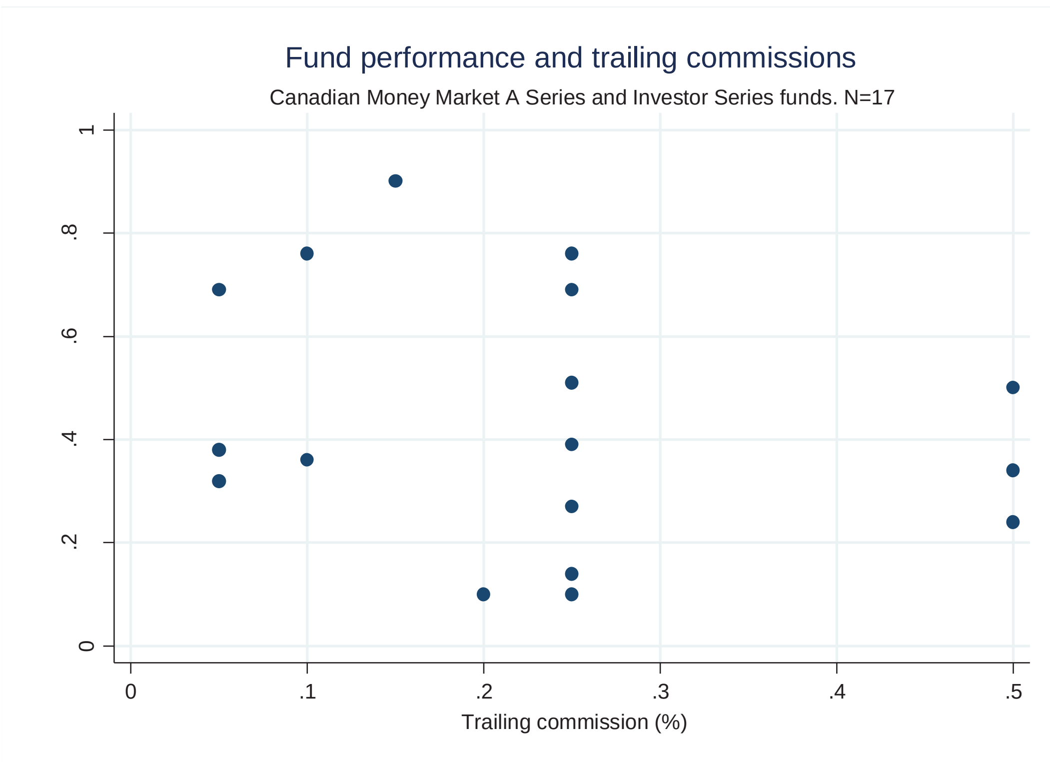


Figure 23: Fund Performance and Trailing Commissions, Canadian Money Market, A-Series and Investor Series



We conclude that, despite some variation in trailing commissions across no-load mutual funds sold in Canada, there is no evidence that higher levels of trailing commissions lead to suboptimal fund performance for investors.

Conflicts of Interest under Alternative Compensation Schemes

Banning embedded commissions will increase the prevalence of other compensation schemes. The inherent relationship between agent and principal suggests that any compensation scheme creates a potential for conflict. In this section we look at the potential conflicts under alternative compensation schemes for advisors. We note that to some extent, the conflicts of interests under alternative compensation schemes are rather similar to those under embedded fees. Thus, to the extent that this is the case, a ban on embedded commissions would not remove the conflict of interest between advisor and investor.

One such alternative compensation scheme is the fee-based platform. In this arrangement, the advisor receives fees from the investor in form of a percentage of AUM. This scheme, while fully transparent to the client, creates potential conflicts of interest.

One example of such conflict is the fact that advisors may be tempted to take undue risks to grow their clients' accounts and thereby boost their own fees. This may be against the best interest of some investors who would find it optimal to have lower amounts invested in mutual funds. Moreover, fee-based platforms are characterized by financial advisors' strong disincentive to provide investment, financial planning and tax solutions that do not involve advisor management or which might reduce the amount of investor assets under management. For example, the advisor might be disinclined to advise investors to reduce debt or invest in assets such as real estate which would nevertheless be optimal for an investor given his or her situation, risk profile or other characteristics. Similarly, an asset-based advisor might also be reluctant to recommend holding cash or static bond portfolios outside of the fee arrangement, which could lead to inferior outcomes for investors. Overall, fee-based platforms incentivize financial advisors to recommend investment strategies that focus on maximizing fee-eligible assets that benefit the financial advisors rather than focusing on fulfilling the investor's objectives. In a recent report on conflicts of interest under fee-based platforms in the UK, for instance, the FCA expressed concerns that advisors have an incentive to grow the size of their funds in order to increase AUM – which is not necessarily aligned with investors' interests.[79] An additional conflict can arise where advisors feel the need to demonstrate their value to the client by frequently changing portfolios when a "buy-and-hold" strategy would provide better returns.[80]

As noted previously, in Canada, it is common for MFDA-licensed dealers to also be licensed as dealers of insurance products. Therefore, in addition to traditional mutual funds they are able to sell segregated funds, a type of mutual fund that includes insurance and is appropriate only for investors with certain goals. Segregated funds are more expensive than traditional mutual funds, and may have embedded commissions. Because these funds are insurance products, they are not regulated by the CSA and therefore existing regulations such as the CRM-2 do not apply to them. This may create incentives for advisors to recommend segregated funds instead of traditional mutual funds, if embedded commissions are banned by the CSA.

A third alternative is an account where the advisor charges the investor on a per transaction basis. This provides the advisor with an incentive to increase the number of transactions in order to earn higher fees. This would give rise to "churning" (artificially high turnover rates) and would go against the best interest of the investor.

Another alternative to embedded commissions are arrangements with hourly fees, where the investor pays the advisor a flat fee per hour of work. Within this framework, there is a comparatively low risk with regard to a potential misalignment on specific fund selection between advisor and investor. That said, there still exists a potential conflict of interest under this scheme. As advisors get paid at an hourly basis, they have an incentive to

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[79] Financial Conduct Authority, 2016
[80] Strategic Insight, 2012

report longer hours to the investor. Due to asymmetric information with regard to the amount of hours required to complete specific tasks coupled with limited possibilities for the investor to monitor the advisor's behaviour, the advisor is in a position to overcharge the investor. In addition, the advisor has an incentive to recommend products requiring active asset management in order to get more paid hours which might not necessarily be aligned with the interests of the investor.

As shown previously, recent academic study in Canada indicated that generally advisors in Canada act in an honest manner and their advice is not influenced by their potential personal gain. We have shown previously that the overwhelming majority of Canadian investors seem to have developed mutual trust with their advisors.

In contrast, there is strong evidence of conflicts of interest driven by advisor compensation in the United States, where advisors are not compensated via trailing commissions.[81] The study's findings were in line with similar studies conducted by Zhao (2008). Zhao (2008) analysed mutual fund data for the US from 1992 to 2001 and found that load funds with higher loads and 12b-1 fees receive higher flows. A similar result was shown by Bergstresser et al. (2009). The authors analysed US fund flows sold through advisory channels and through direct channels without an advisor. Analysing funds sold through the advisory channel showed that fund flows increase with the load paid to the advisor.

Chalmers and Reuter (2013) analysed the potential conflict of interest with regard to investment providers in the Oregon University system. Their study showed that mainly younger, less highly educated and less highly paid employees took advantage of an offer to meet with a financial advisor. The authors compared the portfolios of investors with an advisor to portfolios of self-directed investors and found that advised investor portfolios were significantly riskier. In addition, the fund allocation of advised investors suggested that they tended to purchase funds associated with higher fees.

Mullainathan et al. (2012) conducted an experiment in which trained auditors sought the help of a financial advisor. One set of investors presented the advisors with a portfolio largely in line with the advisors' financial interests whereas another set of investors presented a portfolio less aligned with the advisors' financial interests. The results indicated that advisors tend to confirm investors' biases when those biases are in the advisors' interest. In addition, advisors are inclined to recommend actively managed funds which pay higher fees even in cases where investors present a well-balanced low-fee portfolio.

While embedded fees are not common in the United States, there are clearly significant problems with conflicts of interest. This suggests that other factors also drive conflicts of interest and that conflicts can exist through various fee structures.

Summary of Findings

Any agent fee scheme, including the ones applicable to financial advisors, create their own set of potential conflict of interest between the principal and the agent. Thus the replacement of embedded fees by another fee scheme will not eliminate the potential for conflict interest.

The variation in the magnitude of commissions paid by different funds to advisors in Canada do create an incentive for advisors to recommend particular funds. However, we did not find evidence to suggest that Canadian investors consistently lose from purchasing certain compensation type of mutual funds.

There is no credible evidence for negative consequences of this potential conflict of interest in Canada. In fact in the US where embedded commissions are substantially less prevalent than in Canada, there is significant evidence of advisors interests not being aligned with their clients where in Canada there is evidence to the contrary.

[81] In the US, 12-1b fees are charged in a similar way to trailing commissions, but they are used for marketing rather than advisor compensation.

Canada's current transparency rules make embedded commissions fully known to investors and in contrast to negotiated fees between investor and advisor they can be compared among advisors and clients. One of the principles of a perfectly competitive market is that information on prices should be known to all market participants. Moving away from embedded fees to individually negotiated fees will violate this principle and therefore may actually reduce competition.

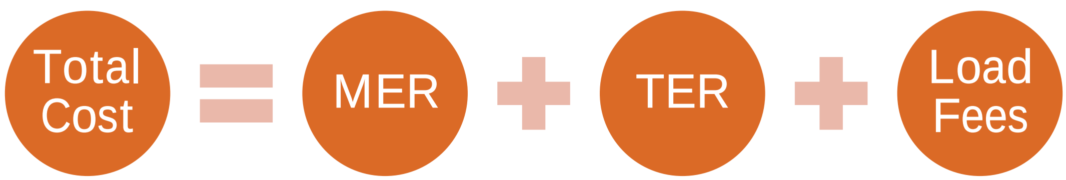
Cost of Financial Advice in Canada

The costs of financial advice and owning mutual funds are complex, and different countries charge investors in different ways. The full cost of advice to an investor includes any direct fees, hourly fees, trailer fees, and sales commissions. Further, costs of owning funds include the management expense ratio (MER), an ongoing management fee taken off the top of returns by the fund manager, and any front and back end loads. Comparing the MER between different countries fails to take into account all of these cost channels. The following section describes the typical cost channels in Canada and internationally.

The Cost of Advice

The typical (non-fee-based) cost structure for investing in Canada involves three different types of payments: the management expense ratio, the trade expense ratio and any load fees. Together, these fees reflect the full cost of owning the fund. The following figure illustrates this model.

Figure 24: Total Cost of Mutual Fund Ownership on Non-Fee-Based Platforms



The **management expense ratio** is usually the largest part of the fee. It includes:

- Charges for investment management;
- Any trailing commissions;
- Operating expenses such as record keeping, audits, and legal fees; and
- HST.

Figure 25: Components of Management Expense Ratio

The MER is calculated as a share of assets under management, and is charged annually on an ongoing basis. When investors see their net returns, the MER has been subtracted from their gross returns. As noted above, trailing commissions are charged as part of the MER. The MER is available on the Fund Facts sheet and a fund's simplified prospectus. Historical MERs are available on the Management Report on Fund Performance (MRFP). Typically, Canadian investors buying funds with trailing commissions do not pay for advice outside of the above charges.[82]

International Comparison

[82] RBC Global Asset Management, 2016

Trailer fees as a form of advisor compensation are more common in Canada than they are in other countries, and this makes it difficult to compare the total cost of investing. Canada consistently has among the highest MERs in the world, but comparing MERs alone would be misleading, as Canadian MERs include the fee investors pay for advice while in most other countries it is often paid separately. However, we note that the typical trailer levels in Canada are higher than those in the UK and Australia prior to their bans on embedded commissions, even though in all three countries, trailers usually cover the full cost of advice. On the other hand, while the US has some of the lowest MERs in the world, a detailed study done by Strategic Insight for IFIC showed that when taking all relevant fees into account, the cost of investing in the US and Canada is similar.

In countries where trailers are not common, advice is usually paid for on a direct-fee basis. Emerging models of advice are able to provide direct-fee platforms for mass-market investors. For example, in the United States Vanguard offers direct-fee advice for investors with at least $50,000 and Merrill Lynch offers direct-fee telephone and online services with an investment minimum of $5,000.

Financial Advisor Compensation

The following table shows international data on the average compensation of financial advisors.[83] We note that the data is expressed in Canadian dollars based on the current exchange rate:

Table 8: Salaries for Financial Advisors[84]

Country	Average Salary of Financial Advisor	Ratio to National Average Salary
Canada	$ 48,483	0.97
United States	$ 76,013	1.71
United Kingdom	$ 58,624	2.12
Australia	$ 67,372	0.93

The above table shows that Canadian financial advisors' compensation is the lowest among the sample countries. The table also shows that Canada and Australia compensation schemes for financial advisors provide them with

[83] PayScale defines personal financial advisor as: "Financial advisors work primarily for financial institutions such as banks, mutual fund companies, and insurance companies. Generally, they work with individuals or institutional clients to assess their financial needs and help them achieve financial goals, such as choosing investments (money market, real estate investments, stocks and bonds), and they also explain tax laws relevant to certain investments and help with insurance decisions.

Financial advisors help clients plan for both short-term and long-term goals, such as education expenses if they have children who are going to college, or for their own retirement, and they recommend various investments to match clients' goals. A bachelor's degree in accounting, business, finance, or a related field is generally required for this position, and those with prior work experience with similar financial institutions may be preferred by some employers.

Applicants may be required to pass Series 6 and Series 7 exams and must be willing to learn their institution's computer system. Knowledge of Microsoft Office programs (Word, Excel, PowerPoint, Outlook) is important, and they must also have excellent verbal and written communication skills and work well with diverse people. They must have thorough knowledge of government (federal, state, local) laws and regulations and follow Security Exchange Commission (SEC) rules and guidelines, as well. They should stay up-to-date with frequent changes in monetary rules and regulations, and some may visit companies with which their institutions are interested in investing. Some may also train or mentor junior financial advisors.

[84] Payscale.com

average compensation that is close to the national average of all workers in their respective countries, while in the US and the UK financial advisors' compensation is around double the national average for all workers in those countries. This appears to suggest that financial advisor compensation in Canada is not a key driver of the cost of mutual funds for investors.

Summary of Findings

Canada has higher average fund management fees than most developed countries. However, in many of those countries compensation for advisors is paid through direct payments rather than included in fund management fees. Since, unlike embedded commissions, data on direct fees is not easily available, it is not possible to ascertain whether the overall cost of advice in Canada is higher than in those countries. However, a detailed study done in this regard suggests that the overall cost of advice in Canada and the US is similar even though the US boasts the lowest fund management fees in the world.

The average advisor compensation in Canada is lower than in the US, UK and Australia. Thus, it is doubtful that advisor compensation is the main driver of the higher fund management fees in Canada. Embedded commissions do not appear to be inflating advisor compensation above international norms.

Hypotheses Regarding the Likely Impacts of a Ban on Embedded Commissions

The following provides our hypotheses regarding the likely impacts of a ban on embedded fees. Our hypotheses are based on economic principles and the empirical evidence presented in this Report. These hypotheses represent our best estimates of what may happen following a ban on embedded commissions, but we are not able to test them due to practical limitations on the types of causal inference we are able to make. The following section estimates the potential effect of a ban on the economic footprint of the financial advice industry. In the section after that we bring evidence from other jurisdictions that were considered in developing our hypotheses.

Hypothesis 1 – A ban will reduce the demand for advisor services as well as the supply of advice, both of which will act to reduce the use of or access to advisors by mass-market investors. Mass-market investors who would continue to use an advisor will likely see an increase in the cost of advice.

Why are we saying that?

1. Behavioural economics teaches us that consumers reduce their demand for a service when the fees for that service are salient and subject to negotiation as opposed to being embedded in the overall price of the product, even if they have full knowledge of the embedded fee. This combined with the fact that consumers will not be able to benchmark the outcome of their negotiation with their advisor using published information, will in our view lead investors who currently use an advisor to stop using her.
2. Fee based platforms in Canada require a minimum size of portfolio. Depending on the firm offering this platform this minimum typically ranges from $100,000 to $300,000The reason for the minimum is the economies of scale involved in serving the financial needs of clients. Many investors who currently use an advisor do not meet this threshold.
3. Advisors who serve mass-market investors will not find it economically worthwhile to continue to serve some of those clients, if they are forced to reduce their fee significantly below what they currently receive from embedded fees. In those cases, mass-market investors who wish to continue being served by a financial advisor will find the cost of advice higher as a result of the need to compensate for the dis-economies of scale involved in serving smaller account. In other words, the hidden subsidy that currently exists as a result of embedded commissions will disappear when advisors will negotiate a separate fee arrangement with each client.

Hypothesis 2 – A ban on embedded commissions will likely eliminate some existing misalignments between advisors' and investors' interests but may give rise to new misalignments.

Why are we saying that?

1. A ban on embedded commissions in the sale of mutual funds would eliminate the incentive to recommend funds based on the commission the advisor would receive. Our assessment shows that there is some degree of variation in trailing commissions which suggests potential conflicts of interest.
2. In principle-agent relationships, any compensation scheme creates a potential for conflicts of interest. Thus, misalignments between the interests of an advisor and an investor can occur under alternative compensation

schemes as well. Under a fee-based platform, for instance, advisors might be incentivized to take undue risks to boost their own fees even where this is not in the best interest of their clients.

Hypothesis 3 - Reduced profitability for some players may lead to consolidation of the advisory industry and the risk of increased bias towards funds produced by the same organizations that provides the advice. Banks are generally in the best position to serve mass-market clients who will stop using independent advisors.

Why are we saying that?

1. Advisors and dealers who rely significantly on mass-market investors may become economically non-viable or would have to shrink their business significantly.
2. Canadian investors who will stop using an advisor, will either invest without the aid of an advisor, use robo-advice, or use an institution that will provide tailored advice to mass-market investors.
3. Canadian banks are best positioned as far as infrastructure and reputation, to serve the mass-market advisors through robo-advice and advice models that are affordable to those investors. This is especially relevant for smaller and more remote communities, where banks might be the only option to a local independent advisor that can afford to continue to serve their clients.

Sensitivity Analysis on the Potential Impact of a Ban on Canada's Economic Footprint

This section attempts to estimate the potential impacts of a ban on embedded commissions on the economic footprint of the investment advisory industry in Canada. The economic footprint includes Output, GDP, labour income and jobs. Our estimates should be seen as the part of the Canadian economy that is at risk as a result of a ban on embedded commissions and not as the actual loss to the economy. In reality some of that risk will be mitigated through restructuring in the economy, which is not possible to estimate at this point.

Economic Footprint of Canada's Investment Advisory Industry

To assess the economic footprint of the investment advisory industry in Canada, we rely on confidential operating data received from our survey of mutual fund dealers. We use the survey responses in accordance with other data on the number of financial advisors by province to develop an estimate for the number of financial advisors and revenues generated by the advisors in Canada.

Methodology

The fundamental philosophy behind our economic footprint analysis is that spending on goods and services has attendant impacts throughout the economy. For instance, providing financial advice will generate demand for the inputs to this process (primarily labour) that in turn generates additional demand that extends beyond the initial spending. Our economic footprint analysis permits the estimation of this cascading effect by using the multipliers calculated by Statistics Canada based on its input-output model of the provincial economies.

Our analysis estimates the relationship between the revenues generated by investment advisory agents and the resulting impacts throughout the economy (including demand for other goods and services). For the purpose of this report, economic footprints were estimated for the following measures of economic activity:

- **Output** – the total gross value of goods and services produced, measured by the price paid to the producer. Output double counts the value of intermediate inputs and so GDP is usually a preferable measure of economic activity.
- **Value added or GDP** – the value added to the economy, or the unduplicated total value of goods and services. GDP includes only final goods to avoid double counting of products sold during a certain accounting period.
- **Labour Income** – the salaries and wages accrued by employees.
- **Employment** – the number of jobs created or supported. It is expressed as the number of full-time equivalent ("FTE") jobs indicated in person years.

Economic impacts are typically estimated at the direct, indirect and induced levels:

- **Direct impacts** result from the investment advisory agents' spending on suppliers and employees.
- **Indirect impacts** arise from the activities of the firms providing inputs to the investment advisory agents' suppliers (in other words, the suppliers of its suppliers).
- **Induced impacts** are the result of consumer spending by employees of the businesses stimulated by direct and indirect expenditures.

- **The total economic impact** equals the sum of the direct, indirect, and induced economic impacts.

Baseline Provincial and National Economic Footprints

Using the aforementioned framework, we estimated the total (i.e., including direct, indirect, and induced impacts) 2016 economic footprint of the investment advisory industry.[85] The results are summarized in the table below:

Table 9: Total Economic Impact by Province

Total Economic Impact	Output ($ million)	GDP ($ million)	Labour Income ($ million)	FTE Jobs
NL	243.6	122.5	83.3	990
PE	98.3	50.2	31.4	533
NS	638.3	307.9	204.5	3,718
NB	490.2	240.1	156.1	3,007
QC	4,304.0	2,146.4	1,432.6	21,656
ON	11,408.1	5,361.0	3,605.1	51,781
MB	639.3	305.8	192.0	3,446
SK	595.3	272.9	170.4	2,734
AB	2,810.5	1,339.7	885.0	11,121
BC	3,696.3	1,731.4	1,113.3	17,098
Total	**24,924.0**	**11,877.8**	**7,873.6**	**116,086**

Sensitivity Analysis

One potential consequence of banning embedded commissions would be that advice is only available on a direct-fee basis. Currently, direct fee platforms have a minimum threshold on investment size, typically at least $100,000 but often more.

We understand from our discussions with dealers that, under the current embedded commission framework, fund manufacturers deal with all operating fees (i.e. the administration of getting the fees from the investors etc.) and then pass a portion of these fees along to the dealer. However, with direct fees (i.e. banned embedded commissions), the dealers would need to set up their own administrative processes to take on the work previously done by the fund manufacturers, thus incurring higher administrative costs. This reality means that dealers would likely set a minimum investment size to ensure that their administrative costs do not exceed their expected fees. For the purposes of our analysis, we have assumed that a minimum investment threshold of $100,000 would be instituted across all advisors, which is in line with existing research.[86]

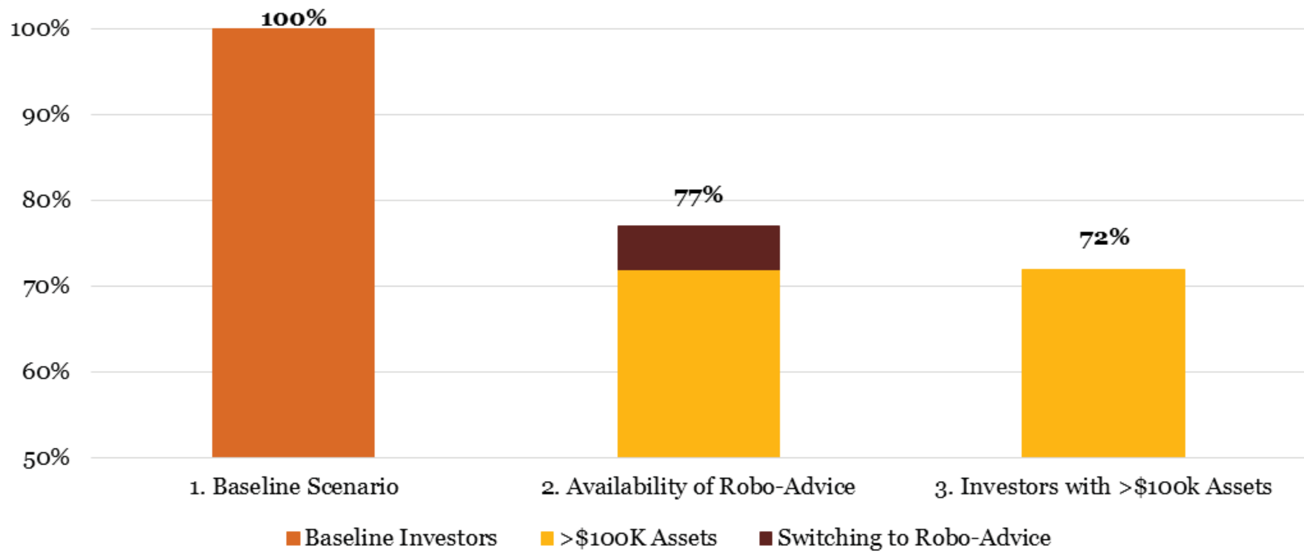
We identified investors who have under $100,000 to invest as the group at risk of losing financial advice through traditional channels in the case of a ban on embedded commissions. Among investors with MFDA-licensed dealers, as opposed to IIROC-licensed dealers, this group accounts for approximately 83 per cent of investors worth 28 per cent of the total assets under management.[87] We focus on those with an MFDA-licensed dealer because those dealers can sell only mutual funds. As noted earlier in this report, many MFDA advisors are dual licensed. We note that this could potentially allow for regulatory arbitrage with those advisors being able to sell commission-based

[85] PwC Dealer Survey
[86] PwC Dealer Survey
[87] POLLARA, 2016

segregated funds as these would not be captured by a CSA ban.[88] As we do not know how many advisors might take advantage of this option, this consideration is excluded from our analysis.

Based on the 2016 Pollara survey, we found that approximately 17 per cent of those investors who would be affected by the imposition of a $100,000 threshold would not be opposed to relying on robo-advice as a substitute to traditional financial advisors. Our figures for investors comfortable with robo-advice are based on the 2016 Pollara survey of mutual fund holders.

Figure 26: Advisor Revenue as a Share of Current Level under Different Scenarios



The above chart graphically depicts the effect that a $100,000 minimum investment threshold would have in three separate scenarios:

- **Scenario 1: Baseline Investors –** Under the Baseline Scenario, we ignore the effect of a minimum investment threshold. Clearly, the economic footprint in this scenario would be identical to the one calculated above (i.e. 100 per cent of the Baseline economic footprint).
- **Scenario 2: Availability of Robo-Advice –** Scenario 2 considers the situation where all investors currently with less than $100,000 in investments would not be able to seek traditional financial advice. However, in this scenario, we assume that investors who are comfortable with robo-advice will still be receiving financial advice (albeit, not through a traditional, in-person advisor). This would shrink the economic footprint of the investment advisory industry by approximately 23 per cent compared to the Baseline Scenario.
- **Scenario 3: Investors with >$100,000 in Assets –** Scenario 3 considers the situation where all investors currently with less than $100,000 in investments are not able to seek financial advice. In this scenario, we assume that no investors will switch to robo-advice and instead investors with more than $100,000 in assets will have access to advice, because they meet the minimum threshold to be eligible for direct fees. This scenario shrinks the economic footprint of the investment advisory industry by approximately 28 per cent compared to the Baseline Scenario.

[88] See "Conflicts of Interest under Alternative Compensation Schemes" for more information.

Based on the above sensitivity analysis, we estimated the total (i.e., including direct, indirect, and induced impacts) expected shrinkage that Scenarios 2 and 3 would have on the economic footprint of the investment advisory industry.[89] The results are summarized in the table below:

Table 10: Economic Loss Compared to Baseline Scenario, by Province

Total Economic Impact	Output ($ million)		GDP ($ million)		Labour Income ($million)		FTE Jobs	
	Sc.2	Sc.3	Sc.2	Sc.3	Sc.2	Sc.3	Sc.2	Sc.3
NL	56.6	68.2	28.5	34.3	19.4	23.3	230	277
PE	22.8	27.5	11.7	14.0	7.3	8.8	124	149
NS	148.3	178.7	71.6	86.2	47.5	57.3	864	1,041
NB	113.9	137.3	55.8	67.2	36.3	43.7	699	842
QC	1,000.3	1,205.1	498.8	601.0	332.9	401.1	5,033	6,064
ON	2,651.2	3,194.3	1,245.9	1,501.1	837.8	1,009.4	12,034	14,499
MB	148.6	179.0	71.1	85.6	44.6	53.8	801	965
SK	138.3	166.7	63.4	76.4	39.6	47.7	635	766
AB	653.2	786.9	311.4	375.1	205.7	247.8	2,585	3,114
BC	859.0	1,035.0	402.4	484.8	258.7	311.7	3,974	4,787
Total	**5,792.2**	**6,978.7**	**2,760.6**	**3,325.7**	**1,829.8**	**2,204.6**	**26,979**	**32,504**

The imposition of a $100,000 minimum investment threshold would clearly have a significant negative impact on the economic footprint of the investment advisory industry in Canada. For example, the contribution to GDP from the industry would shrink by between approximately $2.8 and $3.3 billion.

However, it is important to note that the above estimate assumes that either all of these investors will stop using their current advisor and turn to DIY-investing or only those comfortable with robo-advice will continue receiving financial advice. . In reality, we expect that some will find other alternatives offsetting some of this economic loss. For example, in other jurisdictions, where a ban on embedded commissions was imposed, the ban was announced years ahead of its implementation, giving financial advisors time to develop new products and services for mass-market investors. In Canada, banks are the most likely to be in a position to offer these new types of services, as they already have a client base and technological platforms. For example, BMO has already introduced a robo-advice service, and such services can be combined with existing client service offerings.

The move from an advisor to DIY-investing is expected to reduce the amount of savings available to those Canadians at retirement. To estimate the impact, we relied on a 2016 Canadian study by Montmarquette and Viennot-Briot that found that after controlling for potential influencing factors, having financial advice for 15 years or more increased household assets by 290 per cent compared with those households without a financial advisor (3.9 times the value of assets of the equivalent non-advised households)[90].

For the purpose of our analysis we assumed that the average Canadian accumulates approximately $200,000[91] in financial assets prior to retirement. Since approximately half of households in Canada use a financial advisor[92], it

[89] Pollara Survey, PwC Survey Results
[90] Montmarquette and Viennot-Briot, 2016
[91] Based on two sources: BlackRock 2015 Global Investor Pulse Survey finds the average savings of pre-retirees of $125,000. According to Statistics Canada, the average value of private pension assets and non-pension financial assets in 2012 was $280,000 among those ages 55 to 64.
[92] Conference Board of Canada, 2014

follows that the average savings of retirees who do not use an advisor for at least 15 years are equal to $80,000 prior to retirement. For those who use an advisor, the average savings accumulated equal approximately $320,000.

The above analysis indicate that, on an order of magnitude basis, those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice.

Jurisdictional Review

Introduction

Assessing the impact of a ban on embedded commissions in Canada, inherently, lacks the perspective of a direct empirical study. In other words, we do not have the luxury of a controlled experiment in Canada that would tell us how stakeholders will react and what will be the economic impacts of a ban on embedded fees. That is the reason that our Report, thus far, has used economic theory and empirical studies on relevant issues that indirectly assist us in developing informed hypotheses. Having said that, the use of international comparisons can act as somewhat of a proxy for the direct empirical study we are missing in this assessment and to assist us in developing our hypotheses. Some countries have already banned trailing commissions, and more have considered such a ban. The following section provides an overview of the global regulatory environment concerning embedded commissions.

Broadly, there are three types of regulatory environments. Countries that have enacted a ban on embedded commissions, countries that have enacted a partial ban on embedded commissions, and countries that have no ban in place. Countries that have enacted a ban include the UK, Australia, and the Netherlands. We have chosen the UK and Australia as case studies due to data and information availability. Countries with a partial ban include all countries in the EU, which are subject to the Markets in Financial Instruments Directive (MiFID II). MiFID II prohibits independent advisors and portfolio managers from accepting and retaining commissions, unless they are minor, non-monetary benefits such as hospitality of a reasonable value. Independent distribution represents approximately 11 per cent of the European fund industry. Advisors that are not independent will continue to be able to receive fees and commissions from third parties. These regulations will come into effect on January 3, 2018. In addition to the MiFID II regulations, countries in the EU may impose additional regulations on financial services, and many have done so. Finally, many countries have no bans or restrictions on embedded commissions. Of these countries, many have considered a ban as part of a review of financial regulations. Some financial regulators indicated their reasons for not pursuing such a ban, and we have included case studies on some of these countries including New Zealand, Switzerland, and Singapore.

There are a few important considerations when looking at case studies. Each country has a different regulatory environment and each has made different choices in policy design. Bans also usually accompany other changes to financial services regulation, so it may be difficult to isolate the effects of the ban. Another challenge is that our main case studies, Australia and the UK, banned embedded commissions in 2012 and 2013 respectively, and included grandfathering provisions, meaning that it may be too early to see the full effects of the policy change. When drawing our conclusions from these case studies, we took into account these challenges.

Mapping Embedded Commissions

The following chart provides information on the regulatory status of embedded commissions in the 35 OECD countries plus India, Singapore, Hong Kong and South Africa.

Table 11: Regulatory Status of Embedded Commissions by Country

Country	Ban	Effective Date	
Australia	Yes	1-Jun-13	The Australian Government introduced 'Future of Financial Advice' (FoFA) reforms in 2012, with compliance beginning in 2013. Reforms include a ban on conflicted remuneration structures including commissions and volume based payments, in relation to the distribution of and advice about a range of retail investment products.
Austria	Partial	3-Jan-18	Subject to MiFID II

Belgium	Partial	3-Jan-18	Subject to MiFID II. Belgium has also banned commission payments for insurance products.
Chile	No		The most recent reform, the “Capital Market Reform III”, was introduced in 2010 and aimed at increasing security levels of financial transactions and reinforcing regulatory and supervision capabilities. This set of reforms enhanced competition in the credit market by increasing available credit instruments and improving consumer information. However, the Reform did not remove commissions that advisors receive, though it discussed imposing a ceiling to broker's commissions.
Czech Republic	Partial	3-Jan-18	Subject to MiFID II.
Denmark	Yes	1-Jul-17	Subject to MiFID II. Additionally, the Danish Financial Supervisory Authority has banned commissions from investment funds in connection with discretionary portfolio management. This is part of the Danish financial Business Act (FIL).
Estonia	Partial	3-Jan-18	Subject to MiFID II.
Finland	Partial	3-Jan-18	Subject to MiFID II.
France	Partial	3-Jan-18	Subject to MiFID II. In 2016, the Autorité des Marchés Financiers (AMF) released its consultation paper interpreting the research payment provisions in the MiFID II Delegated Acts, and suggested that the French will continue to allow commissions but try to be accommodating to industry concerns so long as they do not conflict with the MiFID II language. Specifically, the AMF was very clear that the Mifid II rules do not conflict with the continued use of commission-sharing agreements.
Germany	No		Through a series of reforms in 2012 and 2014, Germany has adopted rules to raise standards for advisors, enhance fee and commission disclosure, and create a separate designation for fee-based advisors. The German securities regulator, BaFin, has indicated that it does not intend to ban embedded commissions and will not go beyond MiFID requirements in regulating fees.
Greece	Partial	3-Jan-18	Subject to MiFID II.
HK	No		Hong Kong has considered a range of regulatory reforms and has decided to consult on targeted reforms and enhanced disclosure. After reviewing global regulatory initiatives and impacts as well as conducting its own research, the SFC determined that it would rule out banning embedded fees but would focus on enhanced disclosure and targeted reforms.
Hungary	Partial	3-Jan-18	Subject to MiFID II.
Iceland	Partial	3-Jan-18	Subject to MiFID II.

India	No		In August 2009, the Securities & Exchange Board of India (SEBI) banned front-end load fees for all mutual fund schemes. In the fall of 2016, SEBI issued a consultation where it proposed preventing mutual fund "distributors" (mutual fund sales agents) from providing incidental or basic investment advice with respect to mutual fund products. In 2016, SEBI enhanced disclosure rules requiring absolute amounts of commissions disclosed in semi-annual consolidated account statements provided to investors.
Ireland	Partial	3-Jan-18	Subject to MiFID II.
Israel	No		According to the Israel Securities Authority, licensed investment advisors and portfolio managers are obligated to comply with fair disclosure principles, including: In the case of marketing agents, disclosure of ties and preference to certain financial instruments; Disclosure of all fees and commissions levied on the client.
Italy	Partial	3-Jan-18	Subject to MiFID II.
Japan	No		The Amendment of the Financial Instruments and Exchange Act of 2006 approved several changes related to promoting full compliance with investor protection rules and improving investor convenience. A ban on commissions was not one of these changes. However, the Financial Instruments and Exchange Law stipulated that financial instruments firms should comply with additional rules of conducts in conducting sales or solicitation of securities or derivative transactions.
South Korea	Partial	2016	The Financial Services Commission (FSC), the Financial Supervisory Service and a number of financial arms of the government in Korea announced that created a designation for Independent Financial Advisors (IFAs) in early 2016. IFAs are not allowed to receive any kind of commission or benefits from financial companies. Instead, they only receive commissions from their clients. The commissions will be set based on the customer's assets and number of consultations, and will be neutral from the content of portfolios. Also, IFAs will not be allowed to design or sell financial products, but only allowed to conduct discretionary investment management services, in which they advise customers about the products on what to invest in.
Latvia	Partial	3-Jan-18	Subject to MiFID II.
Luxembourg	Partial	3-Jan-18	Subject to MiFID II.
Mexico	No		In Mexico, investment advisors are not permitted to keep custody of client assets, offer guaranteed returns or receive fees from intermediaries for referrals or for promotion of any products. There is an initiative under way to revise the law, which will further focus on sales practices to ensure that the clients' interests are protected, particularly from conflicts of interest.

Netherland	Yes	Jan-13	In January 2014, the Dutch Authority for Financial Markets (AFM) placed a ban on all commissions paid by a product issuer to an advisor relating to advice. The ban applies to virtually all investment, insurance (except property and casualty insurance), mortgage and protection products. The ban was triggered by high-cost insurance policies that were mis-sold to consumers. Today, clients must pay directly for individual portfolio management, investment advice and execution-only services.
New Zealand	No		The Ministry of Business Investment and Enterprise undertook a review of financial regulation in 2008, and considered banning commissions but decided not to.
Norway	Partial	3-Jan-18	Subject to MiFID II.
Poland	Partial	3-Jan-18	Subject to MiFID II.
Portugal	Partial	3-Jan-18	Subject to MiFID II.
Singapore	No		Singapore undertook a comprehensive review of retail investment industry in 2012 and ruled out placing a ban or cap on commissions.
Slovak Republic	Partial	3-Jan-18	Subject to MiFID II.
Slovenia	Partial	3-Jan-18	Subject to MiFID II.
South Africa	Yes	2017	In November 2014, the FSB put forward 55 Retail Distribution Review regulatory proposals that affect market conduct regulation. Implementation is planned in three phases, beginning in early 2017. The prohibition of product supplier commissions on investment products and insurance products is to be implemented in two phases, expected in 2017: the first phase will relate to lump sum investments and the second phase will impact recurring contribution investments. Commissions will still be permitted for recurring contribution investment (savings) products sold in the low-income sector.
Spain	Partial	3-Jan-18	Subject to MiFID II.
Sweden	No		Subject to MiFID II. Following a 2016 review, the Swedish minister for financial markets and consumer affairs recently issued a statement saying that the government will not proceed with the proposal on a ban that goes further than the MiFID II rules. Enhanced disclosure and targeted reforms will be implemented as required by MiFID II rules.
Switzerland	No		Two new pieces of regulation, the Financial Services Act and the Financial Institutions Act, are in the process of being passed. They do not ban embedded commissions, but they do require all fees and commissions to be disclosed to clients.
Turkey	No		The most recent provision of the Capital Market Law published on December 30, 2012 did not mention any ban on commission for investment advisors. Investment advisors in Turkey are required to disclose the total value of any benefit obtained by persons or institutions that prepare and/or publish the provided comments and recommendations if any, in case there is any other benefit obtained by them in favour of themselves and/or third parties other than the regular payment in return for these publish services.

UK	Yes	Dec-12	The Retail Distribution Review (RDR) raised the minimum level of advisor qualifications, improved the transparency of charges and services and removed commission payments to advisors and platforms from product providers, effective in 2012.
US	No		Embedded commissions are permitted in the US, however they are not common, and a wide range of unbundled fee structures are available.

Case Study: UK

The Retail Distribution Review (RDR) was launched in the United Kingdom by the Financial Services Authority (FSA). RDR is a set of rules aimed at introducing more transparency and fairness in the investment industry. The most significant change was that financial advisors were no longer permitted to earn commissions from fund companies in return for selling or recommending their investment products. Instead, investors must now agree on fees with their advisors upfront. In addition, financial advisors now have to offer either "independent" or "restricted" advice and explain the difference between the two – essentially making clear whether their recommendations are limited to certain products or product providers.

The aim of RDR was to establish a resilient, effective and attractive retail investment market that consumers had confidence in and trusted. In particular, the aims of the regulator when introducing RDR included the following:

- Improving levels of professionalism among financial advisors,
- Providing consumers with greater clarity as to the nature of the advice they are receiving and the cost of that advice, and
- Changing remuneration arrangements between providers, advisors and platforms to better align with the interest of consumers.

Regulation of commission payments was mainly driven by a concern that the complex nature of retail investment products was increasing investors' reliance on investment advice and there was a concern that embedded commissions could bias the advice provided by brokers. It was asserted that such bias increases the likelihood of financial advice not being provided in the best interests of the investor and potentially leads to investors being miss-sold investment products. The FSA found that mis-selling was further made easier by investors' limited understanding of the financial products they purchased.

The ban on embedded commissions took effect on January 1, 2013. For new accounts, advisors may only be paid for their services by or on behalf of their clients. The ban on embedded commissions means that advisors must provide their customers with two sets of fees: one for the financial product, and on for the advisory services they provide. UK firms and advisors were permitted to receive trail commissions from applicable funds sold prior to the start of the RDR on December 31, 2012, up to January 1, 2016, when they were required to sever trailing-fees arrangements on grandfathered funds. These trail commission payments have been estimated to be around GB£1.5 billion per year.[93]

In addition to the ban on commissions introduced by RDR, a higher minimum level of advisors' education was introduced in December 2012, along with requirements for continuing professional development and adherence to ethical standards. This was implemented following FSA's review which found that levels of training and professionalism among advisors were relatively low compared to other professions and such poor qualifications of advisors could in turn translate into negative consumer outcomes.

93 Collinson, 2012

Lastly, FSA had been concerned about the clarity with which financial advisors communicate to investors the type of services they offer and the prices associated with these services. In order to address that issue, RDR has established mandatory disclosure requirements on the type of service, along with the requirement for independent advisors to cover the full range of retail investment products. Advisors must also set their own charges and communicate these clearly to customers.

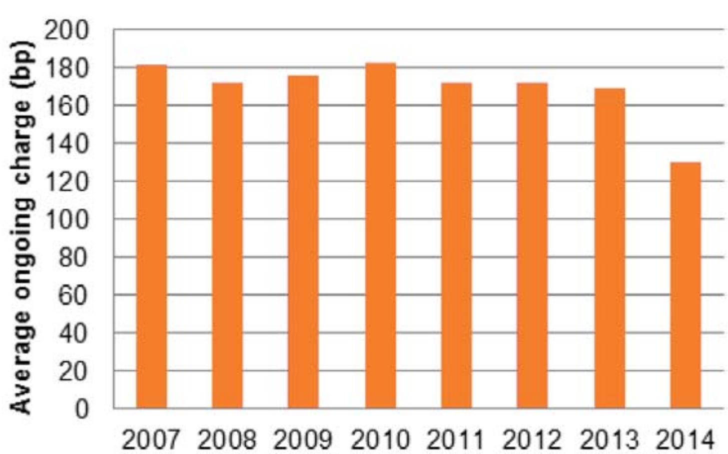
There is important context to consider when reviewing the market changes following the RDR. Trends such as technological change, mistrust in financial institutions, and growth of direct-to-consumer platforms have all influenced the market for financial services, and began prior to the RDR and continued afterwards. Additionally, a number of banks suffered mis-selling scandals that resulted in large fines and lost trust in financial institutions. These scandals caused banks such as Barclays to stop offering retail financial advice services altogether, due to concerns about adhering to regulation requiring suitability of advice for investors.[94] Another important policy change is auto-enrolment in pension funds, which is being phased in between 2012 and 2018 and reduces the assets that investors require advice to manage.

Given the significant changes that occurred around the time of the RDR, and the fact that the RDR involved many different reforms, it is not possible to isolate the effects of the ban on embedded commissions on the financial advice market. The following section outlines changes that occurred following the implementation of the RDR, but these changes cannot be interpreted as being caused by the ban on embedded commissions.

Since the RDR was implemented, there has been a noticeable decline in the sale of products which paid higher embedded commissions pre-RDR and an increase in the sale of products which paid lower pre-RDR commission. Similarly, the proportion of investment products sold from the highest charging share classes relative to lower cost share classes has declined. However, these trends had started prior to the RDR, so it is not clear that they were caused by the regulations.

A significant change in the market following the introduction of RDR was an observed fall in investment management charges of retail investment products. The fall is generally attributed to increased competition from alternative platforms (such as D2C, or direct-to-client) and a general switch to products with lower charges, such as passive funds, which typically have lower fees than actively managed funds. The following figure shows the decrease in average ongoing charges following the RDR.

Figure 27: Average Ongoing Charge for UK-Sold Active Funds, by Retail Share Class Launch Year[95]



[94] Blackmore, 2011
[95] Europe Economics, 2014

While these trends had begun pre-RDR, the relatively large decline in 2014 might suggest that the ban in the UK accelerated the shift to less expensive products. Notwithstanding, we note that the trend toward lower cost products is global (including in many countries where embedded commissions are not banned), as indicated previously in this Report. Thus, there is no strong support to suggest that a ban is required in order to encourage this trend. For example, in Canada, between 2005 and 2015, the asset-weighted MER of long-term funds, which includes the commission paid to financial advisors, declined from 2.14 per cent to 1.96 per cent.[96]

While investment management charges for retail investment products have continued to decline post-RDR, there is evidence that the cost of advice has increased, at least for some consumers. According to Europe Economics, given the low levels of price competition among advisors it is likely that there are incentives for advisors to increase advisory charges in large part to compensate for lost trail commissions on legacy investments. In line with this, more detailed, “holistic” ongoing advice services are now being offered in order to justify higher charges.

However, the UK has also seen the introduction of new hybrid advice models that make direct-fee advice more accessible to mass-market investors. For example, Wealth Wizards partners with employers to provide direct-fee advice on a per-issue basis, with no minimum investment. Robo-advisors such as UBS SmartWealth, with a £15,000 minimum investment, are also entering the UK market. The FCA has been supportive of new advice models.

Following the RDR, fee structure shifted and overall cost decreased. Depending on products chosen, overall cost could be substantially lower for individual investors, and costs decreased 20 per cent on average. Evidence from the FCA shows that prices for actively managed funds did not decrease, but assets shifted to lower-cost funds.[97] Again, we note that this trend has been place prior to RDR and is not unique to the UK in particular or in general to the countries that have instituted a ban on embedded commissions.

In accordance with one of the aims established by FSA, the introduction of RDR has initiated a move towards increased professionalism among advisors. This is evident as the vast majority of advisors are now fully qualified to Qualifications and Credit Framework (QCF) level 4, compared to level 3 before the implementation of the regulation, as well as an increased membership of professional bodies.

In terms of the structure of the market for investment advice, the evidence suggests that although there was some exit from the advisory market following the implementation of RDR, the number of advisors and advisory firms appears to have stabilized. Additionally, asset management has been consolidated, with fewer companies remaining in the market. According to the Financial Advice Markets Review, the number of advisors in the UK decreased almost 25 per cent between 2011 and 2014. This decrease was largely driven by retail banks, which experienced a very significant withdrawal from investment advice provision.[98] As noted above, concerns about adhering with suitability standards contributed significantly to changes in the retail banking sector. The following chart illustrates changes in the number of advisors before and after the implementation of RDR (recall that the regulation was implemented on January 1, 2013):

[96] Strategic Insight, 2017
[97] Financial Conduct Authority, 2016
[98] Fundscape, 2014

Table 12: Number of Advisors in the UK[99]

	Summer 2012	31.12.2012	31.07.2013	31.10.2014
Financial advisors	23,787	20,453	21,684	21,496
Banks & building society advisors	6,655	4,810	4,604	3,182
Stockbrokers	1,202	2,043	2,267	1,906
Discretionary investment managers	875	1,435	1,784	1,698
Other	2,554	2,269	2,221	2,871
TOTAL	35,073	31,010	32,560	31,153

In addition to a reduction in the number of advisors, surveys show that the share of advisors who require a portfolio size of at least £100,000 has increased from 13 per cent in 2013 to 36 per cent in 2015. Transparency in fees and changes in fee structure may also have resulted in a lower willingness to pay for advice: the Citizens Advice Bureau found that only 8 per cent of investors were willing to pay more than £500 for advice, whereas typical pension advice would cost £1,350 when paying on an hourly basis.

However, it is not clear that these changes were caused by the RDR, or more specifically by the ban on embedded commissions. According to a 2009 survey, 25 per cent of advisors said they would leave the advice market pre-RDR anyway, regardless of the introduction of new regulations.[100] Moreover, contrary to ex ante concerns related to potentially adverse impact of the policy on the availability of advisors, there remains a large number of advisory firms and advisors to serve consumers. A 2014 study commissioned by the FCA did not find evidence of a shortage of advisors overall, but did not estimate supply and demand separately for mass-market investors.[101] As noted by CASS Consulting, even without RDR, the landscape for the advisory sector would have begun to change. Technological advances have been marking the creation and delivery of investment products more accessible and cheaper to a wider audience, whether guided by an advisor or not. A 2015 report by Oxera notes that, based on interviews with industry participants, adverse effects in terms of access to financial advice are not clear at this stage, and that the initial decline in the number of financial advisors could be due to the ban on embedded commissions or other factors, such as increase in the mandatory level of professional standards.

The head of the FCA has recently expressed concern[102] over an advice gap created by the RDR, but empirical reports published by the FCA to date do not support this conclusion.

There is no solid data on the decline of the number of clients using an advisor in the UK, however the general consensus is that many mass-market investors stopped using an advisor or were asked by their advisors to leave, and that investors who could benefit from advice do not have access to an advisor. This is caused by a combination of lack of supply of advisors for this market and lack of willingness to pay for advice among mass-market investors. Where a reduction in access to advice has been identified, it is not clear what caused this reduction, and due to factors discussed above, we cannot confidently attribute any changes to the ban on embedded commissions.

[99] Fundscape, 2014 and APFA, 2016
[100] CASS Consulting, 2013
[101] Towers Watson, 2014
[102] FCA, 2016b

Case Study: Australia

Australia passed a suite of financial reforms entitled the Future of Financial Advice (FoFA) act in 2012. The reforms came into effect on June 1, 2013. As with the UK, the ban on embedded commissions was grandfathered, so it is too early to draw any definite conclusions from the Australian experience.

There were four main reforms associated with FoFA: enhanced regulatory powers, a ban on conflicted remuneration including trailer commissions, statutory best interest duty and fee disclosure to the consumer. Clients are also required to “opt-in” every two years in order to continue receiving financial advice.

Prior to the implementation of FOFA, Australia’s fund compensation model was very similar to Canada, including management fees, ongoing commissions/trailer fees (front-end up to 5%, back-end load ranging from 0.5% and 1%, and no load funds), and where applicable, platform fees (up to 2%). More than half of Australian funds were classified as no-load funds, which typically had lower MERs than front-end or back-end load funds. Additionally, pre-FoFA, trailing commissions on Australian funds averaged 0.60% per annum.

The overriding principles of FoFA were “financial advice must be in the client's best interests – distortions to remuneration, which misalign the best interests of the client and the advisor, should be minimized; and in minimizing these distortions, financial advice should not be put out of reach of those who would benefit from it.”[103]

In a 2014 review, the Financial Services Council was broadly supportive of the FoFA reforms, although they noted that they imposed significant compliance costs, and proposed a suite of changes to make the regulation more transparent and less costly. This review also noted that there is a significant advice gap in Australia. A 2014 survey found that while 53 per cent of Australians would want to receive comprehensive financial advice only 20 per cent currently had an advisor. A main problem seems to be the high cost of financial advice, which seems to have increased following FoFA.

A 2014 report by ASIC, a financial services regulator in Australia, surveyed dealers and found that advisor numbers and the type of advice provided did not change as a result of FoFA. However, revenue structures for advisors changed. Retail accounts moved to direct-fee, hourly fee, or a combination of the two. Licensees did not think that the reforms would help to promote affordability of financial advice.

Transparency and Disclosure

As previously noted, Canada has very strong regulation on disclosure and transparency. While reforms in Australia and the UK were designed to increase transparency, their disclosure ratings from the Morningstar Global Fund Report did not increase following their reforms, and remained poor.

Figure 28: Morningstar Global Fund Report Disclosure Ranking

Morningstar Global Report Disclosure Ranking				
	2015	2013	2011	2009
Canada	A-	B	B	A
UK	C+	C+	B	B
Australia	D+	D+	D	D

[103] Australian Government, 2014

In the eyes of regulators, disclosure appears to be a key ingredient in promoting fairness in financial markets. The following section outlines the reasons why countries chose not to ban embedded commissions and notes which reforms they undertook instead. Most opted for stronger disclosure rules as an alternative to banning conflicted compensation.

Countries that Contemplated and Rejected a Ban

New Zealand

New Zealand passed financial reforms called the Financial Advisors Act in 2008 in order to "promote the sound and efficient delivery of financial advisor services and to encourage public confidence in the professionalism and integrity of financial advisors." According to a report by the Ministry of Business, Innovation and Employment, prior to these reforms trust in financial advisors was low.[104] Reforms introduced professional standards for financial advisors. In order to provide certain types of financial advice, advisors must be authorized by the Financial Markets Authority. These advisors are called Authorized Financial Advisors and must be professionally certified and adhere to a code of professional conduct that specifies ethical behavior as well as skills and knowledge. These advisors must also disclose to clients how they are paid for their services, among other things.

A 2016 report by the Ministry of Business, Innovation and Employment reviewed the effects of these reforms and explained why New Zealand chose not to ban embedded commissions as a way to address conflicted remuneration. The first reason is that they did not want to risk restricting access to advice. Given that willingness to pay for advice is low, the government felt that there was a "significant risk" of reducing access to advice, particularly for small investors. The report notes that evidence from the UK[105] suggests that banning embedded commissions lowers access to financial advice.

A second concern was that such a ban addresses only one form of conflicted remuneration. A ban on embedded commissions only applies to advisors selling third-party funds, whereas institutions such as banks may pressure advisors to sell certain products using in-house channels. In fact, if embedded commissions were banned, other types of conflicted remuneration may even increase.

Given these concerns, the report instead supported policies that would promote sound financial advice rather than targeting specific forms of remuneration. The report recommends clear disclosure of fees and any potential conflicts of interest, and regulations requiring advisors to act in their clients' best interest.

Singapore

In 2012, the Monetary Authority of Singapore established a Financial Advisory Review panel to conduct a review of practices in the Financial Advisory industry. The goals of the review were to raise the quality and competence of financial advisors, to make financial advising a dedicated service, to lower distribution costs, and to promote a culture of fair dealing.

In 2013, the panel published a report of its recommendations.[106] These included a minimum academic entry requirement for financial advisors, continuing professional development, and competency and financial requirements for the leadership of FA firms. The panel also noted that misdealing with respect to investors was fairly common in Singapore, and recommended that both firms and industry associations should play a larger role in encouraging fair dealing.

This report explains why banning trailer commissions was not chosen as a policy to reduce distribution costs: "From a survey conducted by MAS, 80 per cent of the respondents indicated that they would not pay a fee for financial advice. Thus, a 'fee-only' model may result in more Singaporeans being under-advised or under-insured. It is also not clear that fees will be lower than commissions. Indeed, it is possible that consumers may end up

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[104] Ministry of Business, Innovation and Employment, 2008
[105] FCA, 2016
[106] Monetary Authority of Singapore, 2013

paying more." The panel was concerned that a fee-based model may lead to clients losing access to financial advice, and did not have confidence that banning trailer fees would reduce costs.

Instead of banning trailer commissions, the report recommends clear fee disclosure and comparability of products in order to encourage price competition in the market for financial advice. Specifically, disclosure of trailer fees is advocated. This is already the policy in Canada, where trailer fees are disclosed in dollar terms.[107] Another recommendation is that firms adopt performance indicators for financial advisors based on metrics other than sales volume. This is in order to discourage advisors from pressuring clients into purchasing more than they need.

Switzerland

In March of 2015, changes to financial services regulation were announced in Switzerland. The Financial Services Act and the Financial Institutions Act were passed in 2016 and will come into effect in 2017. The intent of these bills was to create uniform regulations, encourage competitiveness and protect consumers. Changes introduced by these bills will include guidelines for prospectuses, training and continual professional development, conduct provisions based on the type of client (retail, professional or institutional), supervision of managers of individual client assets, and new disclosure rules. Per a press release from the Swiss Confederation[108], trailer commissions will not be banned. Instead, there will be strong disclosure rules requiring complete transparency of all remuneration and other benefits received from third parties. In addition to this disclosure requirement, a 2014 ruling from the Federal Supreme Court requires that the advisor's compensation must be easily understandable to clients.

Hong Kong

In Hong Kong, intermediaries have been required to disclose monetary and nonmonetary benefits received or receivable in relation to distribution of an investment product since 2011 as one of the key measures to enhance investor protection following the global financial crisis.

According to a November 2016 consultation paper issued by the Hong Kong Securities and Futures Commission ("SFC"), after reviewing global regulatory initiatives, the SFC determined that it would rule out banning embedded fees but would focus on enhanced disclosure and targeted reforms. Based on a market research quoted by the SFC[109], 54 per cent Hong Kong investors rely on friends and family for information about financial matters and planning, while only 29 per cent rely on financial planners. Only up to three per cent of retail fund distribution in Hong Kong was done through the independent financial advisor channel. Moreover, one of the top barriers to financial planning is that that consumers in Hong Kong feel that the fees charged for financial advice are not worth it, per the same source. The SFC concluded that the adoption of a pay-for-advice model with a complete ban on receipt of commissions by intermediaries may not seem appropriate for Hong Kong.

SFC was also concerned about the unintended consequences of eliminating commissions. According to the consultation paper, "whilst a pay-for-advice model may eliminate the inherent conflict of interest in receiving benefits from product providers in the sale of investment products to clients, it may have unintended consequences. For instance, an 'advice gap' may have emerged in jurisdictions adopting a pay-for-advice model where investors who are without the resources to pay for or unwilling to pay for advice for any reason could be left with no or very limited access to investment products."

Instead, SFC proposed a two-pronged approach: (1) governing the conduct of intermediaries when representing themselves as "independent" or as providing "independent advice"; and (2) enhancing the disclosure of monetary benefits received or receivable that are not quantifiable prior to or at the point of entering into a transaction. SFC believes it is a balanced approach more appropriate for Hong Kong's market landscape and would avoid any potential unintended consequences associated with a pay-for-advice model.

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[107] Morningstar, 2015
[108] Swiss Confederation, 2015
[109] Financial Planning Standards Board and GfK, 2015

Sweden

In February 2016, Finansinspektionen, the Swedish financial supervisory authority published a report on a review of the Swedish savings market. While conflict of interest was identified as a concern in embedded fee arrangements, the Swedish minister for financial markets and consumer affairs recently issued a statement in May 2016, saying that the government will not proceed with the proposal on a ban that goes further than the MiFID II rules.

The Financial Supervisory Authority stated its reasons behind its proposal and tackled the concerns voiced about a ban of commissions and its possible consequences. Some of its conclusions are as follows:

- **Major industry adjustments:** A commission ban would entail major adjustments and transition costs for the Swedish financial industry. With transparent pricing, firms providing financial advice will need to demonstrate what value they are adding whereas product providers that pay high commissions to get their products onto the market will instead have to compete on pricing and quality. FI believes this will lead to simplified advisory services and an increased range of lower-fee products and argues that the gains from a better functioning savings market will outweigh the transition costs on the long term.
- **Advice gap:** With respect to concerns that a commission ban would potentially cause firms to no longer offer advice and result in a shortage in the supply of advisory services to consumers with modest assets, FI finds no empirical proof that this would be the case. FI also notes that to argue against a ban on commissions on the basis that consumers won't be willing to pay a price which they have always been paying, but which is now clearly visible, is not a good argument. In FI's view, clear pricing creates possibilities for consumers to influence the supply of advisory services. If advice, as it looks today, is perceived to be expensive in relation to the value it provides, there is an opportunity for other types of advisory services to emerge -- services that are more cost-efficient and adapted to consumers' willingness to pay. Accordingly, FI finds that transparent pricing for advice can lead to simplified advisory services that are more adapted to consumers' needs.

According to the May 2016 statement, the Swedish government will be proposing legislation in response to EU directives, which will not ban commission-led sales of financial advice and products.

Germany

Commission-based investment advice is currently the predominant model in the German market. Funds without loads or trailing commissions exist but are difficult for investors to locate and they make up a minimal percentage of assets.[110] Through a series of reforms in 2012 and 2014, Germany has adopted rules to raise standards for advisors, enhance fee and commission disclosure, and create a separate designation for fee-based advisors. On August 1, 2014, German Federal Financial Supervisory Authority ("BaFin") adopted Fee-Based Investment Advice Act to boost transparency regarding the fees or commissions advisors receive for investment advice. BaFin, has indicated that it does not intend to ban embedded commissions and will not go beyond MiFID requirements in regulating fees. Research did not identify detailed reasoning behind the conclusion.

[110] Morningstar, 2015

Summary of Findings

Current transparency rules in Canada are significantly stronger than in the UK and Australia both prior to their respective bans on embedded commissions and currently. Thus, given that transparency is one of the means to mitigate the risks inherent in agent-principal relationships, these risks should be significantly less acute in Canada.

There is no strong evidence from the UK or Australia that cost of advice has decreased as a result of the ban on embedded commissions. The shift to lower cost products such as ETFs following the ban is a continuation of a trend that has been evident in many countries including Canada and it is difficult to ascertain to what extent, if any, banning embedded commissions accelerated this process.

On the other hand, it is not clear whether an advice gap was created in these countries following the ban on embedded commissions. In this regard, we note that in Canada the use of embedded commissions is more wide spread and thus the likelihood of an advice gap would be more pronounced than in those countries. We further note that bans on embedded commissions in UK and Australia followed evidence of major mis-selling of investment products in those countries,[111,112,113] but that Canada has not seen mis-selling on this scale.

Other countries have contemplated a ban on embedded commissions and have rejected it, generally for the fear of an advice gap. Instead they generally opted for more disclosure as a solution to conflict of interest issues.

[111] Ferguson & Vedelago, 2013
[112] Money Marketing, 2009
[113] Hyde, 2013

Conclusions

Based on our assessment and subject to the scope of review and limitations of this report we conclude the following:

1. Transparency, financial literacy and long term relationships between advisors and investors are the ultimate assurance for a well-functioning financial advisory market, where interests of advisors and investors are aligned.
2. Canadian investors who use advisors are generally well educated and have trust in their advisors that has developed through long term relationships.
3. Current transparency rules in Canada are at a level that creates a critical mass of informed Canadian investors which acts as an effective deterrence against the possibility of misconduct by financial advisors.
4. There is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour. A ban on embedded commissions would likely eliminate some of these influences, but would create new instances of misalignment of interests between investors and advisors via new fee schemes.
5. Banning embedded commissions in Canada would likely lead to negative consequences for the mass-market investors in the form of:
    a. Less access to financial advice;
    b. Lower savings available at retirement; and
    c. Higher cost of advice for those who would want to continue receiving financial advice.
6. Robo-advice is a viable alternative solution for some investors who would stop using an advisor but not for all.
7. Banning embedded commissions may lead to industry concentration that would create other forms of biases such as those created by greater vertical integration.
8. The estimated economic footprint of Canada's investment advisory industry amounts to around $25 billion in total output, $12 billion in total GDP, $8 billion in labour income and 116,000 full-time equivalent jobs. These figures include the direct, indirect and induced impacts on Canada's economy.
9. In the absence of embedded commissions, the potential imposition of a $100,000 minimum investment threshold for providing advice would have a significant negative impact on the economic footprint of the investment advisory industry in Canada. For example, if no new advice models were introduced, the contribution to GDP from the industry would shrink by between approximately $2.8 and $3.3 billion.

10. The move from an advisor to DIY[114] investing is expected to reduce the amount of savings available to those Canadians at retirement. On an order of magnitude basis, those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice.

[114] DIY investors do not use the services of a financial advisor. They may research investment products themselves and purchase them using an intermediary such as a bank or online brokerage.

Appendix A: Limitations

To conduct this assessment, PwC relied upon the completeness, accuracy, and fair presentation of all information, data, advice, opinions or representations obtained from various sources which were not audited or otherwise verified. These sources (collectively, the "Information") are listed in the Scope of Review section of this report.

The findings of this assessment are conditional upon such completeness, accuracy and fair presentation of the Information, which has not been verified independently by PwC. Accordingly, we provide no opinion, attestation or other form of assurance with respect to the results of this assessment.

This assessment has been prepared for the Investment Funds Institute of Canada (IFIC) for their exclusive use. PwC disclaims any contractual or other responsibility to other persons who may use or rely on this assessment.

Receipt of new data or facts: PwC reserves the right at its discretion to withdraw or make revisions to this assessment should we receive additional data or be made aware of facts existing at the date of the assessment that were not known to us when we prepared this assessment. The findings are as of April 2017 and PwC is under no obligation to advise any person of any change or matter brought to its attention after such date, which would affect our findings.

Our assessment must be considered in its entirety by the reader, as selecting and relying on only specific portions of the analyses or factors considered by us, without considering all factors and analyses together, could create a misleading view of the processes underlying this review and the conclusions there from. The preparation of an economic analysis is a complex process and it is not appropriate to extract partial analyses or make summary descriptions. Any attempt to do so could lead to undue emphasis on a particular factor or analysis.

Use limitations: Any use that a third party makes of this report or reliance thereon, or any decision made based on it, is the responsibility of such third party. PwC accepts no responsibility for damages, if any, suffered by any third party as a result of decisions made or actions taken, based on this report.

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Appendix C: Glossary

Brokerage: A financial institution that facilitates the purchase and sale of securities including mutual funds. Synonym of **dealer**.

Credence Goods: Goods whose value is difficult for consumers to assess.

Dealer: A financial institution that facilitates the purchase and sale of securities including mutual funds. Synonym of **brokerage**.

Deferred Sales Commission (DSC): See **load fee.**

Direct Fee: A fee paid to an advisor as a share of assets invested.

DIY Investing: DIY investors do not use the services of a financial advisor. They may research investment products themselves and purchase them using an intermediary such as a bank or online brokerage.

Embedded Commissions: Any fee paid from a fund manager to a dealer. These include trailing commissions and commissions on deferred sales charges.

High-Net-Worth: Investors with between $1 and $5 million investable assets.

Load Fee (Front Load, Back Load): A sales fee paid to an advisor upon purchase of a fund, in the case of front load, or sale of a fund, in the case of back load. Front load fees are also known as **Initial Sales Charges (ISC)**. Back load fees are also known as **Deferred Sales Commissions (DSC).**

Management Expense Ratio (MER): An ongoing fee paid to a fund manager. The MER includes management fees, administration costs, trailing commissions and HST. It is deducted from investors' returns.

Mass-affluent: investors with between $100,000 and $1 million investable assets.

Mass-market: Investors with under $100,000 investable assets.

Retrocessions: See **trailing commissions**.

Trading Expense Ratio (TER): The ratio of fees paid for executing trades to assets invested. Fees for trades are taken off of returns and are paid from the investment as they are incurred.

Trailing Commissions: Commissions paid from a fund manager to a dealer on an annual basis. These fees are included in the management expense ratio (MER) paid by investors. Also known as **trailers**, **trailer fees**, or **retrocessions**.

Ultra-high-net-worth: Investors with investable assets over $5 million.

Appendix D: List of Acronyms

AMF: Autorité des marchés financiers

CSA: Canadian Securities Administrators

CSF: Chambre de la sécurité financière

CRM2: Client Relationship Model – 2

D2C: Direct to Consumer

DSC: Deferred Sales Charge

ETF: Exchange Traded Fund

FoFA: Future of Financial Advice

IFIC: Investment Funds Institute of Canada

IIROC: Investment Industry Regulatory Organization of Canada

MER: Management Expense Ratio

MFDA: Mutual Funds Dealers Association

MiFID II: Markets in Financial Instruments Directive - 2

OSC: Ontario Securities Commission

POS: Point of Sale (Regulation)

QCF: Qualifications and Credit Framework

RDR: Retail Distribution Review

ROR: Rate of Return

SRO: Self-Regulatory Organization

TER: Trade Expense Ratio (in Canada), or Total Expense Ratio (in some countries including the US)

Appendix E: Reviews of Cumming et al (2015)

A Dissection of Mutual Fund Fees, Flows, and Performance by Cumming, Johan, and Zhang: A comment

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December 22, 2016

Contents

1 Introduction

The article addresses the question of whether investors and their advisers seek out skilled fund managers or not. Their empirical evidence suggests that this is much less likely when advisers and their dealers are paid trailing commissions, when advisers work for dealers that are affiliates of the fund manager and it is less likelier still when advisers use the deferred sales charge purchase option.

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As a consequence, the results of their research suggest that investment decisions are being made, to a significant degree, based on something other than portfolio manager skill, e.g., trailing commissions. The main claim of the paper is that trailing commissions drive flows and have a negative effect on future alpha in a both economically and statistically significant way. The argument is based on an assertion that higher flow-performance relation incentivizes fund managers to achieve higher alpha because the fund manager will receive disproportionately more flows into the fund for each increase in performance. The study measures the impact of the value of advice on the risk adjusted return, the "alpha," and does not take account of other directions where the advice might yield value. The recent trend of smart beta funds would suggest that alpha alone is not a sufficient measure. We first relate their work to previous research, then we discuss their methodology and results, and finally provide our critique.

2 Related Research

The asymmetric information problem between brokers and their clients has been studied extensively in the previous literature. Bergstresser, Chalmers, and Tufano (2009) study the benefits of intermediation of funds and find that investment advisers provide no benefit at all. Quite contrary, they find that the value of their advice is negative even before accounting for fees. The funds recommended by brokers show no more skill than funds sold through direct channels. Christoffersen, Evans, and Musto (2013) look at the incentives of brokers and how this influences the investment advice they give to investors. Specifically, they focus on revenue sharing between investment fund families and brokers and how it influences the inclination of the independent adviser to prefer certain families. Brokers are regulated by a regulation agency in the US to act "in the best interest of the customer without regard to the financial or other interests of the broker, dealer or investment adviser providing the advice" and a preferential treatment of some advisers would be a breach of this rule. They conclude that the revenue sharing agreements and front load do, to some degree, influence the decision of the brokers. Chalmers and Reuter (2012) also point to a conflict of interest between brokers and their clients where brokers abuse their information advantage. Anagol, Cole and Shayak (2013) conduct a field experiment in the Indian life insurance market and find out that the agents give sub-optimal advice to their clients for their own gains. The distinction in performance between funds that are sold directly to retail customers and those that are intermediated by brokers is drawn in Del Guercio and Reuter (2014). They contend that funds that sell directly do not under-perform index funds after fees but the funds that sell their shares through brokers do significantly under-perform. The determinant of fund flows in general are studied in Sirri and Tufano (1998). Del Guercio and Tkac (2002) extend this research with a similar type of regression analysis as in the present paper. Vayanos and Woolley (2010) study flows between investment funds and their effects on asset prices. They find that flows cause assets to comove in ways unrelated to fundamentals, affect assets with high idiosyncratic risk the most, and raise the expected returns of funds experiencing outflows.

3 Methodology

The main advantage of the study is a new proprietary database for Canada that stretches over 2003-2014 period. The data is obtained directly from the funds and comprises 66.7% of the market's AUM. It includes 43 out of 113 fund families available in Canada. The main advantages of the data are precisely measured fees and their structure and new flows to and from the funds. It is normally impossible to precisely measure the net flows from differences in AUM since a portion of inflows and outflows naturally occur on regular basis and are not related to new actions of the investors. It is also usually impossible to precisely measure the fees paid by the investors as the fee structures are very complicated and are variable from case to case. This problem is not present in their dataset because it is directly collected from the funds.

The study derives its results in two steps. First, present net flows to the funds are explained by their fee structure and previous performance (alphas). Next, the sensitivity of the flows is used to study its impact on future alphas attributed to an increased motivation of the fund managers when they are compensated by higher inflows. Alphas are estimated using Fama-French US market US dollar valued 4 factors on 12 monthly observations before the flows are observed.

There are four purchase options for funds:

- No load - no front end commission, no deferred sales charge, pays trailer fee to fund dealer.
- Deferred sales charge - investor pays redemption fee to the fund company if sold before specified period. Dealer gets trailing commission and up-front commission.
- Front end (initial sales) charge - dealer can charge front end commission upon sale and also trailer fee.
- Fee based purchase option - dealer charges fees directly to investors account.

And four types of funds:

- Stand-alone funds that cannot be purchased directly from fund manager.
- Stand-alone funds that can be purchased directly from fund manager.
- Funds of funds that cannot be purchased directly from fund manager.

- Funds of funds that can be purchased directly from fund manager.

The analysis is then structured independently for the four types of the funds with the main focus on Stand-alone funds that cannot be purchased directly from fund manager.

3.1 Regressions

The first part of the analysis is a regression relating future net flow to the past alpha and fee structure or the past fees paid. The results of Table 3 are obtained from the following panel regression they describe as

$$\begin{aligned} Flow_{t+1} &= Constant + \beta_1 * Alpha_t + \beta_2 * Alpha_t^2 + \beta_3 * PurchaseOptionDummy \\ &\quad + \beta_4 * PurchaseOptionDummy * Alpha_t + \beta_5 * controls + residuals, \end{aligned} \tag{1}$$

while the results of Table 4 (for the subset of funds that do not allow for fee based purchase options) are obtained from the regression

$$\begin{aligned} Flow_{t+1} &= Constant + \beta_1 * Alpha_t + \beta_2 * Alpha_t^2 + \beta_3 * MER_t + \beta_4 * Alpha_t * MER_t \\ &\quad + \beta_5 * Alpha_t^2 * TrailerFee_t + \beta_6 * TrailerFee_t + \beta_7 * Alpha_t * TrailerFee_t \\ &\quad + \beta_8 * Alpha_t^2 * TrailerFee_t + \beta_9 * OtherFee_t + \beta_{10} * Alpha_t * OtherFee_t \\ &\quad + \beta_{11} * controls + residuals. \end{aligned} \tag{2}$$

Here, MER is a mean expense ratio and TrailerFee is the commission that dealers of the funds receive periodically from the fund. A better notation would acknowledge the fact that $Alpha_t$, $Flow_{t+1}$, MER_t, $TrailerFee_t$, and $OtherFee_t$ vary across fund, but the parameters e.g., β_1 do not vary with fund, which is a restriction in their approach. The variable PurchaseOptionDummy is time invariant in this case. The regressions of the first type are estimated as a panel with random effects and the standard errors are clustered by FundSERV code. The regressions of the second type are estimated as a panel with FundSERV code "fixed effects". The term fixed effects seems to be as used by Peterson (2009), which is different from its use in other panel data settings, Hsiao (2003).[1]

The second part of the analysis focuses on what drives future alpha and whether it can be predicted by the past new flows in particular. This is estimated in an equation relating future alpha to the past flow-performance sensitivity

[1] There is some ambiguity in their description because they say, following the equation on p30

> *Fund fixed effects are used in Table 4 because the right hand side variables are time variant, and because the Hausman (1978) confirmed the validity of the random effects specification.*

$$\begin{aligned} Alpha_{t+1} &= Constant + \beta_1 * Flow - PerformanceIntercept_t \\ &\quad + \beta_2 * Flow - PerformanceSlope_t + residuals. \end{aligned} \tag{3}$$

Flow-Performance Intercept is the amount of flows that the fund receives regardless of its past performance. The Flow-Performance Slope is the sensitivity of flows to the past performance.

4 Results

All the relationships that the authors expected to find are present in data. Specifically, trailer commissions and deferred sales charges are related to lower flow-performance sensitivity. Equation 1 and Equation 2 document that flow sensitivity to alpha is lower and flow intercept is higher with higher trailer commission. That means that flows are higher for funds with higher trailer commission and are less sensitive to their prior performance. The flow sensitivity is also significantly lower for funds with deferred sales charge that is discouraging the investors from withdrawal.

The main results for Equation 3 are significant at the 1% level and are also economically significant in that a 1-standard deviation increase in the flow-performance intercept is associated with a 2.22% to 3.87% decrease in future alpha, relative to monthly alpha in the data. A one standard deviation increase in flow-performance sensitivity corresponds to a 4.9% increase in future alpha on average. The authors also provide changes in alphas for funds that have changed their trailing commissions during the sample period. 2.5% of the funds increased their trailer fees and their alpha has dropped by 32.4% on average. 0.6% of the funds have increased the trailer fees and their alpha increased by 87.9% on average. The average decrease in trailer fees from 0.43 to 0.27 leads to the economically significant effect of increasing average alpha from 0.09 to 0.17.

When the results from both stages of analysis are connected together the authors can provide an estimate of the effect of trailer commissions on future alpha. The authors then claim, following this logic, that a 1-standard deviation increase in trailer fees is conservatively associated with a 1.43% decrease in future alpha (Table 5: Panel A and p. 49).

The results for alphas computed based just on 12 data points are a source of some skepticism with respect to the robustness but authors show that the conclusion holds when they are estimated

A couple of sentences later they say "*Standard errors are clustered by FundSERV Code*". There are two possible interpretations. Either they are using the same procedure as in Table 3, which is random effect/clustered standard errors, or they included firm specific dummy variables as controls in the main regression and then clustered the errors in computing their standard errors. But it is not clear.

using 3 years period (36 observations), with Sharpe ratios, and with index adjusted returns. We discuss this further below.

A plausible estimate (p 107 contains just over 200 numbers for example) is that the paper contains around 10,000 numbers distributed across the various tables, which makes it rather hard to be definitive in our discussion and we concentrate on some key methodological issues.

5 Problems with the study

5.1 Endogeneity problems with the regressions

It is hard to believe that future alpha does not depend on its past values. Indeed, if alpha wouldn't actually depend on its past values then the whole argument of the study, that investors are worse off for some fee structures, would be invalid as there would be no predictability of the fund's returns. This would in turn mean that looking at the past performance of the funds adds no information about future and investors are just chasing non-existent more skilled managers. The same conclusion would be valid to advisers in that they could not provide any useful recommendations about better performing funds since there are none to give. This puts the whole argument made in the paper on its head. It is quite likely that with the addition of past values of alphas in the Equation 3 the effect of past flows would be much lower as it is capturing some of its effects. The issue with adding the lags of alphas is that this will cause endogeneity problem that would invalidate their methodology.

An even more fundamental problem is that the sensitivity of flows to the past alpha (an estimated coefficient in the previous regression) is a function of the lag of alpha. Regressing the sensitivity on future alpha in fixed effects panel regressions then leads to endogeneity problems if there is some fixed effect related to alphas, which is highly likely and there are many good reasons for it to be so. These issues are not addressed in the paper at all. For both of the endogeneity problems described in this section, it would be needed to apply methods that are built to tackle with them such as internal instruments in a dynamic panel setting.

$$\begin{array}{llllllll} Indirect\ way: & Alpha_{t-1} & \rightarrow & Flow_t & \rightarrow & Alpha_{t+1} \\ Direct\ way: & Alpha_{t-1} & \rightarrow & \rightarrow & \rightarrow & Alpha_{t+1} \end{array}$$

The argument can be expressed as

$$\begin{aligned} Alpha_{t+1} &= Constant + \beta_1 * Flow - PerformanceIntercept_t + ... \\ &= Constant + \beta_1 * f(Alpha_t) + ..., \end{aligned}$$

where f is a transformation corresponding to a fixed effect regression coefficients in the Equation 2. It is evident that $f(Alpha_t)$ will be correlated with an error term if there are fixed effects present. Christoffersen, Evans, and Musto (2013) run similar regressions as Equation 2 but they do not infer any causality but rather just mention an association between the two variables. Frazzini and Lamont, (2008) document that by chasing better performing funds the investors lose money because the persistence of performance is short-lived. To conclude, the relation in Equation 3 is natural and is not unexpected but the causal interpretation that the authors provide is not valid in terms of their framework.

The same argument as in Equation 3 is also valid in Equation 2 as it is likely that future flows would be closely related to their past lags. Addition of these lags to the regression would again cause problems with endogeneity. The problem is less severe here than with Equation 2 as the effects of past flows can be extracted by the fixed effects and are fairly stable over a short period. The lags of inflows have been used to explain future inflows in Christoffersen, Evans, and Musto (2013). To conclude, the methodology chosen by the authors is strong in its simplicity and the results are apparently robust over specifications, but the problems of endogeneity have not been properly addressed and any causal interpretation of the results is dubious at best.

5.2 Future alpha - sensitivity regressions don't have to be valid globally

The second stage of the analysis in Equation 3 is limited in that it is not certain whether the future alpha is related to the sensitivities in the same way for all subsets of the stocks. The regressions are made globally for all funds with different fee structure together but it is quite possible that funds that charge high trailing fees to incentivize the dealers have quite different dynamics. The motivation behind this assertion is that dealers would target less sophisticated investors with these fee structures who are expected ex ante to change less frequently their choice of funds.

5.3 Reverse causality

The relation of a choice of poorly performing funds and fee structure is natural but it can be the case that the causality between the flow-performance sensitivity and future performance goes the other way around than the authors suggest. Their argument for the relationship is that managers facing higher sensitivity of the flows have higher incentive to outperform looks weak at best. It is unlikely that an unskilled portfolio manager would suddenly gain skill because he could attract more funds. The causality could be precisely the other way around in that an unskilled manager will seek an arrangement that would give him flows regardless of his performance, e.g. paying more to the advisers to incentivize them to sell their fund. The clients are facing an inherent asymmetric information problem when they take an advice from their adviser. As a result, the geography of clients for different fee structure can be quite different. This again leads to an endogeneity problem that is not addressed in the paper. The different composition is partly evident from question 22 in their FAQ:

> *"Q22: The average asset mix of commission-based and fee-based accounts is quite different, as dictated by differences in clients who typically use these accounts. For example, an embedded fee mutual fund account at an MFDA dealer would choose from a total universe of mutual funds which is 34% in Equity Funds and 49% in Balanced Funds. A fee-based account, which would typically be at a full service IIROC dealer, would choose mutual funds from a universe which is 41% in Equity Funds and 33% in Balanced Funds."*

Looking at the problem from the perspective of portfolio managers who posses the true skill, they would have little motivation to opt for costly options of paying high fees to their dealer and would rather focus on investors that are more sophisticated and have thus higher sensitivity of their investment decisions to the relevant data (past performance). This relationship would again show in the results through higher sensitivity of future alpha to past sensitivity of flows but the causality would be different from what the authors suggest. This issue is fundamental when assessing the results of the study from a policy perspective, which was the reason behind its creation, as the problem of information asymmetry will be just shifted to a different fee structure and the consumers will not be better off if a more stringent regulation is introduced.

To conclude, there could be two equilibrium approaches the funds could adopt. The first one is using incentives for dealers to sell their fund while providing average to below average performance. The second is not paying high sums to the distribution channels and relying on their superior performance in outperforming the market to do the job instead.

5.4 Some Further Econometric Issues

Here we give some detailed discussion of some econometric issues, many of which were supposedly answered in the questions document. Our assumption is (the notation used in the paper is a bit misleading on this) that the implicit model adopted in Table 3 is

$$F_{i,t+1} = \beta_0 + \beta_1 \alpha_{it} + \beta_2 \alpha_{it}^2 + \sum_j \gamma_j D_{ji} + \sum_j \delta_j D_{ji} \alpha_{it} + \eta_{it}, \tag{4}$$

where $F_{i,t}$ is flow at time t, η_{it} is a random error term, mean zero given the observed random variables α, D, but correlated within FundSERV codes, that is,

$$\operatorname{corr}(\eta_{it}, \eta_{js}) = \begin{cases} 1 & \text{if } t = s \text{ and } i = j \\ \sigma_\ell & \text{if } t = s \text{ and } i \neq j \text{ share the same } \mathit{FundSERV\,code}\ \ell \\ 0 & \text{else.} \end{cases}$$

There are eleven years of monthly data. The dummy variables D_{ji} are 1 if the option j is present and zero otherwise ($j = 1, 2, 3, 4$); the dummy variables are mutually exclusive and exhaustive, i.e., $D_{1i} + D_{2i} + D_{3i} + D_{4i} = 1$. In models 1-4 a single dummy variable is included, whereas in Model 5 three dummies are included, which corresponds to a saturated case since a constant is included. The model for Table 4 includes variables that vary over time, but otherwise the specification is the same, just applied to a subset of the data. The model for Table 5 reverses the direction and puts α_{it+1} on the left hand side. How the error terms in such a model arise is very mysterious and not articulated.

1. It is not clear why the authors consider Models 1-4 at all, since including one dummy at a time is subject to omitted variable bias - although the dummies are not mutually correlated, omitted dummies are surely correlated with α_{it} and α_{it}^2.

2. The regressor α_{it} is not observed and has to be replaced by the estimated value $\widehat{\alpha}_{it}$, which uses the previous 12 months data of returns. These estimated alphas (*generated regressors*) are measured with error and probably quite a lot of error given that only twelve months are used to estimate the five parameters of the Fama-French 4 factor model (many academic tests fail to find significant alphas in this model, which is precisely why it is widely used). In fact, given the global mean and standard deviation of the alphas in Table 1 one may consider the given estimates as noisy estimates of zero. In this case, the econometric estimates that they produce are biased and even biased in large samples. Note also that even if $\widehat{\alpha}_{it}$ were an unbiased estimate of α_{it}, its square $\widehat{\alpha}_{it}^2$ is not an unbiased estimate of α_{it}^2. Furthermore, the bias in alphas or their square would obviously lead to bias in other coefficients, and the direction of this bias is not easy to describe.

   (a) The robustness results based around using 3 years of data to compute the alphas do not resolve this issue: the estimation error is smaller yes, but the autocorrelation of the estimated $\widehat{\alpha}_{it}$ must be very high then because the difference between $\widehat{\alpha}_{it}$ and $\widehat{\alpha}_{it+1}$ is only two months out of 36. This regressor must be extremely persistent, and we know from Stambaugh (1999) the effect that that can have on regression coefficients.

(b) In addition, the secondary effect of generated regressors is that the standard errors should reflect this preliminary estimation, Pagan (1984). In this case the correct standard errors would be likely much larger since the estimation error in the regressor is verry big.

3. One might expect decreasing returns to scale: as the industry's size increases, every manager's ability to outperform passive benchmarks declines. Normalizing by AUM essentially imposes constant returns to scale and is unnecessarily restrictive, since AUM could be included as a regressor to control and identify returns to scale.

4. The econometric specification really is rather over simplified given that the sample size is so large, it is not surprising that one gets significant coefficients. There are around 800000 observations (Model 1-5 in Table 3) and Model 1 apparently has four estimated coefficients in the mean equation (apparently there are no additional controls). In general one would expect heterogeneous effects, Pesaran (2006). One of the most commonly used panel models in finance, the market model, is of the form $R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}$, where R_{it} and R_{mt} are returns on asset i and the market respectively. In this case the coefficient β_i varies across i. The same is true in the Fama-French regressions themselves, which is how one obtains alphas that vary with i. In the current study, the authors have some variables that vary across both firm and time for which it would be quite natural to allow for heterogeneous effects, i.e., parameters that vary across firm or time. The consequence of not doing so may be another source of bias either in the estimates or the standard errors.

5. Commenting on Table 3, p26, the authors say: "*A 1-standard deviation increase in prior alpha causes a 10% increase in future flow (based on Model 5, and this effect is most conservatively estimated at 4.2% in Model 2 and least conservatively estimated as 16.7% in Model 6) and this effect is statistically significant at the 1% level in all models*". Given our notation, the effect of changing from α to $\alpha + \sigma$ for fund i at time t on the flow in period $t+1$ ceteris paribus is

$$F(\alpha \to \alpha + \sigma) = \beta_1 \sigma + \beta_2 (2\alpha\sigma + \sigma^2) + \delta_j \sigma,$$

where purchase option j was present. The authors clarify (in A20 in the answers to questions document) how they compute this quantity, which reveals that they just compute $\beta_1 \sigma$. The quadratic term in some cases is too small to make a difference but not in Model 6 and Model 7 say of Table 3. Also, some of the interaction effects completely change the number. For example in Model 5, the coefficient on Purchase option deferred sales charge times alpha is -0.00174 and when the dummy is one this almost completely offsets the claimed effect.

6. The authors divide through by average monthly flow in the sample to get to these numbers like 16.7% (Model 6, Table 3), which is misleading. In fact the average monthly flow in the sample is -0.0187 not 0.0187, and so they are actually dividing by the absolute value of this. The standard deviation of the average monthly flow is in fact 0.0864 from Table 1, which suggests that they are dividing through by something that is not significantly different from zero. Indeed, one would expect that in the long run average monthly flow across all firms should be exactly zero. So why the ratio they have chosen is of particular economic significance is not clear.

7. Furthermore, the substantial variation of the effect from between 4.2% to 16.7% calls into question the statistical significance of the find. There is a relationship between the variability of such effects across mildly different specifications and the variability of the effect that would occur across hypothetically drawn samples in the same specification. Either this is bias, in which case one would worry about bias from elsewhere, or it is just variability in which case it should be similar to the sampling variation. These issues are even more pronounced with table 4.

8. As already remarked, the specification is purely static, so that any effects are supposedly only transmitted over one month whereas one might want to distinguish between short run and long run effects. A lot of economic theory only predicts relationships about long run equilibrium effects. Why not put lagged flow in the specification, like some other authors?

9. In (1) the authors include "Controls" but it seems that there are actually no additional variables in Table 3. One would have thought that there are a host of observable time series variables that could be used to predict aggregate flow and hence individual flow. For example market returns, industrial production, terms structure variables, junk spread etc. Given the homogeneous coefficient structure the authors have set on it would be straightforward to include this in the model. Indeed, one could also include the cross sectional average of flow at each point in time, following the logic of Pesaran (2006). Year dummies or even dummies for every time period would seem to be an alternative. Other authors have included lagged values of flows in the panel regressions. The authors repeatedly argue that their results are robust to different window lengths or specifications, but they do not submit their model to a rigorous testing by including obvious observable determinants of fund flows and testing whether their coefficients survive this omitted variable challenge.

10. In Table 3, the R^2 are indeed very small. For comparison if one tried to predict daily S&P500 returns by their first lagged value one might get an R^2 of 0.0009, which seems to be somewhat

larger than many of the reported panel regression R^2 here. The authors argue in Footnote 19 that "*It is quite normal for R^2 to be low in a panel setting because the same variables are used to explain the differences in outcomes for different FundSERV codes, and not only the same FundSERV code at different points in time*". But in all their regressions there are variables that vary across both funds and time. There is some argument that the R^2 is in and of itself not important so long as the model is correctly specified and the coefficients are statistically significant. However, it surely gives one pause to thought when ones model of a phenomenon explains so little of the observed variation. What is explaining the remaining 99.91% of the variation? The elephant in the room could completely squash the claimed effects, and it is not appropriate to be so confident on ones findings in this case. The R^2 do increase in Table 4 because more variables are included. Del Guercio and Reuter (2014, Table II) shows substantially higher R^2 (0.08) for their panel regressions with 122,000 observations.

11. The constant value in the regressions of Table 3 is always negative and significant. This says that when all the observed right hand side variables are zero, flow is negative.

12. It is not clear why on page 26 the authors say that flow is convex or not. In models 1-5 the quadratic parameter is not significant. In models 6-7 the parameter is significant but the t-stats are more like 4 than 10, which when the sample size is 800,000 is not particularly impressive (in the hunt for the Higgs boson, the evidentiary standard was set at 5). The claims made in the paper are very strong and the fact that this may be used for guiding policy suggests one should reserve a higher evidentiary standard than 2.5σ.

13. The regressions for Table 3 and Table 4 have the same left hand side variable (from different samples) and some common variables on the right hand side (constant, α, and α^2) but are otherwise non-nested. The estimated coefficients on α seem to be quite different from Table 3 to Table 4, and the t-stats also are quite different. The authors are implying that this flow performance relationship is something real and invariant after controls are applied, but this does not seem to be the case.

14. The standard errors are clustered by FundSERV code but this is still implicitly assuming that the effects do not vary over time (no heterosekdasticity). Apparently there are 14357 groups in Models 1-5, Table 3, which suggests that in constructing the standard errors the authors have estimated parameters σ_ℓ, $\ell = 1, \ldots, 14357$ to construct their standard errors. This is a lot of parameters each with around 50 observations per parameter. By contrast, they only estimate four parameters for the main effect of interest.

15. Figure 5 shows the robustness against the choice of sample by doing a rolling window analysis. The authors argue that this is consistent with the earlier results. However, the period to period variation of the marginal effects is extreme, from 45% to 5% over a period of two years in the Direct purchase, stand alone funds category, and from 0 to around 23% for the indirect purchase, stand alone firms. Figure 7 is even more variable. This just shows that whatever effects the authors are claiming to have found they are not really well identified, and vary substantially over time.

16. The regression (3) suffers even more from the issues discussed above, since both sides of the regression are generated from some previous procedure, yet the standard errors are constructed as if these variables were observed directly. How to take account of this pre-estimation was all worked out in the 1980s so there is no excuse to not deal with this issue properly.

17. The definition of the flow perfomance intercept and flow performance slope is not given in the main document and in the FAQ document, they were asked

Q19: This paper's description of the creation of "Flow Intercept" and "Flow Slope" are not very clear. Can the researchers elaborate on the construction of the flow intercept and slope intercept variables, and how the conclusions provided on page 59 are reached based on these constructions?

Their reply was less than revealing.

> *A19: We invite you to read the methodology section starting on page 4 which provides a good explanation of the flow-performance intercept and flow-performance slope. The conclusions follow directly from the empirical methods. Note that flow-performance intercept and flow-performance slope are well accepted terms in the literature and widely used in dozens of prior empirical studies on mutual fund flow and performance*

They don't give any references, and perhaps there are none that use their specification exactly, so we should have been given the formula here. They do say in Table 5 that: *flow intercept refers to level of flow in a given month irrespective of past alpha*, which then makes you wonder why in Figure 2 the horizontal axis for the intercept panel is α.

6 Conclusions

The paper has worked with an extremely large and rich dataset and produced interesting results. The main concern is that the conclusions they derive are simply too strong to be justified, especially if they were to be the basis for legislation or policy. Although they claim their many results are robust to various alternative implementations, the results indicate that there is some fragility in the results across time period and in other dimensions. The economic magnitude of the effects they claim is also open to different interpretations. The statistical significance is also questionable given the limited static specifications they have focussed on and the fact they ignored the generated regressor issue and the endogeneity issue. There are numerous econometric issues with their methodology that have not been answered. Furthermore, the causal interpretation that the authors are pushing is simply not defensible. At most they can claim some weak association in the data they have used with the limited specifications they report. There is such a clear endogeneity problem embedded in the issue and they have not shown any clear strategy for separating out a causal effect unless lagging variables by one period is supposed to be credible.[2] Without a clearly articulated structural model it is hard to separate out the various effects and their interpretation.

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[2] Usually some kind of natural experiment is invoked or at least differences in differences (matching methods) that control for common trends. This is easy to do in the current context, and is widely practiced in empirical finance.

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Report on "A Dissection of Mutual Fund Fees, Flows, and Performance" by Cumming, Johan, and Zhang

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Following a request from the Canadian Securities Administrators (CSA), this work builds an extensive data set of mutual fund flows and performance. It then analyzes this newly created data set and claims to show that flows into funds that are sold on a fee basis are more responsive to performance than funds that that are sold with commissions. It then shows that funds whose flows are more sensitive to performance have better future performance.

There are many dubious methodological choices made by the authors, but overall, the quality of the econometric work is much better than previous work by Cumming that I have analyzed. For example, he works with relative flows into funds by dividing net flows by past asset size. This alleviates many econometric issues that would arise in working with the level of flows such as trends and heterogeneity in the size of funds (large funds would get a preponderance of weight in the analysis). There also many robustness check sand subsample analyses that make the results more convincing. That being said, there are issues and concerns that will be raised in the data and econometric sections below.

The more serious criticisms in my mind is the interpretation of the results. The work does not seem to answer at all the question of whether fee-based or commission-based remuneration is better for individual investors. It is not clear at all what objective investors are assumed to be trying to achieve. The report shows that funds that attract investors that make their decisions based on past performance have better future performance. And it turns out that fee-based funds attract more such investors. Is that because of poor advising and neglecting that past returns are not a good indication of future returns? I also find the logic quite circular: in the first step, flows are related to past alpha, and in the second step, alpha depends on past sensitivity to performance (which itself depends on past flows and past alpha).

The paper finds that funds sold through affiliated dealers perform worse. Lortie claims that one consequence of the change in remuneration rules is that more funds are sold through affiliated dealers, so this finding is an argument for the status quo.

I find the use of alpha of a fund as a measure of performance of a fund to be unsatisfactory, in particular for index funds. At one extreme, if a fund tracks the market index perfectly, its alpha will be 0 in each period *by construction*, and no inference could be made about the relation between performance and net inflows.

I divide my technical comments into two categories. The first one discusses issues with the data, while the second discusses various issues in econometric methodology. These are listed as dubious choices that have been made by the authors. Without access to the data, it is hard to know in most instances what impact different choices would have on the results.

1- Data

The authors have assembled what seems to be an impressive data base of information on Canadian mutual funds. The unit of observation is a FundSERV code which is distinct for each fund and for each purchase option. For example, if the same fund can be purchased either as front-load or back-load, it would generate two separate codes. The data is monthly, and the sample period is January 2003 to October 2014.

While the authors claim (correctly) that their data base is very extensive, it covers only an estimated 66.7% of assets under management for stand-alone funds and 51.5% of assets under management for funds-of-funds. There is no information on the missing data and whether sample selection is a problem. Similarly, the reported coverage is an average over the sample period and probably varies each month with better coverage over more recent episodes.

In fact, there are a lot of missing observations. The authors take the view that these missing data points are random and not related to any variable, whereas one would think that underperforming funds and/or funds attracting little new inflows would be more likely to disappear or be merged with other funds. To get a sense of the number of missing observations, there are 22,077 distinct FundSERV codes in the data set and the time span is 142 months for a potential of 3,134,934 observations. The largest number of observations in any of the tables is 1,209,285, barely a third of the possible observations. There is no information given at all about these missing data.

The dependent variable is computed after removing some flows such as pre-authorized inflows, systematic withdrawal plans, and switches in and out. These flows would be responsive to past performance but maybe more sluggishly. Maybe that is the argument for removing these items, but that is not mentioned. Presumably, these arrangements are not distributed evenly over the funds, and their removal has an effect on the results.

There is no information available on the asset classes covered by the data. It is possible that some of the estimated effects come from changes in the composition of the mutual funds covered in the data base. For that reason, I find the whole Table 2, which compares the means of various variables among two samples, useless. It is also not clear how the statistics were constructed and whether the two populations were supposed to be independent.

2- Econometric issues

Simultaneity / Endogeneity

What is really being estimated is a market equilibrium where the net quantity of a fund bought depends on its characteristics, its past performance and its price. The price variables are taken as given and exogenous in the analysis, which is the same as assuming that the supply curve for a given fund is perfectly elastic (horizontal). The estimated relation is then interpreted as a demand curve for mutual funds with a given past performance (as measured by alpha) after controlling for other characteristics.

One would think that the supply curve for mutual funds is not perfectly elastic and that it becomes more expensive to supply a larger fund with a given performance. In other words, even if a fund gets larger, it is assumed that the fund company will not change its price structure to limit inflows or to reflect that it becomes harder to sustain the given performance.

Therefore, the exercises that consist of looking at the effect of a change in prices on quantities as done in Figure 1 are only meaningful under this assumption that the supply curve is horizontal. Otherwise, they do not mean much because changes in fees are not exogenous. This Figure 1, which is meant to be illustrative, is an event study where the performance (as measured by alpha) before and after a supposedly exogenous change in trailer fees. Since we are not told how alpha is calculated, it hard to make general statements, but the apparent reduction in performance is only due to changes that occur at least 12 months after the change in fees. It is hard to see anything before that, and it is hard to blame the change in fees for changes that happen more than a year later without controlling for anything. The right-hand panel of Figure 1 also reveals that only a few funds seem to make a large contribution since the median behaves quite differently from the mean. And note that only .6% of funds are included in this Figure.

Generated regressors

The main regressions consist of relating the net flows into a fund to its characteristics and its past performance. Its past performance is measure by alpha or the intercept of a regression of the fund returns on the 4 Fama-French North American factors. There is no allowance for different risk factors for funds in different asset classes (for example bond funds and international equity). The estimated intercept from this regression is the alpha for the fund. While it is not explicit, these regressions are estimated over rolling windows (possibly 12 months as mentioned on pp. 54).

These estimated intercepts are, in a second step, later included as regressors in the main equations of net flows. Their coefficient becomes the object of interest (the performance slope) with a higher slope meaning that the flows into a fund are more sensitive to past performance. This is interpreted as giving incentive to fund managers generate higher returns (after controlling for the risk factors).

Including an estimated regressor creates econometric problem. A mismeasured regressor makes the OLS estimator biased and inconsistent. This measurement error will not disappear, even asymptotically, because alpha is estimated over a fixed window size. It is thus not clear how one can interpret the performance slope and intercepts that are the main objects of interest.

However, measurement error will bias the coefficient towards 0 and make the variable appear less significant. Thus, findings of significant coefficients associated with mismeasured regressors are noteworthy. It must also be noted that the problems associated with even a single mismesaured regressor transmit to all the other estimated coefficients if there is a correlation among regressors.

The second set of results, relating alpha to past flow sensitivity, suffers from the same problem as the flow sensitivities are also estimated.

Heterogeneity

The authors exploit the panel structure and control for unobserved heterogeneity by allowing an individual effect for each FundSERV. They also cluster the standard errors by FundSERV, another good point. The individual effect is either of the fixed or random effect form. Random effects are preferred on efficiency grounds and because they allow for estimation of coefficients on variables that are constant in time, but fixed effects are valid under more general scenarios since they do not require the regressors to be uncorrelated with the individual effect. The authors use a random effects specification in the first part of the paper when looking at the effect of alpha on fund flows because they are interested in coefficients on variables that do not vary over time (like the effect of the type of purchase option). A specification (Hausman) test should be reported to validate the choice.

For Table 4, because the included regressors are all varying over time, a fixed effects specification is selected. I suspect that the sentence on p. 41 on the results of the Hausman test is incorrect, and that the test invalidates the random effects model. Yet, one must wonder how much variation is present in some of the regressors such as trailer and other types of fees to precisely identify the effects. The authors report that there are fee changes in 8.52% of the months only.

Many fund characteristics are available and have not been used in the analysis, such as age, asset class, whether it is an index fund, or whether it is distributed through discount brokerage. It would be preferable to use these to try to reduce the relative importance of the individual effects.

Winsorizing

Outliers (large positive or negative returns) can have a large impact on econometric results. Given that the sample includes the financial crisis, mane large negative returns must be present in the sample that would dominate the analysis. Authors often try to limit the importance of the phenomenon using different methods, for example by removing outliers, smoothing (taking moving averages) or winsorizing which is the method used in the current paper. This consists of taking all returns beyond a certain threshold and replacing it by that threshold. In the current paper, I was quite concerned when the authors mention that they use a threshold of 1%. I thought that they took all monthly returns that are larger than 1% and smaller than -1% and replaced then by ±1%. However, in Figure 4, the authors clearly state that they winsorize at 1%

and 99% which must mean that returns beyond the 1% and 99% quantile are replaced by the appropriate quantile. This is more appropriate, but it still says that 2% of the returns because there are probably not enough time series observations for each fund) or using the overall distribution obtained by pooling all observations together.

Serial correlation

It is known that hedge fund returns exhibit serial correlation and there is evidence that mutual funds that hold a large fraction of illiquid long-term assets may also have some serial correlation. Some diagnostics on this would be appreciated as it would invalidate inference.

Collinearity/ identification

In many instances, the authors mention collinearity problems (page 37, 52, and 61). This is not surprising as one would think that identification is difficult when most data falls into 2 of the four purchasing options. Only 8.4% of the data falls into the no-fee category.

Footnote 24 suggests that adding past alpha to the second set of regressions creates collinearity. I have no idea how to interpret this.

Review of "A Dissection of Mutual Fund Fees, Flows, and Performance" by Douglas Cumming, Sofia Johan, and Yeling Zhang

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Whenever retail investors hire an intermediary to assist with their investment decisions, the potential for conflicts of interest arises: Investors want to receive the best service and the highest possible returns, net of fees, while intermediaries and fund managers want to earn high fees and grow their assets under management.[1] Given the existence of a vast array of discount and full-service brokers–along with index funds and actively managed funds–it is important to understand which factors determine the quality of the match between investors and funds and the scope for conflicts of interest.

It is natural to expect that the scope for conflicts of interest is largest among funds catering to the least sophisticated investors who monitor fund performance less than their more sophisticated counterparts. If investor sophistication were observable, we could therefore simply compare the investment performance (and fees paid) for funds catering to investors of varying degrees of sophistication. Unfortunately, investor sophistication is unobserved and the key challenge in the literature is to find instruments or proxies that correlate strongly with investor sophistication.

One such proxy for investor sophistication is whether a fund is sold directly to investors by the fund management company or whether it is sold via an intermediary. The notion is that more sophisticated investors cut the intermediary and are able to invest directly while, conversely, less sophisticated investors rely on brokers for their investment decisions.

The report by Cumming, Johan and Zhang (the "Cumming report") also distinguishes between funds that cannot be bought directly from the fund management company and funds that can be bought directly. However, in addition, the report uses fund purchase options as a way to proxy for fund characteris-

[1] Assuming that mutual fund families try to maximize the fee-weighted assets under management, Del Guercio and Reuter (2014) argue that they have a weaker incentive to generate strong investment performance for the mutual funds sold to unsophisticated investors, i.e., the funds sold via brokers/intermediaries. Rather, fund families have an incentive to allocate their resources towards improving performance for the funds that exhibit the greatest flow-performance sensitivity, i.e., directly sold funds.

tics that may attract less sophisticated investors and thus deepen the scope for conflicts of interest between investors and intermediaries.

1 Existing Literature

A large body of research in empirical finance finds that, on average across time and across funds, actively managed US mutual funds underperform a set of passive benchmarks on a net of fees basis.[2] Given the vast sums of money at stake in the managed fund business, it is natural to ask why retail investors do not simply invest in passively managed funds. One possible explanation is the service and investment advise–beyond merely executing trades–that brokers and other intermediaries can provide.

A number of studies have analyzed and quantified the importance of conflicts of interest between investors and intermediaries. Del Guercio and Reuter (2014) hypothesize that the retail market for mutual funds is segmented according to investor sophistication. One segment of this market contains less-unsophisticated investors who buy funds through intermediaries that typically bundle portfolio management with financial advice and other services. Investment performance is just one consideration for less-sophisticated investors and may not even be the most important determinant of their investment decision. This means that less-sophisticated investors are not as responsive to funds' risk-adjusted (alpha) performance as more sophisticated (self-directed) investors are. By implication, the brokers/managers of funds dominated by less sophisticated investors do not have as strong economic incentives to generate high investment performance as managers of funds dominated by more sophisticated investors.

The lack of sensitivity to risk-adjusted performance among less-sophisticated retail investors need not be a sign of irrationality provided that the quality of the financial services they receive from their investment advisor makes up for any inferior investment performance. Whether this is the case will depend on the magnitude of any underperformance reported for the funds held by the least sophisticated investors.

Empirically, Del Guercio and Reuter (2014) find that the flows of directly sold funds are significantly positively related to past risk-adjusted returns. In contrast, they find no significant relation between flows and past risk-adjusted performance among broker-sold funds. Instead, Del Guercio and Reuter find a significantly positive relation between flows and past raw returns for broker-sold funds. Since one way to generate higher raw returns is by loading more on risk factors (i.e., by increasing betas), this finding suggest that broker-sold funds have more of an incentive to generate returns by selecting stocks with high betas on risk factors earning positive risk premia. Conversely, the managers of direct-sold funds have a stronger incentive to generate high returns through their risk-adjusted returns.

Bergstresser, Chalmers, and Tufano (2009) find lower risk-adjusted returns for funds that are sold via brokers relative to directly sold funds. They interpret

[2]See, e.g., Gruber (1996), French (2008), and Fama and French (2010).

this as evidence of material conflicts of interest between brokers and investors.

Christoffersen, Evans and Musto (2013) investigate whether it makes a difference if brokers are compensated one-off, e.g., through a share in the initial load, or on a recurring basis linked to funds' investment performance, e.g., through revenue sharing. They find that new investments are positively correlated with the load paid to the broker, while future performance is negatively correlated with broker payments from loads. Conversely, revenue sharing is not significantly related to future investment performance although it does seem to drive initial investments.

These studies are clear about which type of fund (direct or broker-sold) or investment arrangement attracts different types of investors who are more or less sophisticated as reflected in how sensitive they are to prior investment performance. In turn, differences across funds in flow-performance sensitivity are related to the scope for conflicts of interest between investors and intermediaries.

2 Purchase options and hypothesis development

The Cumming report analyses the relation between flows and performance for different purchase options. There are many types of fees and purchase options available in the Canadian mutual fund industry. To explore how the flow-performance sensitivity is affected by different types of purchase options, the Cumming report includes interaction terms between dummies for purchase options and past risk-adjusted performance in a set of flow-performance regressions.

2.1 Purchase options

The report focuses on four options for investors to purchase shares in Canadian mutual funds:

1. **No load**: Under this option, the investor pays no front end or back-end sales charges but the option includes a trailer fee that is paid to the fund dealer (6% of the sample observations)

2. **Deferred sales charge**: Under this option, the investor pays a fee in case of early redemption, i.e., redemption prior to a minimum holding period. In addition, the fund company pays the dealer an up-front commission and a trailer fee. (46% of the sample)

3. **Front end charge**: This option involves an initial sales charge in addition to a trailer fee. (38% of the sample)

4. **Fee based option**: This option involves no front-end or deferred sales charges and does not have trailer fees for the dealer. Dealer fees are instead charged directly to the investor's account. (8% of the sample)

Some mutual funds can be purchased directly from the fund company while others can only be bought through an intermediary. The decision to buy directly from the fund company has been used as a proxy for investor sophistication and linked to the potential for conflicts of interest by authors such as Del Guercio and Reuter (2014). The hypothesis is that the potential for conflicts of interest between fund managers and retail investors is greater when investors are unsophisticated and pay little attention to risk-adjusted investment performance. Importantly, investors can be expected to self-select into the two categories based on their level of sophistication with the most sophisticated investors purchasing funds directly, while less sophisticated investors purchase with the help of an investment advisor.

2.2 Hypothesis development

The Cumming report explores a wide variety of fee structures and purchase options. However, it offers no explicit formulation of hypotheses for ranking the different purchase options and fee structures by investor sophistication and, in turn, relating them to dealers and fund managers' incentives.

This point is important because, in trading off between front- or back-end loads versus regularly occurring trailer fees of different magnitudes, it is not always clear which type of purchase option a sophisticated investor would prefer. For investors with a short holding period, annual trailer fees might be more attractive than, say, a large redemption or front end charge. Conversely, for long-term buy-and-hold investors, smaller trailer fees may be preferable even in the presence of other charges. It is not clear to what extent the different purchase options can be used as proxies (instruments) for investor sophistication.

It is, therefore, desirable to develop a clear set of testable hypotheses for how different purchase options attract different clienteles, i.e., investors with different degrees of sophistication or, alternatively, different flow-performance sensitivities. In particular, it would sharpen the analysis to rank the four purchase options according to whether they are more or less likely to attract investor types with different levels of sophistication and different degrees of sensitivity to prior investment performance.

At present, the report does not develop such rankings or hypotheses. This makes it difficult to interpret the empirical evidence since there are eight types of purchase options, namely four options for directly-purchased funds and four options for dealer-sold funds.

Moreover, it is not clear how to relate the results reported for stand-alone funds versus those for fund-of-funds. To what extent do these types of funds attract investors with different levels of sophistication? In turn, are there notable differences in the potential for conflict of interest between investors and intermediaries for these funds?

3 Data and summary statistics

3.1 Data

The Cumming report's analysis is based on a unique (proprietary) data set comprising 43 fund families (out of a total of 113 in existence). Assets under management amount to $746 billion which covers two thirds of the overall Canadian market of $1.1 trillion in AUM.

FundSERV codes are used to identify each unique combination of fund series and purchase option. In total there are 22,077 FundSERV codes and just over one million observations over the twelve-year sample period, 2003-2014.

The data set forms a panel as it covers both cross-sectional and time-series information. The data set is very rich in that it covers multiple purchase options and funds purchased either directly or through an intermediary.

3.2 Summary statistics

Summary statistics for flows, risk-adjusted performance and the various purchase options are provided in Table 1. It can be seen that the mean value of net flows during the 12-year sample was negative. I suspect that part of this is related to the global financial crisis in 2008-09 but it raises questions about how representative the historical sample period is. This is less of a concern, of course, to the extent that the effects are identified off cross-sectional differences among funds.

Two pieces of information that are missing from the analysis in Table 1 are statistics on funds' (raw) returns along with statistics on funds' performance net of fees. Raw returns are important because, unlike risk-adjusted returns, they are not affected by estimation error.

Returns net of fees are what investors should ultimately care about and so it is important to consider these to fully understand the scope for (and net effect of) conflicts of interest between investors and fund managers and dealers. Net returns are also considered by other studies. For example, Del Guercio and Reuters (2014) find that while direct-sold actively managed mutual funds do not significantly underperform passively managed funds on a net of fees basis, broker-sold actively managed funds underperform index funds by 110-130 basis points per annum net of fees. This suggests that all underperformance among actively managed funds originates from broker-sold funds and indicates a conflict of interest between brokers and unsophisticated investors.

In addition to raw returns and performance net of fees, the report should break down the statistics by the funds' (main) asset class and/or investment style. These statistics can help provide important clues as to the flows and performance for different types of funds and across different segments of the market.

4 Estimation of risk-adjusted returns

The Cumming report uses panel regressions to estimate how the relation between flows and past risk-adjusted performance is affected by funds' purchase options and fees. In these flow regressions, a high intercept is interpreted as evidence that flows are insensitive to past performance. In contrast, a high coefficient on past risk-adjusted performance (alpha), i.e., a high flow-performance slope, is interpreted as evidence that flows are highly sensitive to past risk-adjusted performance, consistent with a strong incentive for fund managers to perform well and less scope for conflicts of interest between fund managers and investors.

How funds' alphas are estimated is key to this analysis. The Cumming report measures risk-adjusted performance (alpha) using a conventional four-factor Fama-French model, i.e.,

$$R_{it} = \alpha_i + \beta_{1i} R_{mt} + \beta_{2i} SMB_t + \beta_{3i} HML_t + \beta_{4i} MOM_t + \varepsilon_{it}, \qquad (1)$$

where R_{it} is the gross return on fund i in month t. R_{mt}, SMB_t, HML, and MOM_t are the North-American market excess return, size, value/growth and momentum risk factors, data on which are obtained from Kenneth French's data library. The same set of risk factors appear to be used regardless of the funds' investment objectives or their focus on different asset classes. Risk-adjusted performance is estimated using a 12-month rolling regression of (1) which yields a series of fund-alpha estimates, $\hat{\alpha}_{it}$, $t \geq 11$.

I have a number of concerns with the report's estimation approach related to the (i) choice of the length of the estimation window; (ii) choice of risk factors; and (iii) investments in non-Canadian assets.

4.1 Choice of estimation window

The rolling estimation window comprising 12 monthly observations is very short. One year of monthly observations does not offer a reliable sample on which to base estimates of fund performance. Moreover, estimating five mean parameters, including the critical value of α_i, from a sample of 12 monthly observations is likely to produce very noisy alpha estimates.

The Cumming report does not offer any compelling reasons why such a short estimation window is used. In particular, it does not offer empirical evidence that Canadian funds shift their factor loadings more frequently than, say, US funds do, which would appear to be a reason for using such a short estimation window, besides the desire to get a longer evaluation sample on which to run the flow-performance regressions.

The alpha estimates play a key role in the flow-performance analysis. Moreover, part of the identification of the effect of prior risk-adjusted performance (alpha) on flows comes from time-variation in the alpha estimates. Using a very noisy and potentially unreliable estimate of alpha will make it more difficult to accurately estimate the flow-performance relationship.

Note also that it is common practice in the finance literature to use a somewhat longer rolling window of monthly return data to estimate fund alphas. A common choice is to use 24, 36 or 60 months of returns data. These longer estimation windows retain the ability to capture time-variation in factor loadings (β) and evolution in skill (α).

In fairness to the Cumming report, the authors conduct a robustness analysis using a three-year estimation window. Table III.3 suggests that the main results on the flow-performance relation appear to go through with the longer estimation window. While this finding is reassuring, it is notable that the estimated slope coefficients on the lagged alpha are substantially larger when using the three-year alpha estimates (e.g., 0.00604 for Model 1, Table III.3, Panel A versus 0.00148 for the same model in Table 3). It is not clear why the slope coefficient should be this much higher for the three-year alphas than for the one-year alphas and it would be valuable to compare in more detail the magnitudes of the estimates in the flow regressions based on 12-month and 36-month rolling windows.

4.1.1 Index-adjusted returns

As a simple way to handle estimation error in the performance estimates, Online Appendix IV of the Cumming report uses fund gross returns net of the S&P/TSX composite return to measure performance.

Comparing the results in Table 3 to those reported in Appendix Table IV.3, it appears that some of the flow-performance estimates can be quite sensitive to how fund performance is being measured. For example, for funds that cannot be purchased directly, the 12-month alpha estimates in Table 3 show no evidence of convexity. In contrast, among the same set of funds, Table IV.3 shows a significant convex relation between index-adjusted returns and subsequent flows. Moreover, the sign of the coefficient of the interaction term between the lagged performance and the purchase option deferred sales charge switches from negative and significant in Table 3 to positive and significant in Table IV.3.

This simple index-adjusted approach to measuring fund performance imposes a beta of unity on the funds' exposure to the S&P/TSX composite portfolio– an assumption that is unlikely to be accurate for many funds, especially funds focusing on fixed income.

An alternative way to compute risk-adjusted returns would be to identify funds with similar exposures to different styles. Having identified such funds, a risk-adjusted return can then be obtained by subtracting the peer-group matched average of such funds' returns from the original fund's return. This is a more non-parametric approach that only uses beta estimates in order to construct the peer-group average and so is likely to be more robust to estimation error than the current approach to obtaining alpha estimates.

4.2 Choice of risk factors

A second issue is that the report uses the same four risk factors to analyze the performance of funds invested in very different asset classes, including equities and fixed income. In my view this is inappropriate. For example, the performance of fixed income funds is likely to depend on their exposure to bond-specific risk factors such as level, slope and curvature factors for government bonds and default risk factors for corporate bonds.

Moreover, using different risk factors to measure the performance of funds invested in different asset classes is common practice. For example, in a recent paper on measuring the performance of actively managed bond funds, Ferson et al. (2014) consider factors capturing the term structure of interest rate (through a level, slope, and curvature factor) credit, liquidity and mortgage spreads, an exchange rate factor, and two equity risk factors. They find that many bond funds have significant exposures to these risk factors, and that their loadings vary a great deal across bond funds with different investment styles.

Related to this, the report would benefit from a detailed analysis of how the factor loadings differ across equity versus bond funds and also whether the inclusion of bond risk factors such as those listed above affect the results. Critically, it is important to study how the distribution of alpha estimates differ across funds specializing in different asset classes. For example, the report finds an average four-factor alpha of 0.25% per annum for stand-alone funds. How does this estimate vary across stock and bond funds and is the distribution of alpha estimates properly centered for funds pursuing different investment objectives, e.g., bond versus stock funds? Because of the importance to the Cumming report of the alpha estimates, these are critical questions to address before conclusively interpreting the flow-performance regressions.

In the presence of an alpha regression model that is likely to be misspecified for at least some of the funds, it is not clear what the alpha estimates capture. Misspecified alpha estimates do not necessarily capture the skill of the fund manager and so a positive relation between (misspecified) alpha estimates and future flows need not be a sign of investor sophistication. Rather, if bond funds in some period experience high returns and see subsequent high inflows, this could simply be because interest rates came down, benefitting most bond funds. In the absence of controls for bond-fund specific risk factors, this effect is unlikely to be captured by the current set of (equity-focused) risk factors and would come across as “skill”, i.e., alpha. Is it possible that the current set of results, in part, capture future inflows into non-equity asset classes after these asset classes outperformed stocks, particularly during the global financial crisis?

To address these points, the report should undertake a detailed analysis of the distribution of alphas using separate regressions of the flow-performance relation for funds with different investment objectives and different emphasis on asset classes such as stocks and bonds.

4.3 Investments in non-Canadian assets

A third issue is that funds are likely to differ in whether they predominantly invest in Canadian versus US stocks. To explore this issue, the Cumming report could include separate Canadian and US market risk factors and, perhaps, also use separate US and Canadian size, value, and momentum factors. To the extent that the US and Canadian investment markets are not fully integrated, the results could well change.

Whether-and by how much–individual funds are exposed to foreign currency risk could also matter to the results. This point could be explored by including a currency risk factor (e.g., the strength of the US versus Canadian dollar). Exposure to a commodity risk factor is another point that could be considered.

4.4 Net flows and alpha estimates

Table 2 provides summary statistics on net flows and alphas. Among the funds that cannot be bought directly from a fund company, the report finds evidence (Panel A) of higher average flows into funds that have a higher trading expense ratio, a higher maximum initial trailer, and higher deferred sales charges. Such effects appear to be absent for funds that can be purchased directly (Panel B).

Interestingly, there is also evidence that funds that cannot be bought directly and that were sold with the no-load purchase option produce significantly higher alphas (on the order of 0.4%) than other indirectly-sold funds. Again, no similar effect is identified for the directly sold funds.

Comparing the alphas for funds that cannot be purchased directly from the fund manager (Panel A) to the alphas for funds that can be purchased directly (Panel B), the average alpha appears to be higher in the former group. Although this comparison does not control for other differences among the funds, this is nevertheless a surprising finding which seems to run counter to the notion that indirectly purchased funds are bought by less sophisticated investors with less of an ability to monitor risk-adjusted performance.

4.5 The effect of permanent shifts in trailer fees

Section 3.3 in the Cumming report explores the effect on risk-adjusted performance of a permanent change in trailer fees. Comparing the risk-adjusted returns for the set of affected funds prior to a rise in the trailer fee (using a six-month window) to their performance after the change (using a 24-month window), the report estimates that, on average, the alphas for these funds dropped from 0.45 to 0.30, i.e., by 15 basis points per year–a drop of one-third. The results of this analysis are shown in Figure 1.

It is not clear why the report uses a six-month pre-change estimation window but a 24-month post-change window. What considerations brought the authors to choose these values? Also, assuming that the report continues to estimate alphas using a twelve-month trailing window, the first 11 alpha estimates after the fee change will use data from the period prior to the change date. This will presumably contaminate the post-change alpha estimates. Moreover, it leads to serial dependence between the pre- and post-break alpha estimates which will affect the t-statistic reported in the bottom part of Figure 1. The report would benefit from explaining how these effects are addressed.

5 Flow-performance regressions

Having estimated alphas as a measure of the funds' risk-adjusted performance, the Cumming report next turns to the relation between flows and performance. Specifically, the report uses panel regressions to quantify the flow-performance relation while controlling for the effect of a variety of covariates. The regression specifications take the form

$$Flow_{it+1} = c_i + \beta_1 \hat{\alpha}_{it} + \beta_2 \hat{\alpha}_{it}^2 + \beta_3 DPur_{it} + \beta_4 DPur_{it} \hat{\alpha}_{it} + \beta_5 Controls_{it} + \varepsilon_{it}, \tag{2}$$

where $DPur_{it}$ is a zero-one purchase option dummy. $Flow_{it+1}$ is the total monthly (net) flow, i.e., inflows minus outflows, scaled by initial assets under management.

Table 3 reports results from estimating the model in (2). Among funds that cannot be purchased directly from the fund company, funds with deferred sales charges experienced lower inflows than funds without such charges. Panel A also shows that higher past performance (a higher value of $\hat{\alpha}_{it}$) is associated with higher future flows: Increasing the alpha estimate by one standard deviation leads to a roughly 10% increase in future inflows (β_1) for funds that cannot be purchased directly. However, the magnitude of this estimate, albeit highly statistically significant, varies considerably across different models, ranging from 4.2% to 16.7%. Moreover, it is calculated off a low base as the average monthly flow during the sample is low. In absolute terms, the effect seems to be small. The results in the report would be clearer if they discussed the absolute magnitude of the estimated effects.

The effect of alpha on future flows is stronger for funds that can be purchased directly (models 6 and 7), consistent with stronger performance sensitivity among funds that are likely to attract the most sophisticated investors.

A concern with the specification in (2) is that the flow-performance relation is estimated using one-month flows which is a very short period. It is not clear how much of the flow-performance effect carries over to subsequent months. It is important to explore if alphas estimated over a very short period (12 months) have predictive power over flows over a longer period such as one year. Results along these lines would allow the reader to tell the difference between investors displaying return-chasing behavior versus alternative explanations of the findings.

5.1 Convexity of the flow-performance relation

The performance-flow relation in equation (2) appears to be convex (i.e., β_2 is significantly positive in (2)) for the funds that can be purchased directly from the fund company. Conversely, there is no significant evidence of convexity for the funds that cannot be purchased directly from the fund company.

It would be interesting to see if the convexity in the fund-performance relation holds among both stock and bond funds that can be purchased directly. For example, in a recent paper, Goldstein, Jiang and Ng (2016) find that flows into equity funds are convex in past performance–with greater sensitivity to past outperformance than to past underperformance. In contrast, flows to corporate bond funds exhibit *concavity* with greater sensitivity to prior underperformance than to prior outperformance.

5.2 Role of past flows and returns

Unlike some prior studies, the Cumming report does not include lagged flows among the list of covariates. For example, Del Guercio and Reuter (2014) use the regression specification

$$Flow_{it+1} = \beta_1 Flow_{it} + \beta_2 \hat{\alpha}_{it} + \beta_3 r_{it} + \beta_4 Controls_i + \varepsilon_{it}. \tag{3}$$

I think the Cumming report could benefit from exploring the effect of including lagged flows in (2). Including lagged flows could soak up some of the unobserved cross-sectional heterogeneity that affects fund flows and so might lead to more robust results. It would also provide insights into the dynamics of how past performance affects flows over time.

Throughout the analysis the Cumming report uses past alpha to measure risk-adjusted performance. This choice is in line with other studies in the finance literature. However, it would be valuable to also present results that use simple returns, r_{it}, instead of alpha estimates in the flow-performance regressions. There are two reasons for this. First, including r_{it} in the flow-performance regression and comparing the estimates of the β_2 and β_3 coefficients might reveal whether investors base their flow decisions on risk-adjusted performance (high β_2) or on raw return performance (high β_3). One would expect to find a higher β_2 among the more sophisticated investors and a higher value of β_3 among the less sophisticated investors.

Second, it is a challenge to accurately estimate alphas, whereas returns (perhaps measured relative to a simple asset-class specific benchmark) are simpler to measure. Third, while investors should be concerned with risk-adjusted returns if they are adding a mutual fund to a larger, diversified portfolio, for those investors who are concentrating all of their financial investments in a single fund, using total returns could be more appropriate. For these investors, the fee charged by the fund to provide exposure to different risk factors is important.

5.3 Results for funds that exclude fee-based purchase

Turning to the subset of funds that rule out fee-based purchase options, the report estimates the following flow-performance model

$$
\begin{aligned}
Flow_{it+1} \quad = \quad & c_i + \beta_1 \hat{\alpha}_{it} + \beta_2 \hat{\alpha}_{it}^2 + \beta_3 MER_{it} + \beta_4 MER_{it} \hat{\alpha}_{it} + \\
& \beta_5 \hat{\alpha}_{it}^2 MER_{it} + \beta_6 TrailerFee_{it} + \beta_7 \hat{\alpha}_{it} TrailerFee_{it} + \\
& \beta_8 \hat{\alpha}_{it}^2 TrailerFee_{it} + \beta_9 OtherFees_{it} + \beta_{10} \hat{\alpha}_{it} OtherFees_{it} \\
& + \beta_{11} Controls_{it} + \varepsilon_{it}. \qquad (4)
\end{aligned}
$$

For funds that cannot be purchased directly, a higher value of the lagged alpha is associated with a positive increase in flows although the effect is small and not always statistically significant (Table 4, Panel A). Among these funds there is also some evidence of convexity in the performance-flow relationship, as captured by the β_2 coefficient. In total, the report finds that a one standard deviation increase in past alpha is associated with an increase in next-month flows of nearly 19%, measured relative to the average monthly flow.

Scaling the coefficient estimates in this manner is not the best way to report the results in my view. For example, as is clear from Table 4, Panel A, model 6, the calculation of the effect of a one standard deviation increase in trailer fees (1.283) times the coefficient estimate for the trailer fee (0.00208) and the average alpha (0.243) is only 0.0006. This is a small effect in economic terms even though it represents 15.4% of the alpha effect for the same model without an interaction term (0.0042). Since the alpha estimate is already surrounded by considerable uncertainty and is not even statistically significant at the 5% level, scaling the estimated effect of an increase in trailer fees by a small and uncertain number only adds uncertainty to how the results are reported.

5.4 Generated regressor bias in estimated effect of alpha

The measure of funds' risk-adjusted performance, α_i, that is used in the Cumming report is unobservable and so must be estimated. This introduces estimation error and creates a so-called generated regressor problem which can bias the estimate of the flow-performance slope in (2). Moreover, the error from estimating α_i at some point, e.g. $t = 2012:12$, will be highly (serially) correlated with the error in estimates of α_i in neighboring months, e.g. for $t = 2012:11$. 12-month rolling-window estimates of alpha for two neighboring months have an overlap of 11 months and so the estimation error in $\hat{\alpha}_{it}$ will be highly persistent. Put differently: even if α_i is truly zero, 12-month rolling window estimates of α_i will be highly persistent.

Such persistence could potentially lead future flows to become spuriously correlated with lagged alpha estimates due to co-persistence in the dependent (flows) and independent (12-month rolling alpha estimate) variable. Moreover, this issue will be further exacerbated when using a 36-month rolling estimation window which leads to even greater persistence in the estimation error of α_i.

The analysis in Hjalmarsson (2004) suggests that persistent regressors do not cause problems for inference in panel data estimation when they are exogenous. The exogeneity condition is unlikely to hold in the context of the current analysis, however, as past flows and past alphas are likely to be correlated.

Hjalmarsson's analysis suggests that, in panel regressions with fixed effects, the coefficient estimates of highly persistent regressors can be biased. The report would benefit from discussing the extent to which these estimation issues should be of concern.

5.5 Purchase option dummies

The panel regression analysis is performed using purchase option dummies in regressions such as (2). This approach allows the Cumming report to focus on how different purchase options affect the flow intercept (estimated through β_3) and the flow-performance slope (estimated through β_4). For example, the flow-performance sensitivity for a particular purchase option, measured relative to the equivalent sensitivity without this option, is $(\beta_1 + \beta_4)$. Negative estimates of β_4 therefore suggest less sensitivity of flows with respect to prior alpha performance and, hence, a weaker incentive for the fund manager to generate high risk-adjusted performance.

Negative estimates of β_4 are therefore interpreted as evidence that flows are not as sensitive to prior performance for funds purchased under a particular option. However, it should be recalled that the total effect on flows from different purchase options get scaled by the alpha estimate $\hat{\alpha}_{it}$ and thus is equal to $(\beta_1 + \beta_4)\hat{\alpha}_{it}$. If the average alpha estimate, $\hat{\alpha}_{it}$, is not the same for funds that can be purchased directly from the fund management company versus funds that can be purchased in this manner, it becomes less straightforward to interpret the results.

6 Future performance regressions

The Cumming report finds that the flow-performance relation is flatter for funds sold with purchase options that appeal most to less sophisticated investors.

To explore whether funds with higher flow-past performance sensitivity produce better *future* risk-adjusted investment performance, the Cumming report estimates regressions of the form

$$\hat{\alpha}_{it+1} = c + \beta_1 FPintercept_{it-11} + \beta_2 FPslope_{it-11} + \varepsilon_{it+1}, \tag{5}$$

where $FPintercept_{it-11}$ and $FPslope_{it-11}$ are estimates of the flow-performance intercept and flow-performance slope for fund i based on data available at time $t-11$. To avoid overlaps with how the dependent variable, $\hat{\alpha}_{it+1}$, is constructed the authors lag the covariates on the right side of (5) by 12 months.

The mechanism explored in (5) is that purchase options affect the flow-performance intercept and flow-performance slope which, in turn, affect the future alpha if β_1 and β_2 are different from zero.

Empirically, for funds that cannot be directly purchased from the fund company, the Cumming report finds (Table 5, Panel A) a negative estimate of β_1, indicating that a higher flow-performance intercept is associated with a lower future alpha. The report writes "The economic significance is such that a 1-standard deviation increase in the flow-performance intercept is associated with a 2.22% (Model 3) to 3.87% (Model 1) decrease in future alpha, *relative to the average monthly alpha in the data*." (my emphasis). This result suggests lower future alpha performance for funds populated by investors whose flows are not very sensitive to prior risk-adjusted performance.

If I understand the above statement correctly, the effect of changing the flow-performance standard intercept by one deviation is to reduce the future alpha by a proportionality factor (1-0.022) (Model 3) or (1-0.0387) (Model 1). Since alphas are already quite small (see Table 1), this would appear to represent a very small economic effect.

Moreover, the explanatory power of the alpha regression in (5) is very low so it seems that only a very small part of the variation in alphas can be explained by differences in the intercept and slope of the flow-performance relation. It would have been natural to include the properly lagged alpha estimate, $\hat{\alpha}_{it-11}$, in the regression. If nothing else, this would soak up more of the variation in $\hat{\alpha}_{it+1}$ and so could lead to more precise parameter estimates in (5).

Again, it would be interesting to see results for alpha estimates computed net-of-fees. In the absence of such results it is hard to say anything conclusive about potential conflicts of interest for funds that can be purchased directly. Suppose, for example, that funds populated with more attentive and sophisticated investors generate higher (gross) alphas, but also charge higher fees so that, net of fees, the performance is no higher for these funds than for others. This would change the interpretation of the results.

For funds that can be purchased directly, the report finds a positive association between the flow-performance intercept and future alpha. It is not clear to me that it follows from this evidence that there is a lack of conflict of interest for these funds (page 50). The positive coefficient on the flow-performance intercept (β_1) would seem to imply that funds with particularly large outflows regardless of performance (large negative value of $FPintercept$) go on to produce negative alphas. The report argues that "This evidence means that when investing directly, investors are sensitive to fees: when a fund charges more, investors are less likely to invest and invest less." But why should such outflows correlate with future alpha performance?

Turning to the effect of the flow-performance slope on future alpha, the Cumming report finds a highly positively estimate of β_2 regardless of whether the funds can or cannot be purchased directly (Table 5, Panel A). This is as expected if a higher flow-performance sensitivity gives funds a stronger incentive to produce good investment performance. For funds that cannot be purchased directly, the report estimates that a one-standard deviation increase in the flow-performance slope leads to a 5% increase in the future alpha. Assuming that this is again measured relative to the average alpha, the effect does not appear to be very large in economic terms. A qualitatively similar finding is reported for funds that can be purchased directly, i.e., a higher flow-performance slope is associated with a higher future alpha estimate. However, the estimates of β_2 in (5) are notably smaller in magnitude for funds that can be directly purchased compared to funds that cannot be purchased directly. This holds for both standalone funds (Table 5, Panel A) and for fund-of-funds (Panel B), and is even more pronounced for the latter.

6.1 Omitted variables

The specification in (5) is very simple. One concern is that it does not include other fund characteristics that have been associated with future risk-adjusted performance such as fund size, fund family size, fund age, or fund flows–all traits found to be significantly correlated with risk-adjusted performance by Ferreira et al. (2013).

Omitting such variables could mean that the regression suffers from omitted variable bias, making the results difficult to interpret. Indeed, including affiliated dealer inflows-outflows, as the authors do in Table 6, reduces the coefficient on the flow slope in model 5 from 2.935 to 1.562 and from 1.367 to 0.169 in model 6. The authors argue that this variable is a proxy for the magnitude of the conflict of interest between investors and managers, but the results also indicate that the estimates in Table 5 can be sensitive to the inclusion of other variables and so should be interpreted with caution.

7 Summary

The analysis in the Cumming report could benefit from pursuing a number of points laid out in the above analysis. Specifically,

- A key hypothesis of the report is that for funds with those purchase options that attract the least sophisticated investors, the less sensitive flows are to risk-adjusted performance, and the higher the scope for conflicts. If this is the case, the report would benefit from presenting more evidence that there is a close mapping between investor sophistication and specific purchase options. Can the different purchase options be ranked according to the total cost charged to the investor, or is there too much heterogeneity within each purchase option to make such a comparison possible across different purchase options?

- Since the report is concerned with the potential welfare implications arising from conflicts of interest between retail investors and the intermediaries handling their money, it is important to present calculations showing estimates of the economic effects of different purchase options. Specifically, what is the estimated reduction in investment performance associated with higher trailer fees or various charges in basis points per year? How large are the effects both gross and net of fees? Moreover, aggregating the estimates across all funds invested in different purchase options will faciliate an estimate of the total (aggregate) effect.

- The report uses a simple measure of investment performance–risk-adjusted return, or alpha–that is subject to estimation error. A number of robustness tests should be conducted to address weaknesses in the estimation of alphas, particularly the extent to which the present estimation procedure accurately captures risk for funds focusing on asset classes other than (North American) stocks.

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June 9, 2017

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Re: Canadian Securities Administrators Consultation Paper 81-408
Consultation on the Option of Discontinuing Embedded Commissions

Portfolio Strategies Corporation ("PSC") is a Calgary-based dealer that is a member of the Mutual Fund Dealers Association of Canada and registered as a mutual fund dealer and exempt market dealer in Alberta, British Columbia, Saskatchewan, Manitoba, Ontario, and Québec, and as an investment fund manager in Alberta and Ontario.

We appreciate the opportunity to provide comments on the CSA's Consultation Paper 81-408 (the "Consultation Paper"). Below we provide our overall comments followed by our responses to the 36 questions posed in the Consultation Paper.

Questions from the Consultation Paper

1. Do you agree with the issues described in this Part? Why or why not?

Overall, we do not agree with the issues described in Part 2. Specifically:

- There is an implication throughout that investors would pay lower fees if there were no embedded commissions. However, that implication rests on the assumption that individual investors will be able to negotiate a fee directly with their financial advisor that is lower than the embedded trailing commission. The information asymmetry that exists with respect to the current variety of fee options will also exist during one-on-one fee negotiations, since few clients will have an objective basis to assess whether the fee rate offered to them is high, low, or "just right". In addition, most people are simply not good negotiators who try to avoid "haggling", and in many other aspects of their lives pay whatever price is offered. At present, trailing commissions are quite standardized across the mutual fund industry for a given type of fund, which gives investors assurance that they are not paying excessive fees.

- The suggestion that fund managers are focused on embedded commissions to the detriment of fund performance does not accord with basis economic or business sense. Financial advisors typically are, and seek to be, in long-term relationships with their clients. A financial advisor who recommends a poorly-performing fund with the goal of receiving a trailing commission of, for example, 0.10% more than a better-performing alternate fund risks losing many years of revenue from clients who are disgruntled due to the poor performance and leaves for another advisor. For that reason, there have been many funds, and even some fund families, that paid average or above-average sales and trailing commissions but nonetheless no longer exist because the fund performance was below-average and advisors moved their clients to better funds. Footnote 96 is entirely speculative, since there is a long history of financial advisors moving clients away from poorly-performing funds.

- The Canadian Securities Administrators ("CSA") have significantly increased the amount and types of disclosure about mutual funds in the past three decades, including about costs and compensation, but the Consultation Paper notes in passing that those disclosures have not improved investors' awareness or understanding of the nature, types, or amounts of fees related to their investments in mutual funds. Client relationship model ("CRM2") amendments to *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* came into force in 2016 that require detailed disclosure of all types of compensation that registrants receive related to each investor. The Consultation Paper similarly notes that these additional disclosures are not expected to address the CSA's concerns. Despite the significant costs that the industry has incurred to meet the CSA's ever-changing disclosure requirements, the CSA itself does not appear to believe that additional disclosure has achieved much. There is little reason to believe that the additional disclosure to clients in the form of seeing unembedded fee amounts on their statements will achieve a different result.

2. *Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.*

We do not agree with the assumption that there are significant issues or harms to investors due to embedded commissions. Without embedded commissions, advisors won't be paid for ongoing service such as KYC updates which are required in order to provide appropriate advice but which client's don't see as a benefit.

3. *Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.*

Embedded commissions, particularly trailing commissions, are more efficient because they can be calculated and managed on a large scale by the fund companies. It is more time-consuming – and therefore more costly – for a dealer to perform the fee calculations and deductions at an individual account level. As the Consultation Paper notes, fee-based accounts are typically only offered for larger clients. This is due to the overhead involved and will necessarily limit fee-based options to larger accounts. Also, due to the overhead involved, preventing embedded commissions and requiring dealers to offer fee-based accounts will increase the cost and risk of starting a new dealer, which will limit competition and further limit access to advice for smaller investors.

Unlike institutional money management where advisory services are provided at a generally consistent rate over the lifetime of the engagement, a significant proportion of the services that a retail client receives may be at the outset of the relationship. These services include debt management advice, cash management advice, estate planning, tax planning, retirement planning, and general financial planning, in addition to investment advice. It is commercially reasonable for a financial advisor to be paid for these services when they are provided. Many small- to medium-sized clients primarily hold their investment assets within registered plans, which cannot be accessed to pay for service. Embedded DSC sales commissions provide a mechanism for the financial advisor to be paid without the client having to incur taxes on withdrawals from registered plans or a reduction of their invested capital. Without this mechanism, there will be significantly less incentive for financial advisors to provide comprehensive service and advice to small- to medium-sized clients.

Embedded compensation is the only way that small investors will be able to access advice. For example, it takes most advisors one hour to go through the account opening paperwork for a new plan, including explaining all disclosures to the client, and then a further hour to discuss various investment options before a decision can be made. For an experienced advisor earning \$150 to \$200 per hour, the CSA should recognize that a client with a \$2,500 RESP will not be willing to pay \$300 to \$400 for the service involved in opening an account, nor would the CSA find this acceptable.

It is widely recognized that the industry needs new advisors due to an aging advisor population. New advisors cannot afford to perform substantial work for a negotiated fee or an hourly rate that may go unpaid.

4. *For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:*

    - *mutual fund*

- *non-redeemable investment fund*
- *structured note*

should the product be subject to the discontinuation of embedded commissions? If not:

a. *What would be the policy rationale for excluding it?*
b. *What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?*

We do not agree with discontinuing embedded commissions for any type of products.

If the CSA are genuinely concerned about regulatory arbitrage, we believe that they should be taking a public position to remove the exemptions in securities legislation that allow segregated funds to be distributed outside the securities regulatory regime. In our experience, there is no meaningful regulation of segregated funds at the retail level, which exposes investors in segregated funds to unsuitable investments, unsuitable leveraging, and commission-driven churning. Insurance regulators have resisted making changes that would create a more level playing field with mutual funds or that would reduce arbitrage opportunities, and there is no reason to believe that any such changes will happen in the future.

The exempt market does not lend itself to fee-based, direct pay, or billable hours relationships. These products are often higher risk, start-up, venture capital investments with no or limited liquidity in the start-up phase. If embedded commissions were discontinued for exempt market products, many small- to medium-sized businesses would never get created, many of which become successful public companies some years down the road.

5. *Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?*

As noted above, we do not agree with discontinuing embedded commissions for any type of products.

6. *Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?*

As noted above, we do not agree with discontinuing embedded commissions for any type of products.

Distribution channels that do not provide advice, such as discount brokers, should not be permitted to sell products that have embedded compensation.

Regulators may consider limiting embedded commissions to accounts below a certain dollar threshold.

7. *Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?*

For the reason set out elsewhere in our comments, we do not believe that the data presented by the CSA support discontinuation of all payments made by persons or companies other than the investor. It would be quite costly to implement a new direct billing system and this will necessarily increase end client fees.

8. *Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:*

    a. *the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;*
    b. *referral fees; and*
    c. *underwriting commissions*

    Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

We do not believe that these types of payments represent risks to investors. We therefore believe that these types of payments should continue to be allowed.

With respect to underwriting services, there are substantial costs in time, staffing, and legal searches, and the underwriting community can't possibly absorb those costs.

9. *If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?*

We are not aware of abuses of payments that are allowed by Part 5 of NI 81-105. We therefore do not believe that changes to the scope of these payments and benefits are warranted.

10. *With respect to internal transfer payments:*

    a. *How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third-party funds?*
    b. *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*
    c. *Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?*

We do not believe that NI 81-105 has been effective in creating a level playing field. As we have seen in numerous articles in the media in recent months, the sales incentive and compensation arrangements within integrated financial services providers has been subject to abuse to the detriment of investors and other clients. We believe that opaque compensation arrangements – the internal transfer payments – have likely contributed to the abuses. We therefore believe that internal transfer payments to dealers within integrated financial service providers should be required to be on a fully-disclosed basis and should be required to be made on the same basis as third-party compensation. Continuing to allow opaque or discretionary payments within integrated financial services providers will continue to favour dealers within that group – who are inherently conflicted by their investment fund manager relationships – over independent dealers. For example, many bank clients continue to believe that mutual funds at banks are "cheaper" because there are no explicit, disclosed commissions to other areas of the bank.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

Calculation and collection of fees at the dealer level is significantly less efficient than doing so at the fund or fund company level. Preventing investment fund managers from calculating, collecting, and remitting investors' payments to the dealer on the investor's behalf would limit the economical account size for dealers, especially for smaller dealers. Creating artificial barriers to entry and to profitability necessarily limits choice and competition. We therefore believe that investment fund managers should be allowed to calculate, collect, and remit investors' payments to dealers on the investor's behalf.

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

For the reasons set out in the response to question 1, we do not believe that discontinuation of embedded compensation arrangements would meaningfully address the three key investor protection and market efficiency issues.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

We do not agree with the issues described in Part 2, with respect to distribution channels that provide advice. We therefore do not believe that the CSA need to take alternate measures to address them either.

We believe that the CSA should prohibit embedded commissions in non-advisory distribution channels, such as discount brokers.

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

No.

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- *Will investors receive advice and financial services that are more aligned with the fees they pay?*
- *What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?*
- *Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?*
- *What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*
- *What effect will the proposal have on the cost and scope of advice provided to specific investor segments?*

In most respects, fee-based compensation within a client account that is calculated as a percentage of the assets in the account compared to embedded trailing commissions is a distinction without a difference. In each case the client is charged a fixed percentage of their account each month and the net effect on returns is unchanged whether the amount is deducted directly from their dealer account or from the net assets of the mutual fund. Unembedding fees is therefore unlikely to change the level of advice and service.

Further to the response to question 1, any assumption that investors will choose automated advice due to disclosure of unembedded fees in traditional accounts is contradicted by the CSA's finding that most investors aren't aware of their investment fees despite the copious disclosure given to them.

If the discretionary advice channel (portfolio managers) were interested in mass-market clients, there has been nothing to date stopping them from pursuing that segment. However, it is generally a more expensive relationship to service and maintain so portfolio managers do not pursue mass-market clients. From experience, it therefore is unlikely that eliminating embedded commissions would cause a shift to discretionary advice. If there were a shift, we believe that would be negative for most mutual fund clients because portfolio managers focus on investment management whereas the independent dealer channel generally focuses on broader financial planning as contemplated by CSA CP 33-404.

We recommend prohibiting embedded commissions in the discount broker channel. We recognize that transaction costs in that channel will rise when they aren't being cross-subsidized by embedded fees that were intended to compensate the dealer for advice.

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- *Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?*

As discussed in the response to question 3, much of the service for retail clients happens at the outset of the relationship. For large clients, financial advisors and dealers are more prepared to wait through the relationship to be compensated for the resources invested at the initial stage. For smaller clients, the payback from a fee-based account will take much longer. The result is that larger clients, as they are today, are more likely to be offered a fee-based account, but smaller clients are more likely to be asked to pay sales commissions or a direct financial planning fee at the outset of the relationship.

17. Do you think this proposal will lead to an advice gap? In particular:

- *Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.*

There is already an advice gap, as proved by the OSC's own "mystery shopper" exercise where the OSC found that financial advisors were not prepared to accept new clients in the "mass market" asset range. We are not clear why the OSC and other regulators continue to ask whether there is or will be an advice gap when their own research has proved that it already exists.

As with all regulatory proposals that increase the cost to service clients or that are intended to reduce revenues from servicing clients, less wealthy clients will be most affected as they become less profitable, or unprofitable, to service.

- *Do you agree with our definition of an advice gap?*

We would extend the definition proposed in the Consultation Paper – "the group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay" – to include investors for whom the direct cost of advice – without embedded commissions – is unreasonably high in relation to the amount of their investable assets.

- *Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?*

Regulators should distinguish between the type of advice and services provided face-to-face, which is generally more comprehensive, and advice given through other channels, which is generally limited to investment advice. Given the different type of advice and service offered by the different channels, the proposal may create greater gaps in the comprehensive face-to-face channel.

- *What types of advice or services currently provided today would be most affected by the proposal?*

Independent mutual fund dealers are typically focused on financial planning relationships with clients, as opposed to providing only investment management advice, and revenues from mutual funds pays for the financial planning. By limiting options, particularly by preventing DSC commissions from registered accounts, financial planning services will be limited for mass-market clients.

- *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*

The "targeted reforms" proposed by CSA CP 33-404 require significant expertise from financial advisors, and require a significant investment of time at the outset of a client relationship to deal with, for example, debt and cash-flow management planning for the client.

- *How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?*

We believe that embedded compensation remains a cost-effective method of mitigating the advice gap and therefore believe it should be allowed to continue.

- *Do you think that online advice could mitigate an advice gap? If so, how?*

Online advice may mitigate an advice gap to a small degree, but it is unlikely to provide more holistic financial advice, tailored to a client's needs, with respect to debt and cash-flow management, estate planning, tax planning, and matching broader life goals to the client's financial plan. Online advice only addresses the investment component, which is 10% to 20% of the service that a financial planner provides.

- *Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?*

No. Banks don't want small accounts either and are not structured to provide comprehensive financial advice, so the advice gap will continue to widen. We would again refer regulators to the results of the OSC's mystery shopper exercise.

18. *Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:*

    - *Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?*

Yes, but only for larger accounts of $250,000 and up. We believe that both fee-based options and compensation from embedded commissions have appropriate roles within the investment industry, but forcing a fee-only model will prevent clients who are not economically viable under that model from being able to access advice.

Many small- and medium-sized dealers can't afford to implement fee-based accounts which may result in reduced choices and reduced competition in the industry.

19. *How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:*

    - *Do you see payment options and business models evolving at present?*

Yes, larger accounts are moving to the fee-based model.

- *How are they likely to change over time if the CSA were to choose not to move forward with the proposal?*

The transition will continue for lower-cost negotiated fee accounts through the use of technology. It started well before this proposal was published.

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Fee-based accounts are more expensive for dealers to operate than accounts that are remunerated through embedded commissions, which is why they have typically only been offered to more affluent clients. The increased costs are from personnel, systems, and compliance with additional regulatory requirements. Mass market accounts with average value of $50,000 do not fit within this increased cost structure.

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- *Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?*

Yes, the proposal will cause further industry consolidation because smaller firms do not have the systems, personnel, and capital to compete. The result will be further concentration of mass-market investor assets managed by deposit-taker owned firms.

- *What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?*

It will have an anti-competitive effect. Further consolidation in the industry will reduce competition, which will ultimately allow larger market players to dictate higher fees and reduced product choice.

- *What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?*
  - *Independent dealers?*

Independent dealers don't have the scale to compete with banks in the low-fee, low-advice arena. Independent dealers can demonstrate differences in their planning services but need to be able to be paid.

  - *Independent fund manufacturers?*

Independent manufacturers may not have the staff and systems to calculate, collect, and remit fees.

  - *Integrated financial service providers?*

Integrated financial service providers will benefit from the proposal and move higher than their current 90% market share.

- *Mutual fund dealers?*

The proposal will increase costs with no corresponding increase in revenue which will hurt profitability and, for some independent firms, may hurt their economic viability.

- *IIROC dealers?*

IIROC dealers will gain market share because they already have platforms to operate fee-based accounts.

- *Online/discount brokers?*

Online and discount brokers will have to start charging, or will increase, account fees to recover the revenue they no longer receive from embedded fees.

- *What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?*

There is a high likelihood of regulatory arbitrage in favour of segregated funds due to the lack of regulation on them. This harms clients. We have observed this happening for a number of years and insurance regulators have not yet taken steps to address the problem.

- *What would be the impact on dually-licensed mutual fund dealers and insurance agents?*

The proposal will lead to a shift to segregated funds, which are more costly to investors.

- *Will the proposal lead new, lower-cost entrants to the market? Why and how?*

The proposal may encourage the use of robo-advisors but they do not provide the same range of services, which will further exacerbate the advice gap.

- *Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?*

No, as set out above.

- *Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?*

No, as fund managers will continue to feel pressure from regulators to offer discounted fees based on client account sizes in order to eliminate the risk of further fines from the CSA.

- *Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?*

Absolutely. They are, for example, able to recover the operating costs of their branch network from banking revenue.

- *What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?*

The effects are likely to be significant and negative. Again, the CSA is missing the point here. Planning is critical. Taxes are an investor's biggest cost, not the management expense ("MER") ratio. Tax mistakes can have a double-digit percentage negative effect on after-tax cash flow, whereas MER differences are likely to be under one percent.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- *Is there any specific operational or technological impact that we should take into consideration?*

Many smaller dealers, particularly in the MFDA channel, do not have systems that allow them to operate fee-based accounts. Systems can only deliver on this if dealers agree to pay for the information technology "build" and the maintenance of such systems.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- *Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?*
- *To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?*

We do not believe that a transition to direct pay arrangements would significantly change the need for controls and oversight. There have been many reported cases of dealers approving fee-based accounts that have cost the clients more than they would have paid in an account based on transaction fees, and where it was or should have been known from the client's account history that the fee-based option would cost more. A transition to direct pay or fee-based accounts is not a *panacea* for compliance since compliance will still have to assess and approve "reasonable fees" for accounts.

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

As noted in the answer to question 15, fee-based charges compared to embedded trailing commissions is largely a distinction without a difference from a client perspective. From a dealer perspective, fee-based accounts are more expensive to operate which could result in mass-market clients paying higher direct fees in a fee-based account than they pay in the form of embedded trailing commissions. For smaller dealers, eliminating trailing commissions will make smaller mass-market clients unprofitable without any opportunity to recover the revenue elsewhere, apart from increasing the fee rates.

25. *Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?*

We are not aware of other approaches that might be available.

26. *What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:*

- *career path;*
- *attractiveness of the job;*
- *typical profile of individuals attracted to the career;*
- *recruitment; and*
- *relative attractiveness of careers in competing financial service business lines?*

As in any industry, reduced compensation will make the industry less attractive and make recruiting more difficult, and the CSA's overall thrust is that investors should pay less for investment advice, but this is not about performance, MER, or alpha. The CSA should focus instead on getting advice out to the mass market. That will improve investor outcomes far more.

Many new entrants have relied, at least in part, on DSC commissions to earn enough money in their first one or two years in the business to cover the costs of the upfront financial, retirement, tax, and estate planning and risk management. By reducing the revenue stream, the industry will require new entrants who have sufficient savings to sustain themselves for longer periods. That will make it harder yet for younger individuals to enter the industry at the same time that the industry is suffering from aging. This could also lead to increased use of DSC segregated funds, or higher risk IPOs that still have embedded compensation, thus raising obvious conflicts of interest issues.

27. *How practicable are the mitigation measures discussed and how effective would these measures be at assuring:*

- *access to advice for investors,*

Small- to medium investors will not pay for advice explicitly. Having fund companies collect fees and remit them to dealers might work.

- *choice of payment arrangements for all investor segments, and*

Don't remove choices like embedded compensation. Hourly fees don't work and will only shut out small investors.

- *a level playing field amongst competing investment products?*

There will be no level playing field if the advice channel is forced down to the no-advice channel pricing. There are two separate playing fields – advice and no advice.

28. *What other measures should the CSA consider to mitigate the above unintended consequences?*

Allow "no planning" client accounts, or do-it-yourself accounts, at independent dealers with reduced suitability requirements, similar to discount brokers.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions?

Increased use of self-directed registered plans, and open nominee accounts, will lead to investors having to pay annual plan or trustee fees that they had not paid previously. These plan types are the only way that investors can access lower cost ETFs and government bonds. These are not, and will not, be available at client name mutual fund accounts.

In particular:

- *Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.*

Yes. The sale of investments to make investors' payments could lead to realized capital gains on securities that are in a "gain" position.

- *To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?*

Yes. Many consolidations could be deemed dispositions, leading to taxable capital gains with no associated cash flow to investors to pay the taxes.

- *What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?*

Mitigation of the tax problems is outside the jurisdiction of the CSA.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,

- *to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;*

While many advisors use such cross-subsidies in their practices, it is by their choice and not our firm's policy or strategy. The obvious consequence will be much higher fees to get good advice in the hands of lower-wealth investors.

- *does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and*

We note that in any profitable business, total fees must exceed the actual cost of services provided. This is the case in law firms, accounting firms, and all other professional service firms, apart from *pro bono* and "loss leader" engagements.

We do not believe in overcharging high net worth investors for such subsidies or delivering less service than they are entitled to.

- *what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?*

Continue to permit embedded compensation for accounts up to $500,000, which could be tracked by the annuitant's social insurance number.

31. *What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?*

We believe that the unintended consequences of the proposal will be pervasive and negative. We do not believe that there are any measures available that could mitigate those consequences.

32. *For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.*

- *Are there unique costs or challenges to specific businesses?*

Fund companies would have to build the calculation, collection, and remittance functions.

Client may not be open to paying new fees.

- *What transition period would be appropriate?*

A 36-month transition period should be sufficient. We like a percentage staged approach for difficult-to-reach clients who lack incentives to change.

- *Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?*

DSC and low-load schedules absolutely have to be maintained until the redemption schedule is completed. It is a loan repayment schedule that can't be shut off.

33. *Which transition option would you prefer? Why? Are there alternative transition options that we should consider?*

Options 1 and 2 could both work. We reiterate that this should only apply to accounts of $500,000 and up.

34. *As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?*

Yes. We believe that the CSA should reconsider its position with a view to caps being an ultimate solution rather than a transition option. A fee cap will level the playing field: if all equity funds offer the same DSC commission and the same trailing commission, compensation would not be a factor in advisors' fund recommendations.

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

- *address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and*

Yes. Disclosure is enough for investors to make sound choices. They should be able to choose to keep embedded compensation over direct pay, but embedded compensation could be limited to accounts under $500,000.

- *address or not address any additional harms or issues that you have identified.*

We have not identified any additional harms or issues.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

We do not agree with issues described in Part 2. We therefore do not believe that alternative options or measures are required to deal with them.

Concluding Comments and Observations

Now that we have addressed the questions posed by the CSA in Consultation Paper 81-408 we would like to bring your attention to our observations on the embedded Commission issue and some areas of concern.

There can be no doubt that **the majority of Canadian investors have expressed a desire to maintain choice** in how they pay for investment advice, financial, retirement, tax planning and risk management. The CSA has not clearly demonstrated why they feel that clients should no longer have a choice to pay for this advice through embedded commissions if they choose to do so. Further, clients have shown strong reluctance towards paying direct bill invoices for these services due to the unnecessary hassle factor, and may elect to skip paying for advice, thereby harming their ability to achieve their financial goals. And dealers and advisors are concerned about devoting their time on these services and risking the fact that their invoices go unpaid permanently, or they now have to operate a "collections department" to get paid for past services rendered. We draw these facts from actual investor interviews performed in very recent surveys by the Gandalf Group on behalf of AGF Investments, and by Blue Information Design Inc. and CRM2 Navigator on behalf of the Federation of Mutual Fund Dealers. In the UK RDR did not solve the obvious problems that they sought to fix. **The CSA should not be taking solutions to a problem in another country, and assume those solutions will work in our country, when we did not have those problems (such as the UK's pension pricing scandal, lack of transparency) in the first place.** The CSA paper acknowledges that while Sweden has serious concerns about the potential conflicts with embedded commissions they chose to strike a balance instead of an outright ban on embedded commissions. New Zealand decided AGAINST a ban on commissions. Singapore did not ban commissions either. Why is it that the CSA does not appear to give these countries' decisions more recognition when driving the CSA agenda? In the PriceMetrix 5th Annual Report "The State of Retail Wealth", their research has shown that in North America not only has there been a record increase in the percentage of fee-based accounts, there has been an increase in pricing. Also, in the article titled "Advisers accused of overcharging post RDR", written by Julia Faurschou in FT Adviser March 16, 2017 a UK firm stated that "under the commission regime the annual ongoing amount paid to advisors by fund managers was often around 0.5 per cent, but since 2013 advisors have had to charge an explicit fee with many opting for around 1 per cent". That has effectively doubled from the commission regime era. **Preservation of embedded commissions at current levels would prevent such increased costs for retail investors from occurring in such funds.**

We do agree that something should be done where embedded commissions for advice are paid to dealers that do not offer such advice. Rather than try to level the playing field perhaps the CSA needs to finally recognize that there are two distinct playing fields in Canada – the Advice Field and the No Advice Field. The CSA should be focused on better investor outcomes over the long term, allowing Canadians to enter retirement comfortably with sufficient savings – and the stats prove that advised clients invest and accumulate much more wealth when they work with a financial advisor. This was taken directly from the Appendix in the CSA paper. Any savings realized by knocking down advice fees or buying lower cost ETFs instead of actively managed mutual funds will pale in comparison to what sound advice will deliver for investors. Non-advised clients tend to be savers through the use of GICs, savings accounts etc. which won't meet the needs of retirees in a 1% world. This type of non-advised, risk averse saving (not investing) is a huge win for deposit taking institutions but generally quite bad for most investors. Banning embedded commissions will support an already dominant vertically integrated bank model. And there is a definite risk that regulatory arbitrage will occur – some advisors will shift client assets to segregated funds that will still offer embedded commissions. Until the Insurance Industry and CSA get together on this at the very same time, the CSA needs to be recognizing this risk. **We propose that the CSA leave embedded commissions in the advice channel for accounts up to $500,000 in value, and eliminate embedded commissions from the no advice channel. We have no issues with eliminating embedded commissions on accounts over $500,000. At that account size a negotiated fee account is now a viable option for dealers, advisors, and clients alike.**

The CSA paper seems to be overly focused on investor fees for investment advice, and desired better than average performance (that in the CSA's view will be an automatic benefit as a result of reduced fees) in the absence of any discussion on the value received for the financial, retirement, tax, estate planning and risk management that is offered in the advice channel. The CSA does not seem to realize that the majority of the embedded commission pays more for the critical planning component, with very little being paid for the investment advice. This major gap in the CSA's understanding of what embedded commissions are for completely undermines the value of the paper. Put another way, the independent dealer community could, if they chose to do so, offer a "no advice" account at a similarly low cost to what Robo advisors or other Fintech providers charge – which seems to be the CSA's solution for everything. Fintech does not replace valuable advice and it does not build trust or change bad investor behaviour. As an aside, when the Fair Dealing Model was tabled in January 2004 we had asked about offering an account solution for the Do It Yourself investor similar to what Bank Discount Brokers offer, with reduced compliance oversight and KYC update requirements. We were never given that opportunity to compete in this manner. The CSA repeatedly mentions the term “level playing field” but independent dealers are not even allowed on the field – to the delight of the bank owned dealers and discount brokers. The paper also makes vague references to potential conflicts of interest where volume based incentives may cause higher trailer fees to be paid to the advisor. I can tell you that in my thirty years as a licensed mutual fund salesperson I have never even heard of this being available from any mutual fund company, except perhaps at a captive distribution shop.

The CSA also seems to be very selective in the data that they refer to in support of the agenda to eliminate embedded commissions. They state that roughly 90% of mutual fund accounts are with banks and insurance companies, therefore the CSA does not acknowledge that an advice gap even exists. Is the CSA satisfied to have all investors end up at banks and insurance companies? The CSA has conveniently forgotten the results of the OSC’s mystery shopping exercise because the results don’t support the CSA’s argument in this paper. The research found that the mystery shoppers could not get any financial advisors to take their appointment when they declared investable assets of $25,000 and then $50,000. It wasn’t until they declared that they had $100,000 to invest that any financial advisors would agree to meet with them to review their planning needs and investment goals. So here are results that the CSA has in their possession but will ignore; this is not from a biased industry driven study. To further the CSA’s weak argument on the lack of an advice gap, they happily point to opinions of incredibly biased competitors to support this argument. The most egregious example of this is when the CSA points to the Robo advisor community and passive investment strategies as the solution to any possible advice gap. The CSA has completely missed the fact that there is very little to no advice provided by the Robo channel. Another example of selective messaging is when the CSA points to supportive comments from fee based Portfolio Management/Investment Counsel Firms. Of course, these groups will support a move to fee based relationships – it’s their business model. What the PMs and CSA fail to disclose is that the PM/IC firms often have minimum account requirements of $1 million or more, and sometimes $5 million. The vast majority of Canadian investors will never meet such minimum account size requirements, so why even mention these supportive comments when the average mutual fund dealer account is only $50,000 according to the newly released MFDA study. A further statement is made that mass market households do not own investment funds today so they would not be affected by a proposed discontinuance of embedded commissions. That is a misuse of data that shows the majority of investors are “savers” more than they are “investors”. Referring to the PriceMetrix 5th Annual Report again, the data shows that there was a reduction in the number of small households serviced by advisors. Similarly, advisors are targeting more attractive new clients (older clients who typically have higher assets and will yield more revenue). **The advice gap exists**.

Several CSA Members (OSC, ASC, BCSC at Regulatory Forums in particular) have repeatedly stated that they do not want to hear industry opinions or anecdotal evidence; they want fact based data. We draw the CSA’s attention to some outrageous opinions in this CSA paper that can’t possibly be supported by any data. For example, on page 87 the CSA states that Mutual fund managers of funds that pay embedded commissions (trailers) may stop trying to outperform. It reads "investment fund managers will continue to be incented to compete for sales on the basis of the compensation they pay dealers, reducing the likelihood that they will compete on the basis of performance and skill – potentially disadvantaging skilled fund managers who do not pay higher than standard trailing commissions or who do not pay any trailing commissions". What rubbish! Where is the CSA's data to support this statement? Chronic underperformers just won't keep their job, whether the parent fundco pays trailers or not, and no advisor would risk losing a client relationship over an underperforming, unskilled manager. We are in this for the long term because it takes a lot of work to convince a client to work with us at the outset. They can leave us with a stroke of the pen and there is nothing that we can do to stop them from moving. On page 107 and 115 in the Appendix the CSA pulls a ten-year old research opinion and a Globe and Mail article from 2013 that basically state that mutual fund companies add price complexity through ever expanding fund series "to maintain consumer ignorance on prices". I would like to see the facts that this conclusion was based on. I believe it would be safe to say that the fund companies are expanding the number of series to offer volume based pricing to appease regulatory initiatives from two years ago and to avoid regulatory fines where clients may have been entitled to discounted pricing but did not receive such discounts.

Other statements in the paper that require fact based data are where the paper states that if you eliminate embedded commission funds entirely the number of mutual funds will drop from 13,899 to 4,901 - a 65% decline and the conclusion, which is really more of a wildly optimistic guess, is that this will lead to surviving funds becoming much larger in size, which will lead to lower investor costs. We are unaware of any data in any jurisdiction that will support this optimistic theory. Using domestic examples, until very recently, the largest of bank sponsored Dividend Mutual funds had an MER that was almost identical to other Dividend funds at a fraction of their size – no volume discounts here! A follow up point that is made on the next page of the paper is that this radical change will lead to new, low cost entrants. What is that based on? I believe that the CSA paper has taken a Vanguard Executive's comments in a CSA interview some years ago completely out of context. He was asked why Vanguard had not brought their low cost mutual funds to Canada previously. He replied that Vanguard does not pay "platform fees" so they did not think they would be successful here, nor had Canada embraced fee based F class accounts at the time. Such "platform fees" are illegal in Canada, yet the CSA did not seem to know that or just grabbed a supportive soundbite to support their goal of fostering more competition amongst low cost funds or new entrants. So, in effect, there was no such "barrier to entry" as the CSA has stated. Fee based or F class funds were not that prevalent at the time, so Vanguard made the business decision not to be one of the first to try to roll this out.

On page 59 a statement is made that passive portfolios outperform actively managed portfolios, but the time frame used was selective to support this statement, and shockingly the CSA makes no mention of volatility or standard deviation that we are required by regulation to pay strict attention to when assessing suitability and risk tolerance for our clients. Here is another gem in this paper: negative alpha funds will disappear or adapt by focusing more on performance! Again, I have been in this industry for thirty years and I have never seen a portfolio manager that was not focused on performance for a given level of risk.

Thank you for the opportunity to provide our comments. We would be pleased to discuss our comments further if the CSA have any questions on our comments or would like further clarification of them.

Yours truly,

"Mark Kent"

Mark S. Kent, CFA
President & CEO

Mémoire du Mouvement Desjardins

Consultation 81-408 des ACVM sur l'option d'abandonner les commissions intégrées

Présenté à l'Autorité des marchés financiers
9 juin 2017

Desjardins

INCLUDES COMMENT LETTERS

Introduction

Avec un actif de plus de 260 milliards de dollars, le Mouvement Desjardins (Desjardins) est le 1er groupe financier coopératif au Canada et le 6e au monde. Pour répondre aux besoins diversifiés de ses 7 millions de membres et clients, particuliers comme entreprises, il offre une gamme complète de produits et services par l'entremise de son vaste réseau de points de service, de ses plateformes virtuelles et de ses filiales présentes à l'échelle canadienne. Il exerce ses activités dans les domaines suivants : Particuliers et Entreprises, Gestion de patrimoine, Assurance de personnes et Assurance de dommages.

Comptant sur les compétences de ses 48 000 employés et l'engagement de 4 600 dirigeants élus, Desjardins figure parmi les Employeurs de choix au Canada depuis plus de 5 années, selon *Aon Hewitt. A*u 5e rang des institutions bancaires les plus solides au monde et au 1er rang nord-américain du classement 2015 *World's 20 Strongest Banks* de l'agence financière Bloomberg, Desjardins affiche des ratios de capital et des cotes de crédit parmi les meilleurs de l'industrie.

Outre le réseau des caisses Desjardins, les filiales de Desjardins concernées par la présente consultation sont, Desjardins Cabinet de services financiers inc. (DCSF), Desjardins Société de placement inc. (DSP), Valeurs mobilières Desjardins inc. (VMD) et Desjardins Sécurité financière Investissements inc. (DSFI).

DCSF est un des plus importants courtiers en épargne collective au Canada. Ses quelque 7 500 conseillers font bénéficier nos membres et clients épargnants de leur expertise dans toutes les régions du Québec et de l'Ontario, et ce, peu importe leur profil socioéconomique. Au Québec, il offre également les services de plus de 1 000 planificateurs financiers.

DSP est le gestionnaire et promoteur des Fonds Desjardins et des Placements garantis liés aux marchés (PGLM). DSP, en tant que manufacturier, conçoit, développe et commercialise plus de 80 produits en portefeuilles et Fonds Desjardins ainsi que des PGLM pour des encours d'environ 46 milliards de dollars.

VMD est un courtier en placement de plein exercice inscrit auprès des autorités en valeurs mobilières de toutes les provinces et des territoires du Canada. Il compte plus de 300 conseillers en placement et ses actifs sous gestion s'élèvent à plus de 25 milliards de dollars.

DSFI est le réseau de courtage indépendant de Desjardins pour la distribution de fonds communs de placement. Faisant affaire au Québec et au Nouveau-Brunswick sous le nom SFL Placements, il exerce ses activités dans toutes les provinces et les territoires du Canada. DSFI compte 1 154 représentants de courtiers en épargne collective et ses actifs sous gestion s'élèvent à 12,8 milliards de dollars.

QUE PROPOSENT LES AUTORITÉS CANADIENNES EN VALEURS MOBILIÈRES ?

Dans le cadre de cette consultation, les Autorités canadiennes en valeurs mobilières (ACVM) proposent d'abandonner les commissions intégrées pour les remplacer par des mécanismes de rémunération directe pour la distribution de fonds d'investissement. Considérant l'ampleur des changements proposés, les ACVM sollicitent les commentaires de l'industrie.

À cet égard, Desjardins tient à souligner la qualité de la démarche de l'Autorité des marchés financiers (l'Autorité) pour favoriser le dialogue avec l'industrie. Les échanges qui ont eu cours depuis janvier ont sans aucun doute permis à l'Autorité d'obtenir de l'information qui sera précieuse pour la suite des choses.

Que sont les commissions intégrées?

Les commissions intégrées servent à rémunérer les courtiers pour la distribution des produits mentionnés précédemment. Comment cela fonctionne-t-il? Le gestionnaire du fonds d'investissement c'est-à-dire le manufacturier qui conçoit le produit prélève des « frais de gestion » à même l'actif du fonds. Ensuite, le gestionnaire du fonds d'investissement verse une partie de ces frais au courtier du client. C'est cette portion des frais de gestion que le courtier reçoit qui représente « la commission intégrée ». Ainsi, en proportion des unités du fonds qu'il détient, l'investisseur paie indirectement pour les services et les conseils qu'il reçoit aussi longtemps qu'il possède des parts du fonds.

Puisque la commission intégrée n'est pas facturée directement au client, mais prélevée dans les actifs du fonds par le gestionnaire de fonds d'investissement, les ACVM considèrent qu'il y a conflit d'intérêts, et ce, même si les frais sont expliqués par le courtier et divulgués par l'entremise de *l'Aperçu du fonds* et des relevés que reçoivent les investisseurs. Soulignons que depuis janvier 2017, suivant l'introduction complète des exigences du Modèle de relation client-conseiller 2 (MRCC2), les frais liés aux commissions intégrées ne sont plus seulement exprimés en pourcentage mais également en dollars.

Malgré l'introduction de ces nouvelles mesures de transparence, les ACVM semblent considérer que l'abandon des commissions intégrées et leur remplacement par un modèle de rémunération directe demeurent la seule option qui permettra :

- d'éliminer les conflits d'intérêts potentiels découlant d'une rémunération intégrée entre le gestionnaire de fonds d'investissement et le courtier et, par conséquent, les impacts potentiels sur les investisseurs;
- d'améliorer la connaissance, la compréhension et le contrôle des investisseurs sur la rémunération des courtiers offrant des fonds d'investissement;
- d'améliorer la concordance entre le prix payé par les investisseurs et le niveau de services-conseils qu'ils reçoivent en retour.

POSITION DU MOUVEMENT DESJARDINS

D'abord, soulignons que Desjardins reconnaît la légitimité des préoccupations évoquées précédemment et qu'il adhère pleinement aux objectifs des ACVM. Cependant, l'option proposée apparaît disproportionnée, voire trop risquée, considérant la qualité de l'encadrement en vigueur au Canada et l'expérience vécue à l'international. Néanmoins, Desjardins reconnaît qu'il serait approprié de procéder à des ajustements réglementaires en considération du point de vue des ACVM.

Les parties prenantes doivent profiter de cette consultation et de ce qu'elle provoque comme réflexion dans l'industrie pour déterminer les mesures additionnelles à prendre pour mieux encadrer les conflits d'intérêts, pour améliorer la connaissance et la compréhension des investisseurs sur la rémunération des courtiers et pour améliorer la concordance entre le prix payé par les investisseurs et le niveau de service qu'ils reçoivent en retour.

Considérant les avantages que procure le recours aux professionnels pour les investisseurs, la principale préoccupation de Desjardins porte sur l'accessibilité aux conseils. Elle s'appuie sur l'expérience de certaines juridictions, notamment le Royaume-Uni, où depuis l'imposition d'un modèle fondé sur la rémunération directe, les investisseurs ont de moins en moins recours aux services des professionnels pour les appuyer dans la gestion de leurs finances personnelles, ce qui, comme il est indiqué plus loin, peut avoir des conséquences importantes sur leur patrimoine financier.

Pour les investisseurs, les commissions intégrées sont moins complexes que les modes de rémunération directe. L'introduction de ces nouveaux modes où l'investisseur deviendrait partie prenante, en tout temps, de la détermination de la rémunération de son courtier et de la négociation des services entraînera plus de confusion que d'avantages. Une étude citée par les ACVM affirme que la plupart des investisseurs sont incapables de comprendre et d'évaluer les différentes formes de rémunération en vigueur dans le marché actuel (page 128 du Document de consultation 81-408 des ACVM). Ainsi, il est permis de croire que la multiplication de l'offre découlant d'un mode de rémunération directe accroîtrait l'asymétrie informationnelle entre l'investisseur et son courtier. Si dans le contexte actuel les investisseurs sont confus, comment peut-on espérer que la rémunération directe améliore leur compréhension?

Un mode de rémunération plus transparent

Les commissions intégrées constituent un mode de rémunération plus transparent que la rémunération directe parce qu'elles sont connues et accessibles dans un marché hautement concurrentiel. De plus, elles sont clairement divulguées dans le prospectus, dans *l'Aperçu du fonds* et, depuis l'implantation complète du MRCC2, dans le relevé de compte annuel destiné à l'investisseur. Par contre, un marché recourant à la rémunération directe exigerait, pour être fonctionnel, une implication importante des investisseurs qui devraient entrer en contact et négocier avec plusieurs courtiers.

Dans ce contexte, la rémunération directe serait négociée par le client selon des modalités établies par les courtiers. Il est certain que l'information serait peu accessible et l'offre très variée. Le client devrait donc s'investir pour essayer de négocier un bon prix. La rémunération directe risque d'entraîner une telle variété d'offres et de services qu'il en résulterait une forme d'opacité où les investisseurs seraient laissés à eux-mêmes. Qu'il s'agisse de petits ou de grands investisseurs, on les inviterait ainsi à magasiner des services chez plusieurs courtiers, mais sans avoir nécessairement les outils pour le faire. Considérant les défis existants en matière d'éducation financière, comment être certain que cela servirait réellement les investisseurs? Comment ne pas craindre que les investisseurs canadiens renoncent au conseil comme leurs homologues du Royaume-Uni ?

La finance comportementale

Pour Desjardins, la proposition des ACVM, bien que sensée au plan théorique, ne prend pas suffisamment en compte la psychologie des investisseurs, un facteur particulièrement important, notamment lorsque ces derniers sont moins « sophistiqués » ou lorsque l'économie fait des siennes.

Selon les experts en finance comportementale[1], la meilleure valeur ajoutée des conseillers est lorsque ceux-ci convainquent leurs clients de ne pas dévier de leur plan financier sous le coup des émotions. H. Kent Baker, professeur de finance et auteur de *Investor Behavior: The Psychology of Financial Planning and Investing* souligne que « les épargnants ne peuvent absorber toute l'information disponible et la plupart d'entre eux, même les plus rationnels, laissent leurs émotions teinter leur raisonnement. Ils ont un rationalisme limité et s'en remettent souvent à des raccourcis pour prendre des décisions. La finance comportementale aide à cerner les biais cognitifs et à définir des stratégies pour les éviter ».

Pour le formateur et conférencier Michel Villa, ayant récemment donné une conférence sur le sujet devant les membres de CFA Québec[2] : « Beaucoup de gens veulent prendre leur destinée en main tels les clients amateurs de courtage en ligne. Or, ces épargnants ne peuvent être laissés à eux-mêmes. La différence entre la performance d'une stratégie passive d'investissement et la performance, en général moindre, d'une gestion active, c'est l' " écart comportemental ". Ce sont les effets de cet écart que les conseillers peuvent atténuer. La valeur ajoutée d'un conseiller aujourd'hui, ce n'est pas tellement de donner des conseils sur la valeur optimale d'un portefeuille. Un robot-conseiller peut faire ce genre de travail. Là où un conseiller peut vraiment apporter une contribution marquante, c'est lors d'une panique sur les marchés. C'est à ce moment qu'il joue le rôle de guide comportemental et de guide émotionnel. Le conseiller empêche son client de s'écarter de son plan financier à long terme et de ses objectifs de placement. »

Une analyse récente de Dentons Canada LLP[3], s'ajoutant aux nombreuses autres sur la valeur du conseil dans le domaine financier, démontre que les investisseurs n'ayant pas de conseiller présentent une répartition d'actifs plus concentrée dans les produits moins risqués entraînant ainsi des rendements moins élevés. Cette même étude rapporte que le Conference Board du Canada a simulé l'impact économique sur le long terme d'un scénario selon lequel 10 % des Canadiens, actuellement sans conseiller, auraient obtenu des conseils et adopté les habitudes d'épargne des investisseurs conseillés. Les résultats après 5 ans sont probants : le PIB réel et le revenu réel disponible se seraient accrus, l'investissement dans les entreprises serait plus important et le rendement potentiel plus élevé à long terme, ce qui représenterait une augmentation permanente des revenus et des profits dans l'économie. Le niveau d'épargne net annuel des ménages en 2025 serait supérieur de 812 millions de dollars à celui de 2014, l'année de référence.

[1] Parmi ces spécialistes, mentionnons Daniel Kahneman, psychologue et économiste américano-israélien, professeur à l'université de Princeton et lauréat du Prix Nobel d'économie en 2002 pour ses travaux fondateurs sur la théorie des perspectives à la base de la finance comportementale (l'application de la psychologie à la finance) ainsi que H. Kent Baker, professeur à *l'American University* de Washington et l'un des principaux chercheurs et des auteurs les plus prolifiques en finance au cours des 50 dernières années selon *The Journal of Finance Literature*.

[2] Michel Villa, *Conférence intitulée : la finance comportementale, un atout majeur dans votre pratique*, 26 octobre 2016, Québec.

[3] *Financial Advice: A key enabler of individual thrift, wealth accumulation and economic growth. The New Paradigm of Financial Advice: New Technologies, New Regulations, New Business Models. Presentation by Pierre Lortie, Senior Business Advisor, Dentons Canada LLP, Toronto – March 30-31, 2017.*

Des expériences étrangères qui militent en faveur de la prudence

L'expérience du Royaume-Uni, présentée dans le document des ACVM, est riche en enseignement et confirme la préoccupation de Desjardins à l'effet que l'option proposée n'est pas une panacée et comporte des risques significatifs. Sans refaire la genèse de l'expérience du Royaume-Uni, qui est par ailleurs largement documentée, mentionnons que la décision d'aller de l'avant avec le *Retail Distribution Review* (RDR) en 2012 continue de susciter bien des préoccupations.

De 2011 à 2014, le nombre de conseillers inscrits chutait de 23 %. Dès la première phase d'examen des réformes issues du RDR, la *Financial Conduct Authority* (FCA) indiquait avoir remarqué une augmentation des coûts du conseil[4] et ajoutait que : « *there is little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing and able to take on more clients*[5] ». Bref, le nombre de professionnels a diminué du quart, ceux qui restent sont prêts à prendre plus de clients mais ces derniers ne sont pas au rendez-vous. Pourquoi ?

En 2015, « préoccupés par la carence en matière de conseils que pourraient connaître certains clients et par l'absence d'engagement à l'égard des services financiers, le *HM Treasury* (le HMT) et la FCA ont réalisé une étude intitulée *Financial Advice Market Review* (FAMR) accompagnée d'un document de consultation[6] », le HMT indique que les firmes qui offrent du conseil semblent davantage intéressées par les « *wealthier customers rather than the mass market*[7] ». Le document de consultation souligne également que : « *The FCA's product sales data suggests that the proportion of retail investment products (wich includes pensions, retirement income products, and investments) sold without advice has increased from around 40% in 2011/12 to around two thirds in 2014/15*[8] .»

Selon le HMT, ces changements découlent d'un appétit accru des investisseurs envers la technologie, d'une confiance accrue des investisseurs envers leurs capacités, d'une réduction de la confiance envers les professionnels et de l'augmentation des coûts du conseil. Selon Desjardins, c'est l'augmentation des coûts du conseil qui est à la source de ces changements. À partir du moment où les investisseurs considèrent les coûts trop élevés, comment se surprendre de les voir recourir à la technologie avec la conviction qu'ils n'ont plus besoin des conseils des professionnels ?

Quoiqu'il en soit, en mars 2016, le HMT publiait son rapport intitulé *Financial Advice Market Review – Final report* qui présente des éléments très importants à considérer dans le cadre de l'actuelle consultation. En ce qui concerne l'accès aux conseils, le rapport révèle que la prestation-conseil à honoraires « est un service coûteux qui n'offre pas toujours un bon rapport qualité-prix aux consommateurs, notamment ceux qui ont besoin d'aide pour l'investissement de sommes peu élevées ou qui ont des besoins plus simples. Il pourrait ne pas être viable pour les sociétés de servir cette clientèle [9]». Quant à la clientèle du marché de masse, elle est principalement servie par les institutions financières et les consommateurs qui seraient disposés à payer pour recevoir des conseils « sont découragés par les prix élevés ». Enfin, il y est indiqué que la proportion de sociétés qui n'acceptent que des portefeuilles de 100 000 livres et plus est passée de 13 % en 2013 à 32 % en 2015.

[4] Financial Conduct Authority, *Post-implementation review of the Retail Distribution Review-Phase 1*, december 2014, p.2.

[5] *Id.*, p.3.

[6] *Document de consultation 81-408 des ACVM – Consultation sur l'option d'abandonner les commissions intégrées*, janvier 2017, p. 156.

[7] HM Treasury, *Financial Advice Market Review,* octobre 2015, p. 15.

[8] Id.

[9] *Document de consultation 81-408 des ACVM – Consultation sur l'option d'abandonner les commissions intégrées*, janvier 2017, p. 156.

En fonction de ces constats, le HMT recommande de travailler sur l'offre de conseils abordables aux consommateurs et propose la mise en place d'un comité pour aider les sociétés à développer rapidement une prestation de conseils automatisée. Sur l'accessibilité aux conseils, il est proposé de travailler à l'élaboration d'incitatifs pour encourager les clients à demander des conseils et certaines recommandations visent à impliquer les employeurs dans le soutien de leur personnel en matière de finance[10]. Pour Desjardins, ce qui se dégage du Royaume-Uni, c'est que les autorités gouvernementales et réglementaires sont embêtées par les effets découlant de l'abolition des commissions intégrées et peinent à trouver des solutions.

Lorsqu'on observe les réformes internationales de divers pays, on constate que le Canada a déjà mis en place de nombreux éléments de ces réformes. Cependant, l'abolition des commissions intégrées ne s'avère pas une solution idéale pour plusieurs pays dont la Nouvelle-Zélande, l'Allemagne, Singapour, la Suède et plus récemment, l'Afrique du Sud.

La Nouvelle-Zélande, qui envisageait d'interdire les commissions comme au Royaume-Uni, s'est récemment ravisée. Dans un rapport publié en juillet 2016, le MBIE (*Ministry of Business, Innovations & Employment*) a recommandé de se concentrer sur la conduite des personnes qui fournissent des conseils financiers plutôt que d'imposer une interdiction ou une restriction aux commissions. Il est plutôt d'avis qu'une interdiction de ces commissions pourrait limiter l'accès aux conseils financiers, surtout que les Néo-Zélandais se montrent déjà peu enclins à payer ce type de frais. Le MBIE indique que l'interdiction des commissions n'est pas une solution miracle qui améliorerait la qualité des conseils (*not a silver bullet that will improve the quality of advice*) puisque :

- les commissions elles-mêmes ne sont pas nuisibles. Elles sont un moyen de financer le coût de distribution de la chaîne de conseillers. Il y aurait un risque que l'interdiction des commissions en Nouvelle-Zélande limite davantage l'accès aux conseils;
- l'interdiction des commissions ne viserait pas directement la mauvaise conduite des conseillers, comme l'a souligné la FMA (*New Zealand Financial Market Authority*) lors de son récent examen du secteur de l'assurance;
- les mesures proposées concernant la conduite des conseillers représentent une approche plus prudente en première instance. Le MBIE et le FMA continueront de surveiller la conduite des conseillers afin de s'assurer que les mesures sont suffisantes. (Notre traduction)

À notre avis, les ACVM devraient s'inspirer de l'approche néo-zélandaise et travailler à poursuivre l'amélioration des nombreux outils réglementaires dont elles disposent actuellement.

Les conséquences anticipées

Plusieurs études ont mis en lumière des conséquences préoccupantes dans les pays ayant remplacé leur modèle de commissions intégrées par un modèle à honoraires :

- augmentation des coûts de détention des fonds d'investissement pour les investisseurs;
- plus grande complexité et moins grande transparence de la structure des coûts des fonds d'investissement pour les investisseurs (l'information serait beaucoup moins accessible);
- limitation de l'accès des petits investisseurs aux services-conseils.

[10] *Id.*

Selon Desjardins, l'élimination des commissions intégrées comporte plusieurs risques et effets potentiellement indésirables pour toutes les parties prenantes, investisseurs, distributeurs et gestionnaires de fonds d'investissement. Par exemple :

- l'équité entre les investisseurs sera compromise en raison de l'opacité que causera la rémunération directe. Alors qu'aujourd'hui les coûts sont connus et génèrent une compétition favorable aux investisseurs, ces derniers éprouveront de la difficulté à comparer les offres mais aussi à comprendre les structures tarifaires qui leur seront présentées;
- l'expérience du Royaume-Uni démontre que l'accès à toute la gamme des produits et services s'est détérioré, en particulier pour la catégorie d'investisseurs qui a le plus besoin de conseils, ceux dont les revenus et les actifs sont les plus faibles;
- les investisseurs seront réticents, voire refuseront de payer directement à la source et, conséquemment, devront gérer eux-mêmes leur portefeuille avec les risques que cela implique. Des personnalités québécoises tels Pierre Lortie et l'économiste Claude Montmarquette, ont démontré la grande valeur du conseil sur la constitution d'un patrimoine financier et se sont déclarés préoccupés par l'option proposée par les ACVM;
- nous anticipons une tendance marquée vers la consolidation avec la disparition de courtiers de plus petite taille (marché plus concentré et moins concurrentiel) et la diminution du nombre de courtiers (pertes d'emploi);
- un arbitrage réglementaire défavorable aux fonds d'investissement par rapport aux autres types de placement.

Les répercussions sur le réseau des caisses Desjardins

Il est difficile d'évaluer quantitativement les impacts de l'abolition des commissions intégrées dans l'industrie en général et au sein du réseau des caisses Desjardins en particulier.

Toutefois, l'abolition des commissions intégrées augmenterait assurément les coûts liés à la prestation de services auprès des clients car d'autres étapes s'ajouteraient à la démarche-conseil : la négociation de la rémunération du courtier par une rémunération directe, la gestion des liquidités pour le paiement des honoraires, la complétion de documents relatifs à l'entente découlant des négociations, etc. Pour le réseau des caisses Desjardins, cette négociation client par client apporterait une lourdeur administrative significative considérant ses quelque 550 000 investisseurs.

Desjardins s'appuie sur plus de 7 500 représentants en épargne collective répartis dans toutes les régions pour servir plus d'un demi-million d'investisseurs qui se situent en majorité dans le marché de masse, celui des 100 000 $ et moins d'actifs. Si les conséquences anticipées décrites ci-dessus se matérialisaient, il est plausible que des investisseurs délaissent leurs courtiers pour s'occuper eux-mêmes de leurs affaires. Dans ce cas, cela pourrait se traduire par des pertes d'emplois, par l'adoption de comportements sous-optimaux en matière d'épargne et par une pression accrue sur divers programmes gouvernementaux en soutien au développement économique et aux revenus des particuliers.

Les investisseurs de moins de 100 000 $ et l'accès aux conseils

Selon les ACVM, les investisseurs de 100 000 $ et moins représentent une proportion importante de la clientèle des courtiers canadiens. Tous ces détenteurs ayant moins de 100 000 $ ne désirent pas nécessairement, ou ne devraient pas, faute de connaissance, gérer leurs investissements, leur répartition d'actifs, leur projection de retraite ou encore leur planification des décaissements uniquement à l'aide de plateformes technologiques, sans contact et conseil humain.

La technologie peut être un facilitateur dans le processus, mais elle ne peut remplacer le conseiller. Une certaine unanimité règne à l'effet que les robots-conseillers font partie des outils à la disposition des investisseurs mais qu'ils ne devraient pas être les seuls véhicules accessibles, notamment lorsqu'on considère que le conseiller permet :

- d'avoir une meilleure confiance face aux marchés et d'éviter de vendre en panique lorsque les marchés ne sont pas favorables (malgré la très forte baisse des marchés en 2008-2009, les rachats de fonds au Mouvement Desjardins de 2007 à 2016 sont restés stables certainement grâce au travail des conseillers);
- d'acquérir une certaine discipline d'épargne en investissant de façon périodique et en considération des fluctuations des marchés;
- d'obtenir une allocation plus diversifiée de ses actifs et moins limitée aux titres sécuritaires qui offrent des performances plus faibles à long terme;
- de développer de bonnes habitudes d'épargne et d'améliorer ses connaissances financières.

Desjardins craint que l'abolition des commissions intégrées au Canada entraîne, comme au Royaume-Uni, une réduction de l'accès au conseil pour les petits investisseurs. Le recours aux robots-conseillers est certes intéressant mais ne constitue pas une panacée. Il faut plutôt les considérer comme faisant partie des outils auxquels les investisseurs pourront avoir recours selon les circonstances.

Desjardins réalise périodiquement divers sondages et études afin de mieux comprendre les comportements et habitudes de ses membres et clients ainsi que des consommateurs de services financiers en général. Selon des travaux réalisés en 2016 :

- seulement 34 % des Québécois disent avoir déjà acheté ou renouvelé un placement en ligne;
- seulement 17 % des investisseurs québécois disent utiliser fréquemment des outils d'aide à la décision sur Internet pour comparer des produits de placement;
- la très grande majorité de ceux qui transigent en ligne se qualifie plutôt comme « débutants »;
- à la question, confieriez-vous votre argent à des robots-conseillers, 80 % ont répondu n'en avoir jamais entendu parler et 52 % sont plutôt réfractaires à une telle offre. Les principaux freins exprimés sont :
  - la perte du contact humain,
  - le manque de confiance envers l'automatisation et les potentiels risques d'erreurs;
- exposés à 16 critères qui pourraient les influencer à investir auprès d'une institution financière plutôt qu'une autre, les investisseurs québécois considèrent les 3 critères suivants en priorité:
  - sécurité, exactitude et confidentialité,
  - réputation et solidité financière,
  - expertise et compétence du conseiller.

Bien que la génération X et les boomers utilisent de plus en plus Internet pour s'informer, mais aussi pour réaliser des transactions pour leurs placements, cela ne signifie pas pour autant qu'ils sont experts en matière d'investissement. C'est pourquoi, malgré les prévisions des ACVM dans le document de consultation, il est difficile d'imaginer que toute la clientèle du marché de masse migrera vers les services en ligne pour la gestion en mode autonome de leurs investissements. Il ne faut pas confondre le besoin d'autonomie pour une commodité transactionnelle avec le besoin d'accompagnement et de conseils personnalisés pour ses placements, ce que ne peut offrir un robot-conseiller, notamment en période de turbulence.

Un risque de concentration défavorable pour les investisseurs

Un argument qui milite en faveur de la prudence concerne les effets de l'abolition des commissions intégrées pour les courtiers indépendants. Puisque celles-ci constituent une source de revenus prévisible en cohérence avec leur modèle d'affaires, leur abolition, et le fardeau administratif additionnel qui en découlerait, pourrait conduire à une consolidation accrue des réseaux de distribution.

Si cela s'avérait, la diminution du nombre de courtiers sur le marché canadien réduirait la concurrence et se traduirait sans doute par une augmentation du coût des conseils pour les investisseurs. Dans tous les secteurs d'activité, une saine concurrence favorise la cohabitation de modèles d'affaires variés, alignés sur les préférences des consommateurs et à leur avantage.

Lors du dernier Colloque de conformité du Conseil des fonds d'investissement du Québec, un représentant de l'Autorité s'inquiétait de la consolidation au sein des gestionnaires canadiens de fonds d'investissement. Desjardins estime que l'option proposée par les ACVM contribuerait quant à elle à une consolidation des réseaux de distribution.

Un projet susceptible d'avoir des impacts sur les politiques publiques du Canada et des provinces

Au Canada comme ailleurs, les fonds d'investissement ont permis à bien des personnes d'investir indirectement dans des titres qu'elles ne pourraient acheter directement, notamment par manque de ressources ou parce qu'elles ne veulent pas prendre le risque d'investir dans un seul ou un nombre trop limité de titres. Ce type de produit a permis d'appuyer des milliers d'entreprises à la recherche de capitaux tout en permettant aux épargnants de se bâtir un patrimoine, d'assurer leur autonomie et leur sécurité financière. Qu'il s'agisse de participer au développement d'entreprises ou à la constitution d'un patrimoine, à chaque fois qu'un épargnant investit, ne serait-ce qu'un seul dollar, il contribue à préparer sa retraite et à réduire la pression sur les politiques publiques. Les ACVM ont certes la légitimité requise pour proposer et adopter des mesures réglementaires relevant de leurs responsabilités. Cependant, dans le cas particulier de l'option proposée, de ses impacts connus dans d'autres juridictions et des conséquences qu'elle pourrait avoir sur les politiques publiques, Desjardins considère que la prudence est de mise et que les autorités gouvernementales canadiennes devraient être consultées sur l'option proposée par les ACVM.

Dans une étude publiée en juin 2015, l'Institut du Québec, présidé par M. Raymond Bachand, indiquait à juste titre que : « L'importante croissance des fonds communs de placement, tant au Québec qu'au Canada, s'explique principalement par la transition généralisée des fonds de retraite à prestations déterminées vers les fonds de retraite à cotisations déterminées[11] » lesquels sont reconnus pour transférer le risque de l'employeur à l'employé.

L'Institut rajoute que : « L'importance qu'ont pris les régimes à cotisations déterminées a entraîné un déplacement des choix d'investissement des entreprises vers les épargnants, qui ont maintenant un rôle beaucoup plus grand à jouer dans la planification d'une retraite qui soit à la hauteur de leurs attentes. Or, une très grande majorité de travailleurs

[11] Institut du Québec, *Le secteur québécois des fonds communs de placement,* juin 2015, p. i.

ont une connaissance très limitée des différents instruments financiers, et ils se retrouvent souvent avec peu de points de repère en ce qui concerne les décisions optimales pour faire fructifier leurs avoirs.»[12]

Au Québec, sachant que près d'un travailleur sur deux est à l'emploi d'une entreprise qui n'offre aucun régime de retraite, la prudence s'impose encore davantage. Pour Desjardins, toute modification réglementaire susceptible de limiter l'accès aux conseils, notamment pour les plus vulnérables, ne ferait qu'accentuer la part de risque qu'ils supportent déjà et pourrait avoir des conséquences que les ACVM ne peuvent être seules à évaluer.

L'enjeu des conflits d'intérêts

Dans le document de consultation, les ACVM se disent préoccupées par les commissions intégrées puisque celles-ci donnent lieu à des conflits d'intérêts. Un conflit d'intérêts, qu'il soit potentiel, réel ou apparent, provient de l'intérêt divergent ou incompatible de différentes personnes. Peu importe la méthode de rémunération, c'est un phénomène inhérent à toute activité économique comme la prestation de services financiers incluant l'offre de fonds d'investissement. Ce qui importe, c'est de mitiger et de gérer les risques de conflits d'intérêts, notamment par la divulgation. Les institutions financières comme Desjardins y sont sensibles et c'est pourquoi elles ont établi, il y a plusieurs années déjà, un cadre de conduite pour prévenir, identifier, évaluer, atténuer et déclarer, le cas échéant, les situations de conflits d'intérêts réelles, potentielles ou apparentes.

Outre ces initiatives internes (politiques et procédures mises de l'avant par les institutions financières), la réglementation en valeurs mobilières encadre spécifiquement les conflits d'intérêts. En effet, l'article 13.4 du Règlement 31-103 sur les obligations et dispenses d'inscription et les obligations continues des personnes inscrites, la partie 5 du Règlement 81-107 sur le comité d'examen indépendant des fonds d'investissement, la règle 2.1.4 de l'ACFM, la règle 42 de l'OCRCVM ainsi que les articles 2 à 20 du Règlement sur la déontologie dans les disciplines de valeurs mobilières sont adéquats et suffisants pour résoudre les situations de conflits d'intérêts. La *Ligne directrice sur les saines pratiques commerciales* de l'Autorité qui s'applique aux coopératives de services financiers et aux assureurs s'inscrit également dans cette perspective en énonçant ses attentes à l'égard du traitement équitable des consommateurs.

La professeure Catherine Piché de la Faculté de droit de l'Université de Montréal indique dans son texte intitulé : *Définir, prévenir et sanctionner le conflit d'intérêts* que :

> Pour certains auteurs, la révélation (la divulgation) demeure problématique. Deux professeurs de la *University of Chicago Law School* ont étudié en 2009 l'impact de la révélation préalable d'un conflit d'intérêts par des conseillers financiers. Ils se sont demandé si la révélation n'avait pas pour effet de procurer une forme de licence morale d'agir par intérêt personnel, tout en renforçant les biais et préjugés et en préjudiciant les investisseurs concernés. Appuyant leurs conclusions sur des données empiriques découlant de questionnaires expérimentaux, ils ont su démontrer que la révélation n'est pas préjudiciable au client, et que la riposte idéale à envisager dans le cas de conflits d'intérêts financiers est probablement la combinaison de révélation et de la menace tangible de sanctions[13].

[12] Id., p. 6.
[13] Catherine Piché, *Définir, prévenir et sanctionner le conflit d'intérêt*, 2013, p.25

Desjardins considère que peu importe les moyens de rémunération utilisés, des conflits d'intérêts sont toujours possibles, mais ils sont tout à fait gérables grâce à la réglementation en vigueur et aux politiques internes mises en place. De plus, avec le MRCC2 et le nouveau régime d'information au moment de la souscription de titres d'OPC (*Aperçu du fonds*), les conseillers, les courtiers et les représentants de courtiers en épargne collective font déjà l'objet de nombreuses mesures implantées à cet effet. Soyons clairs, le Canada n'a pas à rougir de son régime de divulgation. Selon nos recherches, les investisseurs d'aucune autre juridiction de la planète ne peuvent compter sur les effets conjugués de l'*Aperçu du fonds* et du MRCC2. Cela ne veut pas pour autant dire que tout est parfait et qu'il ne reste plus rien à faire pour offrir aux investisseurs un environnement encore plus favorable.

Les ACVM devraient continuer de miser sur les relations client-conseiller

En 2012, dans le cadre d'une consultation concernant l'information sur les coûts, les rapports sur le rendement et le relevé de compte du client, les ACVM indiquaient ce qui suit :

> À l'étranger, certains organismes de réglementation s'apprêtent à interdire les modèles de rémunération qui comportent des commissions de suivi. Nous ne proposons rien de tel. Nous croyons que les investisseurs peuvent tirer parti des différents modèles de rémunération des courtiers. En revanche, il est impératif que les investisseurs bénéficient d'une plus grande transparence en ce qui a trait à la rémunération reçue par leurs courtiers ou conseillers. À notre avis, cela se traduit par de l'information complète, communiquée dès le début et compréhensible pour l'investisseur moyen.
>
> Les commissions de suivi servent à rémunérer les courtiers inscrits pour les conseils qu'ils donnent à leurs clients. Les intervenants de ce secteur estiment que ces conseils ont une valeur, et nous sommes d'accord avec eux. S'il est mis en œuvre, nous croyons que ce projet aidera les investisseurs à comprendre et à évaluer les coûts et les avantages des conseils qu'ils reçoivent et, ce faisant, que ceux-ci deviendront des consommateurs mieux avertis à cet égard. De son côté, le secteur bénéficiera d'une meilleure relation conseiller-client[14]. (Nos soulignés)

Près de cinq ans après leur publication, ces énoncés sont plus pertinents que jamais. La mention « à l'étranger » réfère au Royaume-Uni qui a banni le recours aux commissions intégrées l'année de la publication du document cité. Ainsi, il y a cinq ans, sans savoir ce que ces changements provoqueraient au Royaume-Uni, les ACVM misaient sur la diversité des modèles de rémunération et sur la divulgation. Aujourd'hui, alors que le Royaume-Uni cherche encore à renverser la vapeur pour redonner accès aux conseils, les ACVM misent sur le bannissement des commissions intégrées et doutent des bienfaits de la divulgation.

[14] Autorités canadiennes en valeurs mobilières, *Projet de règlement modifiant le règlement 31-103 sur les obligations et dispenses d'inscription et les obligations continues des personnes inscrites et Projet de modification de l'instruction générale relative au règlement 31-103 sur les obligations et dispenses d'inscription et les obligations continues des personnes inscrites*, 14 juin 2012.

Pour Desjardins, l'option proposée par les ACVM bouleverserait l'industrie et aurait des conséquences néfastes pour les épargnants aux revenus modestes et pour ceux qui sont à l'aube d'amorcer la constitution d'un patrimoine. Desjardins invite les ACVM à plus de prudence et d'ouverture sur les risques et les préoccupations anticipés par l'industrie et documentés par d'autres juridictions. La seule lecture de l'Annexe C du document de consultation suffit à convaincre de la délicatesse qui s'impose.

Desjardins propose plutôt d'améliorer encore davantage le régime de divulgation de manière à éliminer les conflits d'intérêts. De ces exigences accrues en matière de divulgation découlera l'obligation d'établir un dialogue plus soutenu ce qui contribuera à améliorer la connaissance, la compréhension et le contrôle des investisseurs sur la rémunération des courtiers offrant des fonds d'investissement. En étant mieux informés, les investisseurs seront mieux outillés pour évaluer la concordance entre le prix payé et le niveau de services-conseils qu'ils reçoivent en retour.

RECOMMANDATION N^{O} 1

Considérant que les régimes de retraite à prestations déterminées sont de plus en plus remplacés par des régimes à cotisations déterminées, faisant ainsi assumer les risques de marché aux travailleurs, et que près d'un travailleur sur deux est à l'emploi d'un employeur qui n'offre pas de régime de retraite, Desjardins estime que la prudence s'impose puisque toute modification réglementaire susceptible de limiter l'accès aux conseils, notamment pour les plus vulnérables, ne ferait qu'accentuer la part de risque qu'ils supportent déjà. Cela pourrait avoir des conséquences que les ACVM ne peuvent être seules à évaluer. Dans ce contexte, Desjardins recommande que les ACVM consultent les autorités gouvernementales canadiennes avant d'interdire les commissions intégrées.

RECOMMANDATION N^{O} 2

Desjardins recommande de ne pas interdire le recours aux commissions intégrées. L'évolution récente de la réglementation concernant les rapports sur les frais et le rendement dans le cadre du MRCC2 (Règlement 31-103) et *l'Aperçu du fonds* (Règlement 81-101) représentent des initiatives qui permettent déjà au Canada de se démarquer comme juridiction d'avant-garde sensible aux intérêts des investisseurs.

RECOMMANDATION N^{O} 3

Desjardins recommande que les ACVM, de concert avec l'industrie, évaluent de quelle manière les obligations relatives à la divulgation et à la conduite des conseillers envers leurs clients permettraient d'améliorer encore davantage l'encadrement de la distribution des fonds d'investissement.

RECOMMANDATION N^{O} 4

Desjardins recommande une meilleure supervision des contrôles en place pour la distribution et postdistribution des fonds d'investissement de façon à éviter que des commissions soient chargées au détriment des intérêts des clients et à encourager une plus grande transparence dans le secteur.

Parmi les suggestions d'amélioration, certaines font référence à des éléments de la Consultation 33-404 en faveur desquels Desjardins s'est déjà prononcé. Toutefois, nous considérons qu'une approche pancanadienne harmonisée est à favoriser.

Rehaussement des mesures visant spécifiquement l'encadrement des conflits d'intérêts liés à la rémunération :

- **Divulgation à la souscription** : Évaluer comment les exigences prévues à l'article 14.2.1 du Règlement 31-103 pourraient être rehaussées de manière à assurer une compréhension optimale de la part des investisseurs.

- **Traitement des plaintes** : Évaluer l'à-propos d'établir une obligation réglementaire relative au traitement accéléré des plaintes qui concernent la rémunération.

- **Supervision de la part du courtier** : Voir à établir un cadre qui permettrait au courtier de surveiller de près la rémunération des représentants pour s'assurer que les outils de rémunération disponibles ne soient pas utilisés au détriment de l'intérêt du client. Par exemple, ce cadre pourrait comprendre l'identification des cas d'opérations excessives aux fins de générer des commissions, l'établissement d'un taux de transfert interne dans des nouvelles structures de frais engendrant des commissions pour chaque représentant, l'identification des comptes avec un taux de commissions excessif et des représentants ayant un taux de commissions excessif.

- **Formation des employés responsables de la supervision** : Prévoir une obligation à l'effet que les employés responsables d'une telle supervision soient formés adéquatement et sur une base continue.

- **Formation des représentants - Conflits d'intérêts** : Prévoir une obligation à l'effet que les représentants devraient bénéficier d'une formation accrue pour devenir professionnels et sur une base continue portant sur les conflits d'intérêts engendrés par la rémunération et, le cas échéant, sur les obligations rehaussées s'y rapportant.

Rehaussement général du niveau de service eu égard à la transparence dans les représentations et à la compétence des représentants

- **Connaissance des produits par les représentants** : Prévoir une obligation pour les représentants de (i) comprendre la structure, les caractéristiques, la stratégie, les coûts et les risques de chaque produit qu'ils recommandent à leurs clients d'acheter ou de vendre et de (ii) comprendre l'incidence de tous les frais associés au produit, au compte du client et à la stratégie d'investissement.

- **Information sur la relation** : Introduire une obligation de préciser au client que le conseiller ne peut recommander que certains produits, selon sa catégorie d'inscription.

- **Titres professionnels et désignations** : Les titres professionnels utilisés par les représentants devraient être standardisés. Nous proposons que les gestionnaires de portefeuille et courtiers en placement agissant en vertu d'un mandat discrétionnaire soient appelés « gestionnaires de portefeuille » et nous sommes d'accord que ceux qui agissent sans mandat discrétionnaire soient appelés « conseillers en valeurs mobilières ». Afin de refléter la valeur du conseil et de la relation client-conseiller, l'utilisation du titre « conseiller en épargne collective » (*mutual fund advisor*, en anglais) devrait aussi être reconnue.

June 9, 2017

Every day I read articles about the embedded commissions and the apparent problems they present to clients.

Todays article my Morningstar says the same thing. *“"While clients' best interests are served by holding lower-cost funds, asset managers have an incentive to promote higher-cost alternatives from which they generate more revenue from fees," the Morningstar submission states. "Asset managers use embedded commissions to give advisors incentive to favour higher-cost funds, creating a conflict of interest."* Sounds convincing, but not even close to the reality of the business.

I will admit that I use embedded fee funds for many of my clients. I do collect a fee from the funds for using them and my clients are well aware of this. But what really frustrates me is that the regulators perfect world that would be created by their rules and regulations is not even close to the reality of what is happening in this industry. The maximum trailing commission that I can receive on a fund is 1%, and that is pretty much the same across the board on any equity based, embedded fee fund. All those past articles about people selling funds with higher fees just because they got paid more was not backed up by facts. I only know of two fund companies that offered that in the past, and neither were large companies meaning they attracted very little business. In fact, many of us did not use them because we did not want to be accused of using them for the higher payout, even though they had many good funds (Sentry Funds is a good example)

But what has happened, and this is the “reality” aspect of these rules, is between the media and the regulators talking about embedded fees and the potential ban, many have now gone to the fee for service method. This is much better for clients we hear. Clients will have negotiating power we are told. That is exactly what is implied by the Morningstar article that you published today. REALLY? Better for clients has nothing to do with it. And regarding the article saying there is a benefit to the fund companies to promote these high cost funds, I am sure the fund companies take a small hit revenue wise when an “F” class fund is sold over an embedded fee “A” class fund, but it is usually only 15 to 20 basis points.

From my humble opinion of being in this industry for 38 years, this is really what has happened. The average fee for service in downtown Toronto is 1.45% we have been told, and I would assume the average account size in downtown Toronto is a lot larger than the average elsewhere. Across Canada the standard that most now charge seems to be 1.5% across all the assets held by the client. Of course article after article says that the benefit to the client of fee for service would be that these fees are negotiable but that does not seem to be happening. I have been told by a few people, including some that are working at banks, that there are clients that are paying upwards of 2% on accounts with millions in assets. So with that 1.5% fee for service, that would be a 50% increase over the maximum that I can receive on equity funds with embedded commissions, and a 200% increase on bond funds payout. That is quite the pay increase. Who in their right mind would not go that route if it is better for the client and we can double our pay? This is the reality. But there is more to it!

Why have index funds collected so much money? I know there is the argument that index funds have done better, and during rising markets they are tough to beat. But they are also a tough place to be when markets drop. As one colleague said to me, the thing about index funds is you get 100% of the up, but you also get 100% of the down. And we know how clients feel about the down. But are index funds being sold because they are better than managed funds, or is there more to the equation?

So how would someone like me increase my revenue but not hurt the client? Why not charge a 1.5% fee for service like everyone else seem to be doing. But what about the client? The client may have been paying a 2.5% MER on the embedded commission equity funds. So now that I charge 1.5% fee for service, I can use the F class funds. But, F class funds, without embedded fees, with a 1.5% fee for service gets more expensive that what they had before. I win but the client loses, and that is not right. And there you go… the answer to the index funds prominence in today’s world! The reality of today’s world is the index funds, with no management and low costs, have allowed the fee for service brokers and planners to make more for themselves without increasing the costs for the clients. But what the clients have given up is professional management of their money. Is that a fair tradeoff? Similar over all costs but no management. Shouldn't the clients be compensated for giving up professional management for passive or no management?

This is all about making money, and not money for the client. I believe it is RBC that will not pay a broker on an account that does not generate a minimum of $5,000 in revenue. Do that math on that one. You certainly could not have a client with $400,000 to $500,000 in assets with a combination of embedded fee funds, stocks and bonds and actually get paid for that client. But have that client pay the 1.5% fee for service, throw in a bunch of index funds to keep the costs down, add in some stocks, bonds and other assets, and there you have it.

I still do not see anywhere where this is better for a client. Everyone pushes the cost aspect, such as the line in the Morningstar article shown above "*while clients best interests are served by holding lower cost funds*" they constantly ignore the fact that there is now an additional fee tacked on top of that low cost product. Costs have not gone down for clients in most cases, but revenues for the broker/planner/advisor have. But what the clients have lost in many cases is professional management, the exact thing that you would think Morningstar would be backing. All in all, regardless of all the regulators intentions, I believe the real losers in all of this will be the clients yet no one seems to see that. And when (not if) the markets pull back and we see a correction, suddenly those low cost index funds with the 100% participation in the drop might look to be quite expensive.

Jeff Rockel | Financial Advisor

HollisWealth | HollisWealth Advisory Services Inc.

Removal of Embedded Fees

Introduction

The following is an argument against the removal of embedded trailer fees. While a common discussion point has been access to advice, this paper also addresses the consequences to investors who will continue to access advice if embedded trailers are removed. The overall theme is that, were embedded trailer fees banned, more harm than good would come to investors. Consequences of the ban to be considered in this paper include:

1. Access to Advice—The Smaller Investor and DSC
2. The Loss of the Young and Best Advisors—Reduced Competition
3. Controlled vs Uncontrolled Fee Environment--Potential for Investor to Pay Higher Fees
4. Movement to Segregated Funds—DSC and Embedded Trailers
5. Movement to the Wrong Product Apart from Segregated Funds
6. Potential for More Emphasis on Proprietary Products
7. The Elimination of Choice
8. Loss of the Smaller and Independent Firm
9. The Practical

1. Access to Advice—The Smaller Investor and DSC

Understanding and navigating the many different investment options that exist in the market today is complicated. This is particularly true for investors who have little or no investment knowledge. It applies however, also to those investors that have some knowledge. Even investors who regard themselves as sophisticated benefit from financial advice. Over the past 25 or 30 years, this has become more pronounced as the option of simply going to the bank to buy a GIC no longer provides the return that investors are seeking from a growth perspective. Neither does it provide them with the revenue they need to live in a manner with which they are comfortable. Although not cited here, the fact that investors who receive advice fare better than those who don't, is borne out by many studies.

Common place in the market is for the sale of mutual funds to take place on a deferred sales charge basis (DSC) including both full commission and low load options. This form of compensation is particularly valuable for relationships between smaller investors and their advisor and will be lost if embedded trailers are removed. Financial advisors, like all professional service providers, need to be compensated for the services they render. The DSC model provides advisors with the revenue they need to make the relationship make sense financially. It will not be economically viable for many advisors to serve smaller accounts if the option to earn income on a DSC basis is removed.

It should also be noted that, in determining if it makes financial sense for an advisor to serve an investor without DSC as an option, it is likely that an advisor would not be able to set a precise threshold of assets that an investor would need, to the exclusion of any other factor, in order to determine if the relationship would be economically viable. For example, some investors live in areas where access to advice is more limited. This is particularly true in rural areas. It may be that for those investors, with the DSC option no longer available, advisors will decide that investors who live in more remote locations must have more assets than those in urban centres as the costs to service them is higher. Accordingly, to the extent that certain investors are already less serviced than others, the removal of DSC would further restrict these investors to access financial advice.

To the extent an argument will be made that smaller investors will seek their advice from a channel which can afford taking them on as clients, this hardly seems fair or more importantly in the best interest of the investor. Smaller investors want access to the same distribution channel as wealthy investors and taking actions which discriminate against them, does not seem to be acting in their best interest. This is particularity true given the structure that will be mandated to negotiate advisor fees can already be accessed by those who wish to.

2. The Loss of the Young and Best Advisors—Reduced Competition

The DSC option is an important revenue stream particularly to younger advisors getting into the financial service business. While the focus of the removal of the embedded trailer fees should be considered from the perspective of the investor, it would be short-sighted not to take into account its impact on younger advisors as this impact ultimately effects the delivery of advice and hence investors.

It is the contention of this paper that investors benefit from financial advice. Having young advisors enter the business is critical to the continued offering of quality financial advice to all investors. What's more, the industry should have as its goal the desire to attract the best and brightest people to deliver that advice. Creating an environment where it is difficult to make a living will not support that objective as less people will strive to enter the business. Although not immediately, in the end, the people who will suffer from less financial advisors coming into the financial services business is the investor.

Another consequence of less people coming into the business is that those that remain will have less competition. Competition is critical to creating the best advisor. Although advisors will continue to strive to provide the best financial advice, competition is always a useful tool to create an incentive to be the best one can be. Competition among advisors will also help ensure fees remain competitive and reasonable. With less competition, the potential for high fees exists. Ultimately, investors will be the group that is negatively impacted by less competition.

3. Controlled vs Uncontrolled Fee Environment--Potential for Investor to Pay Higher Fees

Presently, embedded trailer fees fix the amount of income an advisor can earn on a particular mutual fund. Although there exists today an option to negotiate advisor fees through, as an example, F class mutual funds, by removing the embedded fee option for the delivery of mutual funds, advisors will be forced to negotiate and help to determine the amount of income they earn in all instances.

While this may result is some investors paying less, it is not necessarily the case that all investors will pay less. The most vulnerable investors are likely to be smaller investors and those that are less educated. Investors who now pay a common 1% trail (FE) or .5% (DSC) may very well find themselves paying a 1.5% trail or possibly higher. While compliance will have some obligation to monitor this issue, there will be a range of fees that are reasonable and compliant with proper disclosure and that range may provide for many investors paying more than they already do.

In addition, to the extent investors have both fixed income mutual funds and equity mutual funds in their portfolio, the embedded trailer (on FE) is often a blend of 1% and .5%. A shift to a model where fees are no longer embedded may very well result in a flat fee of 1% or higher thereby increasing the fee paid by investors on balanced portfolios.

4. Movement to Segregated Funds—DSC and Embedded Trailers

As reported by the Mutual Fund Dealers Association (MFDA), a significant number of representatives in the MFDA are licensed to sell segregated funds. Given that segregated funds are very similar to mutual funds, in many instances their essential difference is in their costs and certain guarantees (although there are some other difference), many advisors may move to recommend segregated funds where DSC commissions can be earned and trailer fees are embedded. Advisors have already likely recommended segregated funds over mutual funds on the basis that they feel there is less compliance surrounding the sale of segregated funds. Compound the advisor's view of less compliance obligations with the ability to earn a DSC commission and not having to worry about negotiating their trailer fee will certainly mean a more pronounced movement to segregated funds. This will be true whether the investor really needs the benefits of segregated funds. If those benefits are not needed by the investor, the investor will end up paying substantially more in fees for features he or she does not need so that the advisor can earn the compensation that he or she feels is necessary and reasonable in order to deliver the service the investor wants and needs.

While it may not be the responsibility or concern of the CSA to deal with matters that fall under the jurisdiction of insurance regulators, it is impossible to ignore the reality that many investors may find themselves unnecessarily investing in segregated funds and therefore paying more in fees if there is a ban on embedded fees. If the goal is to pursue what is best for investors, creating an environment that pushes investors into similar but more expensive and unnecessary alternatives is not the solution.

5. Movement to the Wrong Product Apart from Segregated Funds:

By the Investor

If the total fees paid by investors become more pronounced as an issue, investors may very well find themselves pursuing options that are cheaper but not better. There is no debating that the fee an investor pays for advice is important. However, fees are only one factor to consider. The more investors focus on this factor to the exclusion of others, the more they are inclined to harm themselves.

By the Advisor

Similarly, advisors who find themselves under pressure to lower fees may recommend investments where the underlying products have lower fees (the fee independent of the advisor fee) so that the total fee to the investor is lower. This shift to an over-emphasis on fees as opposed to the right investment will harm investors.

As an example, advisors may offer index funds so that they are able to maintain their same fee while the total fee to the client is lower. Index funds may however, not be best the solution for a client in a fee based environment.

6. Potential for More Emphasis on Proprietary Products

In the event that removing embedded fees creates greater focus on the part of investors to acquire services with less fees, there may be a push to proprietary products. This may occur if firms with proprietary products offer their product at a fee lower than that of third party product. This would enable the advisor to charge the same or higher fee that he or she is presently earning on third party product although the all in fee (advisor fee and fee to the firm/manager) may be lower. This may be appealing to the investor. The potential harm is that the advisor may be motivated to recommend the proprietary product even though it may not be the best solution for the investor. This would be a detrimental outcome to the investor.

Investors benefit when they are given multiple investments to choose from. When advisors are given incentives to promote proprietary product over third party product, especially when the advisors are able to offer third party products, investors lose.

Although it has been argued that different embedded fees have also influenced advisor behavior in the context of different mutual funds, it is noted that the industry has taken increased measures to make embedded fees on similar products more consistent.

7. The Elimination of Choice

The mutual industry already provides many ways for investors to own mutual funds. This includes investing in mutual funds on a DSC basis (back end load), front end load, volume pricing, embedded trailer fees, and separately negotiated trailer fees. These different choices have different appeal to different investors and advisors and certain options are more suitable for some investors while other options are more suitable for others.

Removing choice is seldom, including in this instance, a good option. Investors benefit when they and their advisor are able to choose the particular fee structure that is best for the investor. Creating a "one size fits all" approach has consequences. The consequences described in this document, while arguably may be unintended, are nevertheless real and negatively affect the investor. Given these negative impacts and the fact that investors can, as it stands today, separately negotiate their trailer fee, there seems to be little benefit to remove a fee arrangement the result of which may deprive many investors of access to independent advice and the other harms noted herein.

8. Loss of the Smaller and Independent Firm

The removal of embedded fees will result in lower incomes to firms. This may or may not be true due to a change in trailer fees. However, it will certainly be true because of the loss of DSC commissions. The effect of lower income will in all likelihood hurt smaller firms and independent firms who will have less resources to meet their increasing compliance obligations and remain profitable. The end result may be that there are less independent firms and fewer and fewer small firms.

On its face, less income to firms and less firms does not seem as it should be of particular concern to those charged with regulating the securities industry and protecting the investor. However, with fewer firms, particularity independent firms, more and more investors will be forced to seek their advice from firms with proprietary products.

With less firms and less advisors there will be less choice. While not immediate, it seems almost inevitable that, as the distribution world shrinks, investors will end up getting less independent advice and fees will ultimately rise.

9. The Practical

In recent years the mutual fund industry has made the change from providing investors with a simplified prospectus to Fund Facts in an effort to provide investors with information that is more meaningful and easier to understand. Included in this information is the management expense ratio which advisors are to discuss with investors. In addition, there is now the requirement that investors be provided reports annually so that they see the actual fees they are paying their advisors/firms in dollars as opposed to simply a percentage as expressed in the Fund Facts. It is felt however, that this additional disclosure may not be enough for investors to fully understand and appreciate the fees they are paying for the services they are receiving. Instead, in order to ensure investors understand and agree to the fees they are paying to their advisor, the embedded fee must be removed and the investor must negotiate the trailer fee earned by the advisor.

Negotiating advisor fees separately is, however, just another layer of disclosure. While it will force conversations about fees, it is difficult to reconcile how, on the one hand providing Fund Facts and disclosing the actual fees paid are not sufficient disclosure, and, on the other hand adding another layer of disclosure, the negotiation of embedded fees, will rectify the issue of investors knowing the fees they pay.

If investors are not sophisticated or knowledgeable enough to manage the information that is disclosed to them through Fund Facts or reports disclosing the dollar amount they are paying in fees, will they be sophisticated enough to negotiate the fees they pay to their advisor? Will they know that they were paying 1% or .5% and are now possibly paying 1.25% or 1.5% or higher? If the existing disclosure hasn't done what it was intended to do, it seems adding another layer of disclosure where investors are forced to negotiate their fees will not be the solution.

<u>Conclusion</u>

Investors need to know what they are paying for the services they receive. Initiatives to pursue this objective as well as the objective of ensuring investors know the different options they have for paying for financial advice is important. The delivery of Fund Facts as opposed to a simplified prospectus and reports that disclose in dollar terms the fees investors pay is a good start. Time will tell how to improve on methods for delivering information to investors on fees they are paying and choices of fee arrangements that they have.

Investors benefit from advice they receive from advisors. All investors should have access to independent advice. The independent channel should not be limited to investors of a certain wealth. By removing embedded trailer fees and forcing all investors to negotiate their own fee arrangement there will be significant and substantial unintended consequences which will negatively impact investors. Some of the negative consequences include but are not limited to:

1. Denying small investors access to advice through the independent channel by making the delivery of service to them economically not feasible;
2. Making entry into the market for young advisors more difficult creating a vacuum for advice and making it unattractive for the best and brightest to pursue financial services as a profession;
3. Creating a more complex fee structure and increasing the likelihood that smaller and mid-sized investors may pay more fees in separately negotiated arrangements than in embedded fees;

4. Creating the likelihood that investors will end up owning more segregated funds which are more expensive than mutual funds and which may not be suitable for the client because they can be offered on a DSC basis and with embedded trailer fees;
5. Creating the possibility that investors may end up in the wrong product in order to keep the all in fee down while at the same time allowing advisors to maintain the same fees they earned when fees were embedded;
6. Creating the possibility that investors will end up investing in proprietary products in order to keep fees down while at the same time allowing advisors to maintain the same fees they earned when fees were embedded;
7. Reducing the number of small firms and independent firms due to the potential loss of DSC revenue resulting in less competition which will ultimately end up with investors paying higher fees and having less investment options;
8. Eliminating an option for those investors who want to use the embedded fee structure;
9. Investors will not benefit from the additional disclosure effectively created by negotiating their fees and may in fact be worse off due to their lack of sophistication.

All of the above negative consequences would occur in order to accommodate a desire for fees to be separately negotiated which, ironically, is a choice that already exists for investors and advisors.

If the only goal is to ensure investors are responsible for agreeing to the specific fee they are paying their advisor, then banning embedded fees is a solution. It seems, however, that the additional consequences, which are real and will almost certainly flow from the ban, far outweigh any benefit that may be gained. Instead the focus should be on assessing how changes in recent years are helping the investors understand the fees they are paying. Once the impact of these changes is understood, additional steps should be devised, if any are needed, to inform investors both as to the fees they are paying and choices they have with regard to fee arrangements so that the right arrangement is reached for each investor.

iA Financial Group

BY EMAIL

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

The Secretary Ontario Securities Commission 20 Queen Street West, 19th Floor, Box 55 Toronto, Ontario M5H 3S8 comments@osc.gov.on.ca	**Me Anne-Marie Beaudoin, Corporate Secretary** Autorité des marchés financiers 800, square-Victoria, 22e étage C.P. 246, tour de la Bourse Montréal, Québec H4Z 1G3 consultation-en-cours@lautorite.qc.ca

Dear Sirs / Mesdames:

Re : iA Financial Group comments on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*

iA Financial Group appreciates this opportunity to submit comments on CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (the "**Consultation Paper**").

We have reviewed and are supportive of the comments provided by The Investment Funds Institute of Canada in response to the Consultation Paper. In addition, we provide herein our additional comments on the Consultation Paper.

About the iA Financial Group
Founded in 1892, iA Financial Group offers life and health insurance products, mutual and segregated funds, savings and retirement plans, securities, auto and home insurance, mortgages and car loans and other financial products and services for both individuals and groups. iA Financial Group serves over four million clients and employs more than 5,500 people. At December 31, 2016, the Company was managing and administering over $130 billion in assets. It is one of the four largest life and health insurance companies in Canada and among the largest publicly-traded companies in the country.

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The Wealth Management subsidiaries of iA Financial Group include the following:

- FundEX Investments Inc., a mutual fund dealer, exempt market dealer and a member of the Mutual Fund Dealers Association of Canada ("MFDA");
- Investia Financial Services Inc., a mutual fund dealer, exempt market dealer and a member of the MFDA;
- Industrial Alliance Securities Inc., a full service securities brokerage and a member of the Investment Industry Regulatory Organization of Canada ("IIROC");
- IA Clarington Investments Inc., an investment fund manager and exempt market dealer;
- iA Investment Counsel Inc., a discretionary portfolio management firm focusing on high net worth private clients;
- Forstrong Global Asset Management Inc., a discretionary portfolio management firm that uses only exchange traded funds to build its clients' portfolios; and
- iA Investment Management Inc., a discretionary portfolio management firm providing services to permitted clients only.

The iA Wealth Management companies believe strongly in the critical role of the financial advisor and their delivery of advice to the Canadian investor. With today's unprecedented market conditions, the role of the financial advisor in helping clients maximize their wealth and reach their financial goals has never been more important. To that end, our dealers' product shelves are not limited to proprietary products, and we offer an open and comprehensive product shelf. We believe the current system in Canada, while perhaps not perfect, is working well for the majority of investors, from mass market retail investors to high net worth investors.

Conflicts of Interest

The Canadian Securities Regulators ("**CSA**") have indicated that conflicts of interest arise as a result of embedded commissions. The singular focus on embedded commissions as the catalyst for misalignment of the interests of investment fund managers, dealers and representatives with investors is extremely narrow in focus. Embedded commissions have been a catalyst for many positive behaviours which have been conspicuously overlooked. For example, embedded commissions facilitate access to advice for new investors as they first start to save and for investors with smaller account sizes, encourage investors to stay invested and provide discipline for long-term investing, and facilitate ongoing advice and services with an advisor.

In addition, a banning of embedded commissions could lead to the rise of a different set of conflicted compensation arrangements. For example, a shift to transactional fees could lead to issues such as non-necessary trading, churning or a shift away from a long term investment approach. A shift to hourly fees could lead to unnecessary work being conducted or excess billing. Any arrangement which involves credence goods and a fee for service (such as financial advisory services or legal services) creates a situation of asymmetrical information and a conflict of interest and potential for abuse. However, the potential for abuse relating to embedded commissions has largely been reduced as the commissions paid across the industry have to a large degree been standardized. As a result, advisors are not financially motivated to recommend one fund over another.

Investor Choice

We strongly believe that choice is of paramount importance to an informed investor. In our view, the banning of certain options to direct or control advisor and client behavior is an extreme response. The current environment provides the investor with alternative fee payment options that address the issues raised in the Consultation Paper: (i) options to pay directly for the acquisition of mutual funds including front-end load, (ii) hourly or flat fee billing, and (iii) fee for service. Regulators have a responsibility to respect the investor's ability to determine their own needs, and should work to preserve choices rather than limit them.

Investor Awareness, Education and Transparency
The CSA has also raised concerns that embedded commissions can limit investor awareness. We believe that a continued focus on transparency of fees and investor education can more directly and efficiently address concerns relating to investor awareness. Our industry, under the guidance of the CSA, has been very proactive in its pursuit of comprehensive disclosure from the point of sale through the life cycle of the product. CRM2 and POS initiatives will be instrumental in creating further visibility of fees, but more time is needed to fully assess their impact.

Collectively, it is our responsibility as an industry (regulators, mutual fund manufacturers, dealers, and advisors) to empower investors to make decisions that are right for them. We feel it is important to remind the CSA that an educated investor will always be in the best position to select the products or services which align with both their needs and their preferred method of payment. Further efforts on the part of all stakeholders are required to enhance the financial literacy of the Canadian investor.

Alignment of Costs with Services
A third area of concern articulated by the CSA is that embedded commissions paid generally do not align with the services provided to investors. While direct pay arrangements may better align with the services provided, they could inadvertently increase fees to the end investor. Both a direct payment and any increase in fees could lead some investors, in particular lower income households, to avoid the direct payment expense. This could have an impact on the long-term financial well being of many Canadians, who, without the benefit of advice, may choose not to invest, or may choose investments that are not suitable for them.

In addition, the natural forces in any mature market should not be discounted. Tremendous shifts have already occurred in our industry, with a natural movement towards fee reduction for the end investor. We have evolved organically from an environment of disproportionate front end loads to the current environment of low-load, front-end zero and fee for service arrangements. With a heightened awareness of fees, many advisors have created pricing tiers for high dollar clients within their fee for service structure. To remain competitive, investment fund managers have launched "preferred pricing" programs which assist investors in navigating the product lineup to ensure the lowest fees possible. All of this has happened in the current environment. In addition, we believe that the additional disclosure arising from CRM2 and POS will be a catalyst for a natural movement towards lower fees for investors, as fees will be visible and discussed more openly.

Unintended Consequences
While well intended, the removal of investor choice through the banning of embedded commissions and DSC could negatively impact the end investor.

We note that the majority of investors holding funds with embedded commissions are those with smaller account sizes (typically those with account sizes of less than $100,000). One unintended consequence of a ban of embedded commissions is that access to financial advice could become limited or unattainable for investors with smaller account sizes or new investors as they first start to save. Given the costs of operating, advisors may naturally move toward investors with larger account sizes, and away from investors with smaller accounts where the commercial value does not justify the costs associated with servicing the business. Fee for service arrangements on smaller client accounts may not be economical, which may create a barrier to entry for new advisors, and ultimately limit access to advice. Additionally, reduced profitability for advisor services may lead to consolidation of the advisory industry, further limiting access to advice.

The pool of trailer fees across an advisor practice has enabled the advisor to provide a myriad of other services which do not directly generate compensation on an individual basis. Working collaboratively with the investor's accountant or lawyer facilitates effective tax planning and estate planning. Helping investors navigate issues and challenges associated with their small businesses is part of a comprehensive financial plan, yet on its own does not generate revenue to the advisor who invests considerable time in these activities. This subsidization draws a direct parallel to our tax system where the consumption of services is possible for all constituents based on the collective revenue received from a broader client base. Disruption will clearly impact today's smaller investors.

As indicated above, a direct fee, a fee for advice that is too high, or reduced access to advisors may lead investors, particularly mass market retail investors with smaller amounts to invest, to migrate away from advice channels and towards a "DIY" approach to investing. Without the benefit of advice, investors may turn to alternative products that do not offer the same level of regulatory protection or towards products that carry risks that are not suitable for the particular investor. In turn, this may result in below average performance based on poor decisions and/or emotional responses, impacting the long-term financial well-being of investors.

Alternative Approaches

We favour a continued focus on transparency of fees and education of the investor. We believe this will be more efficient to address problematic areas and will have the benefit of creating less disruption and less potential for unintended consequences. The effect of current CRM2 and POS initiatives on the industry has not yet been determined, but we believe that market-driven forces are already promoting practices that reduce costs and improve services for investors. In addition, we suggest other forms of legislative intervention be explored, such as:

- standardizing or capping embedded commission by asset class
- requiring a mandatory letter of engagement prior to opening accounts specifying compensation arrangements at the outset, and specifying a complete description of the services to be provided
- a cap on commissions for series offered without advice

Conclusion

We are strong proponents of respecting investor choice, accompanied by transparency and a concentrated effort to educate investors. CSA Consultation Paper 81-408 intervenes in a manner which could potentially mischaracterize reduced investor choice as a benefit with little insight into the impact of a change of this magnitude.

We are not suggesting that the investment industry is void of any opportunities for improvement. On the contrary, the business as it has matured has changed drastically and shifted away from certain behaviours which may have been perceived as conflicted. Current CRM2 and POS initiatives will undoubtedly continue to reshape the business inclusive of all market participants. We feel that it is short sighted to fail to allow the industry the time required to adequately gauge the impact of these initiatives, as well as the impact of other global regulatory initiatives.

We would be pleased to participate in any further public consultation on this topic or discuss our response in greater detail with you. We appreciate the opportunity extended to us to provide our feedback.

Yours truly,

Carl Mustos
Executive Vice-President, Wealth Management

BLACKROCK®

June 9, 2017

Submitted via electronic filing: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:
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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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Montréal, QC H4Z 1G3

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("Consultation")

Dear Sirs/Mesdames:

A. About BlackRock

BlackRock Asset Management Canada Limited ("**BlackRock Canada**" or "**we**") is an indirect, wholly-owned subsidiary of BlackRock, Inc. ("**BlackRock**") and is registered as a portfolio manager, investment fund manager and exempt market dealer in all the jurisdictions of Canada and as a commodity trading manager in Ontario.

BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers, and other financial institutions, as well as individuals around the world.

B. General Observations

BlackRock welcomes a discussion of mutual fund fees in Canada and commends the Canadian Securities Administrators ("**CSA**") on its ongoing efforts to protect investors and preserve investor choice. As a general principle, we support policy changes and regulatory reforms that increase transparency, protect investors, facilitate the responsible growth of capital markets, encourage healthy competition in financial markets, and, based on thorough cost-benefit analysis, preserve investor choice.

Accordingly, BlackRock supports the CSA's objectives of (i) better aligning the interests of investment fund managers, dealers and representatives with those of investors; (ii) delivering greater clarity on the services provided and their costs; and (iii) empowering investors by directly engaging them in the dealer and representative compensation process. However, we believe that the successful implementation of the CSA's policy objectives is dependent on close cooperation with both the industry and investors. Namely, the CSA must focus on reducing regulatory barriers to entry for lower-cost investment product and advice providers to fill any potential advice gap that could be created by the banning of embedded commissions, while continuing to educate investors, including specifically about dealer compensation issues, and promote financial literacy.

In addition, in considering mutual fund fee reform, we encourage the CSA to create a level industry playing field that will maximize the service options available to investors. Specifically, we note that a ban on embedded commissions may have the effect of creating a material competitive advantage for large, vertically-integrated firms over small and/or independent providers, given that such large firms have the ability to cross-subsidize internally by reallocating costs and revenue streams across a range of businesses. The CSA must be mindful of such unintended consequences, which would ultimately reduce industry competitiveness and investor choice.

Beyond these general comments, we have questions and concerns regarding certain of the consultation questions, which are set out in greater detail below. For ease of reference, we have included the full text of each consultation question to which our comments correspond.

C. BlackRock's Responses

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

17. Do you think this proposal will lead to an advice gap?

While we believe that discontinuing embedded commissions would go a long way towards addressing the three key investor protection and market efficiency issues discussed in Part 2, in order to fully address these issues, we believe the CSA must also take active steps to ensure that investors continue have access to a wide range of competing products and advice models. To accomplish this, the CSA should encourage and support the growth of low-cost products and simplified advice models for retail investors, while at the same time promoting and strengthening investor financial literacy.

A. Supporting the Growth of Lower-Cost Investment Products

We agree with the CSA's assessment that embedded commissions function as a barrier to entry in the investment funds market, and that transitioning away from these fees will likely result in more assets being allocated to lower-cost investment products and more lower-cost product providers entering the market. However, we note that even without embedded commissions, significant regulatory barriers to entry and growth in this market continue to exist, including cumbersome disclosure requirements, outdated rules and rigid registration requirements. Failure to address these barriers may continue to inhibit lower-cost products and their providers from effectively scaling their business models.

To that end, we support the recent initiative announced by the Investment Funds and Structured Products Branch of the Ontario Securities Commission ("**OSC**") aimed at reducing regulatory burden for investment funds, and encourage the CSA more broadly to reconsider these rules, as well as those impacting registration related requirements, while emphasizing the underlying policy goals of increased price competition, lower fees and broader access to advice for retail investors.

Creative initiatives such as the OSC LaunchPad help support start-up technology companies in navigating regulation. We encourage the continued expansion of such initiatives to traditional incumbent firms who may be considering digital innovation as a way to scale low-cost advice models.

Based on our experience with the implementation of the Retail Distribution Review in both the United Kingdom and the Netherlands (as well as similar reforms in other markets), we agree with the concerns outlined in the Consultation that eliminating embedded commissions will result in a reduction in the number of traditional advisors serving mass-market investors, potentially leading to an "advice gap"[1]. In this regard, we encourage the CSA to take active steps to ensure that high quality, unbiased professional support is available to all sectors of the Canadian market. As investors grapple with the growing challenges of inadequate savings, disproportionately high levels of cash[2], longer life expectancies, low interest rates, geopolitical uncertainty and a greater need to take responsibility for their own retirement due to shrinking availability of employer-sponsored pensions, many will require professional support to demystify the savings and investment process. To reflect the wide variety of consumers' savings and investment needs, we encourage the CSA to consider what other models of support for consumers may be relevant to empower all Canadian consumers to make effective decisions about their finances.[3] These needs

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[1] The Tower Watson report for the FCA on RDR http://www.fca.org.uk/static/documents/research/advice-gap-analysis-report.pdf and the Joint UK HMT and FCA Financial Advice Market Review 2016 https://www.fca.org.uk/publication/corporate/famr-final-report.pdf. BlackRock's Investor Pulse survey of 4,000 UK investors found that only 15% of those surveyed use the services of a professional advisor.

[2] BlackRock's 2016 Investor Pulse study found that Canadians hold 54% of their investable assets in cash. In addition, more than half of Canadians reject the idea of moving more of their cash into investments, citing insufficient confidence and a lack of understanding of the risks involved.

[3] By way of comparison we recommend considering the Terms of Reference of the UK's Financial Advice Market Review: https://www.gov.uk/government/publications/financial-advice-market-review-terms-of-reference/financial-advice-market-review-terms-of-reference

will only continue to grow as traditional advice providers adapt their business models and fee structures to reflect the new cost of delivering financial advice.

B. Digital Advisors and Digital Tools

Any potential advice gap is also likely to be compounded by the fact that Canadian investors are increasingly faced with choosing between higher cost, full-service investment planning and advice and a ‘do-it-yourself’ execution-only service which does not provide the tools many investors need to help navigate the complexities of the choices they face. In fact, many mass-market investors are not even afforded this choice, as they do not have the minimum asset levels required for fee-based accounts - an amount that is likely to increase in the face of regulatory change.

We believe that a simplified menu of low-cost investment options, when paired with advice surrounding broader financial circumstances, is sufficient to meet the needs of many Canadians. To that end, financial technology, including digital advisors and digital tools, together with human advisors, can provide a new, scalable means to help bridge the gap by providing tailored solutions that increase efficiency and reduce costs for both providers and end investors.

Digital advisors provide a variety of advisory and educational services to clients via internet-based platforms using algorithmic portfolio management strategies, typically through diversified portfolios of low-cost exchange-traded funds. While digital advisors currently represent a very small segment of the Canadian market relative to more traditional financial advice providers, we see significant room for growth in this industry, particularly in response to regulatory change[4]. However, the current regulatory framework, which was designed with traditional, face-to-face advice models in mind, is ill-equipped to govern digital advice in its varying forms, and may render it difficult for providers of digital advice to offer their services or grow in a scalable way. We recommend that regulators review the existing regulation and consider its applicability to digital advice models to determine appropriate supervisory approaches that allow digital advisors to operate while maintaining important investor protections. For example, know your client requirements should be amended to allow digital advisors to obtain key client information from online questionnaires given their online business models.

Similarly, as more investors move to self-directed investing, we see a growing demand for information and tools that will assist them in making their investment decisions, including model portfolios and other digital tools. However, the current regulatory framework is in flux on this point and recent proposed IIROC guidance would, if adopted, move to prohibit model portfolio information from being provided to execution-only clients[5], possibly to the detriment of investors. Without access to proper guidance, do-it-yourself investors may be forced to turn to other, less regulated sources for information, fail to appropriately diversify their portfolios, or hold disproportionate levels of cash; in each case, frustrating the ability of investors to better meet their retirement needs.

In addition, we worry that other recent regulatory initiatives, including certain of the targeted reforms outlined in CSA Consultation 33-404 – *Proposals to Enhance the Obligations of Advisers,*

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[4] According to our 2016 Investor Pulse Survey, while only 1% of Canadians cite using the services of a digital advisor currently, nearly half of Canadians are aware of digital advisors, and forty-three percent would consider using this service in the future.

[5] IIROC Notice- Guidance on Order Execution Only Services and Activities, November 3, 2016 http://www.iiroc.ca/Documents/2016/b7501066-1af8-4e4e-b32e-338d11875b85_en.pdf

Dealers and Representatives Towards Their Clients ("CSA Consultation 33-404") would, if enacted, have significant unintended consequences, including potentially reducing the number of products firms offer and exacerbating the advice gap. We caution the CSA that prescriptive regulations such as these can discourage innovation and create barriers to market entry or growth for smaller, independent firms who may otherwise be well positioned to service smaller clients.

We recognize that appropriate regulatory supervision is important for both digital advisors and execution-only platforms; however, we also note that, without some flexibility in these areas, the growth of technology may be comprised and the advice gap is unlikely to be addressed Without this flexibility, we're concerned that innovative tools may be adopted only by larger industry participants (who can afford to incorporate technology into their traditional business models and offer more scale to their advisors), to the detriment of smaller, independent firms that could target mass-market investors. We strongly support the work the CSA and other jurisdictions are doing with the Regulatory Sandbox and related initiatives, and are encouraged by the fact that IIROC has identified a key priority for 2018 as ensuring IIROC requirements accommodate new advice and service models.[6] We urge the CSA to take these initiatives a step further by working with IIROC to establish specific guidance to allow digital advisors and execution-only providers to operate more flexibly within the traditional registration paradigms. In doing so, we suggest the CSA take a principles-based approach, which focuses on balancing the risk created by innovative tools with the underlying policy goals. For example, the CSA could consider setting appropriate terms and conditions on a firm's advisor registration should they wish to operate an online or digital platform.

We also suggest that the CSA re-evaluate the framework for providing an investment recommendation and Know Your Client (KYC) and suitability requirements with a view to implementing rules that are thoughtful and adjust for the reality that business models and technology are evolving. Enabling firms to move more fluidly and to engage in a lighter touch KYC process when recommending digital solutions will also serve to increase efficiency and cut costs, ultimately increasing access to advice for investors. When assessing online advisors in particular, we also suggest that the CSA focus on such areas as appropriateness of algorithm design and oversight, disclosure standards and cost transparency, policies and procedures surrounding trading practices, and robustness of data protection and cybersecurity.[7]

C. Financial Literacy

Encouraging the growth of scalable, digital tools will go a long way towards reducing the advice gap by increasing the supply of potential advice options available to retail investors. However, it is imperative that the CSA also focus on the demand side of the equation by working to improve the financial literacy of Canadians.

Financial literacy is an essential skill now more than ever. It is integral that investors have the knowledge, skills and confidence to make informed investment choices and build their financial futures. Furthermore, financial literacy is integral to effective financial advice. Studies have shown

[6] IIROC 2018 Statement of Priorities

[7] See BlackRock Viewpoint- Digital Investment Advice: Robo Advisors Come of Age. September, 2016 https://www.blackrock.com/corporate/en-zz/literature/whitepaper/viewpoint-digital-investment-advice-september-2016.pdf

that investors with a low level of financial literacy are less likely to consult with an advisor, while they delegate their portfolio choice more often or do not invest in risky assets at all.[8]

We applaud the work the OSC is doing to increase investor education through its Investor Office, particularly the creation of online resources and tools for new investors. We suggest that the OSC, together with the CSA, take this a step further by making this information more widely available to investors when they need it the most. For example, the CSA could mandate this information be given to investors at specific decision touchpoints, like when they open their first account, or make an investment decision. Investor education should also focus on dealer compensation issues and continue to highlight the impact of costs on performance and investment returns. We also encourage the CSA to collaborate with the Financial Consumer Agency of Canada on its National Strategy for Financial Literacy. In particular, we would like to see basic financial education form a part of school curriculums from an early age.

D. Impact on Competition and Market Structure

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4?

We are generally supportive of regulatory reforms that encourage long-term savings by broadening the choice of investments offered to investors. In this regard, we encourage the CSA to be mindful about implementing any reforms that may unfairly advantage large, vertically integrated players over small and independent providers, as this could negatively impact the competitive landscape and unfairly prejudice end investors. Specifically, we note that, depending on the regulatory response to embedded commissions adopted, vertically-integrated firms might maintain the ability to provide bundled combinations of product and advice without needing to charge or disclose an explicit "advice" fee[9]. In contrast, independent firms would, in practice, be forced to charge an explicit, unbundled, advice fee. The CSA must be thoughtful about preventing this outcome in pursuing its policy goals. One potential solution we encourage the CSA to consider is requiring enhanced disclosure of mutual fund fees on client statements, similar to the detailed dealer compensation disclosures (including absolute dollar amounts) now required on annual client statements as part of CRM2. We also note that even without embedded commissions, there are conflicts within the industry that may remain unaddressed, and could stand in the way of achieving the CSA's objectives.[10] We encourage the CSA to be mindful of these conflicts when drafting this and other policy reforms, including the revised targeted reforms under CSA 33-404.

That being said, we do see a number of potential market opportunities for both independent and integrated asset managers in a post-embedded commissions environment. As noted above, we anticipate significant growth in low-cost investments and in digital advice models (both new, direct to consumer models and business to business platforms). We also expect that dealers and advisors will look more to asset managers for insights and capabilities in an effort to increase scale and reduce costs. We see an opportunity for product providers such as ourselves to partner

[8] Financial Literacy and the Demand for Financial Advice; Riccardo Calcagno and Chiara Monticone, February 11, 2013.

[9] For example, vertically integrated firms may significantly reduce trailing commission payments made from an asset manager to an affiliated dealer, without changing the total fee paid by the client or earned by the firm overall.

[10] See for example IIROC Notice 16-0068 – Managing Conflicts in the Best Interest of the Client, which identified higher payouts for in-house managed accounts where cost savings are not passed on to the client.

with advice providers to deliver digital tools, calculators and services that would streamline and simplify their business models. This could include model portfolios, risk analysis tools, performance calculators and portfolio analysis.

D. Conclusion

BlackRock appreciates the opportunity to provide input on this important regulatory initiative and would be pleased to make appropriate representatives available to discuss any of these comments with you. We would also be happy to participate in any roundtable discussions.

Sincerely,

"Margaret Gunawan"

Margaret Gunawan
Chief Compliance Officer and Secretary, BlackRock Asset Management Canada Limited

"Warren Collier"

Warren Collier
Managing Director and Head of Canada iShares, BlackRock Asset Management Canada Limited

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June 9, 2017

Delivered by Email

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commision
Authorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of securities, Yukon Territory
Superintendent of Securities, Nunavut

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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Consultation Paper 81-408 – Consultation on the option of discontinuing embedded commissions ("the Consultation Paper")

This comment letter is submitted on behalf of the Canadian section ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the legislation referred to above.

About AIMA

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment fund, futures fund and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises over 1,700 corporate members in more than 50 countries, including many leading investment managers, professional advisers and institutional investors. AIMA Canada, established in 2003, now has more than 140 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member. Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount exemptions. Manager members also have multiple registrations with the securities regulatory authorities: as Portfolio Managers, Investment Fund Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount exemptions. Manager members also have multiple registrations with the securities regulatory authorities: as Portfolio Managers, Investment Fund Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our web sites at canada.aima.org and www.aima.org.

Comments

AIMA Canada appreciates the opportunity to comment on these proposed changes, which if adopted could have significant consequences on Canada's investment industry.

We applaud the CSA for their very detailed analysis and consideration of the issues and potential regulatory responses. We urge the CSA, however, to consider all other recent regulatory developments and measure their effect on investors and adviser behaviours before imposing yet another layer of costly regulatory change that may in fact be unnecessary or the cost of which may outweigh the intended benefits.

We do not propose to provide a detailed response to the specific questions asked. Our principal concern is the cumulative effect of all of the recent regulatory changes on the investment industry as a whole. We believe it will be difficult to fully understand the effect of individual initiatives when all are being introduced at the same time. Regulatory burden is increasingly taking up time and resources, at a significant cost, and unless regulators can reasonably determine whether individual initiatives are having the intended effect on behaviours and investor protection, some or much of that regulatory burden may be unnecessary. Ultimately, the cost of compliance is borne by investors.

With that background, we are asking the CSA to postpone any final decision on embedded fees until such time as the investment industry has had time to fully absorb the effect of recent regulatory changes (and in particular enhanced client reporting), until the investing public has had time to react to the enhanced information that they are now beginning to receive, and until the CSA have had time to study those results and are better able to assess whether a drastic regulatory change, such as a prohibition on the payment of embedded fees (or any other form of compensation), is justified.

The regulatory changes proposed in the Consultation Paper are premised on the CSA's conclusion that (i) embedded fees create a conflict of interest between fund manager, dealers and investors, (ii) this conflict of interest cannot be resolved by full disclosure, and (iii) the investment industry has not adequately addressed this issue.

Any form of payment to a dealer in connection with the sale of an investment product creates a potential conflict of interest if it provides an incentive to prefer the sale of one product over another.

Historically, such a conflict has been addressed through disclosure so that a client, knowing of the conflict, can make an informed decision. To that end, recent initiatives of the CSA, including uniform point of sale (POS) disclosure and enhanced investor reporting in the form of CRM2, were designed to help ensure that the investing public is better informed of the fees they can expect to pay and are paying on an ongoing basis.

We believe that the POS and CRM2 reforms have already disrupted the industry with more dealers moving from trailing fees to fee based services. We also believe that more time is required to better understand the effect of those reforms as they work through the dealers' client base. We would recommend that a minimum period of three years would provide additional data to properly evaluate the impact of existing reforms and for the CSA to further assess if additional regulatory changes are still considered necessary.

Allowing industry participants additional time for POS and CRM2 reforms to take hold will allow the industry to adapt naturally to the disruption they are already facing and will yield the following benefits:

- Reduce the risk of further consolidation in the industry which limits available choices to investors and could have follow-on impacts to smaller asset managers who don't have access to the distribution channels currently dominated by the banks.

- Reduce the risk of an advice gap providing more time for automated advisor solutions to be further developed which will further disrupt the way fees are charged and provide investors with more options.

We note that the CSA have stated in the Consultation Paper that they chose not to consider capping embedded commissions, as an alternative to an outright prohibition, on the basis that it would "cause the CSA to take a non-traditional role of setting fee caps for investment products, rather than implementing measures intended to promote market efficiency". We suggest that a prohibition s the same as capping embedded fees at zero, and that the CSA should be focused on the other initiatives they have been implementing to promote market efficiency.

Conclusion

Canada is a unique market. It is regulated differently than other markets and the composition of its investment industry is also unique. It is a small market dominated by the large bank-owned dealers. We respectively submit that the CSA ought not to be too swayed by the regulation of embedded fees in other jurisdictions and to take the time to consider the aggregate of all of the other made-in-Canada regulations before adopting prohibitions that will have definite, and potentially unintended, consequences on the distribution of investment products in Canada.

We appreciate the opportunity to provide the CSA with our views on the Consultation Paper. Please do not hesitate to contact the members of AIMA set out below with any comments or questions that you might have.

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Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By: IPember

Wealthsimple

VIA E-MAIL: comments@osc.gov.on.ca
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June 9, 2017

Ontario Securities Commission
British Columbia Securities Commission
Alberta Securities Commission
Manitoba Securities Commission
Nova Scotia Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Autorité des marchés financiers
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission New Brunswick
Superintendent of Securities, Yukon
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

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Re: Canadian Securities Administrators Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

It is an exciting and challenging time for the financial services industry. The pace of change is accelerating, and as an industry, we have the opportunity to reshape the regulatory framework in a way that puts clients first.

We applaud the OSC for their support of two important regulatory changes that put clients first: implementation of a best interest standard, and the elimination of embedded commissions.

Embedded commissions create an inherent conflict of interest. If a financial advisor earns a sales commission that is hidden from clients, it raises the question - who are they serving: the client, or the products that pay the highest commission?

Clients have the right to expect un-conflicted advice that puts their interests first. If the investment industry can't live up to that promise, how can clients trust them with their life savings?

At Wealthsimple, we have a core value: “Do what's right for each client.” The reason we exist is to help our clients reach their financial goals. The only way we can deliver on that promise is if we earn and keep our clients' trust.

At a time when the public's trust of the financial services industry has been eroded by high profile examples of firms putting their own interests first, stronger regulations that promote “doing what's right for each client” are crucial.

The industry has already taken a step in the right direction by making advisor fees more transparent -

but we can do more. Abolishing embedded fees is another step in the right direction toward this industry being absolutely clear on who we serve and why we exist. It's what we ask of ourselves. And we think that's not too much to ask of regulators and financial institutions.

Yours very truly,

WEALTHSIMPLE INC.

Michael Katchen
Chief Executive Officer

PRIMERICA FINANCIAL SERVICES
RESPONSE TO CSA CONSULTATION PAPER 81-408:
CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

JUNE 9, 2017

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British Columbia Securities Commission
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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
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Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
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Dear Sirs / Madames:

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("Consultation Paper")

Primerica Financial Services ("Primerica") appreciates the opportunity to submit comments on the Canadian Securities Administrators' ("CSA") Consultation Paper 81-408 – Consultation on the Options of Discontinuing Embedded Commissions.

1. Executive Summary

Primerica has been serving Canadian investors since 1986, with a mission to help middle income families become financially independent. The majority of our accounts start out very small and as such contain an embedded fee structure that allows us to put some upfront compensation into the hands of our mutual funds representatives, without reducing our clients' initial investment. This approach is key to servicing our small investor client base. Built-in fees are a reflection of the pooling principle behind mutual funds, making advice affordable and readily available to all investors regardless of account size.

The gap between regulatory intent and regulatory impact of the CSA's proposed ban on embedded fees will disproportionately affect vulnerable consumers and their access to savings and advice. The assumption that technology, including robo-advice, can close the advice gap that will inevitably be left by disrupting the vast majority of Canadians' savings method is overly optimistic. While robo-advice will continue to make its way into the market, and technology will continue to evolve and create efficiencies in the industry, by no means will this alleviate the immediate impact that a ban on embedded commissions will create.

The impact of significant consumer protection initiatives such as CRM2 that have recently been introduced should have an opportunity to be fully assessed - both on investors and the industry - before embarking on additional reforms that attempt to address similar concerns of conflicts of interest. We have in fact already seen the positive impact of CRM2 on investors' knowledge and understanding of the fees they pay and the cost of their investments. The second phase of the British Columbia Securities Commission's ("BCSC") longitudinal study focused on this matter proves this point with empirical data.

We believe caution is warranted so that Canada does not end up with outcomes similar to the UK after the Retail Distribution Reforms ("RDR") were implemented. Many middle income families that previously had access to financial advice no longer have that available to them. As well, the real danger of regulatory arbitrage that could push the mass market to products and services that may not serve them as well as mutual funds needs to be seriously considered.

Regulatory reforms should not impose a one-size-fits-all solution to a diverse industry that has served both investors' needs and our economy well to date. Nor should changes create an un-level playing field, advantaging one type of service delivery model over another. Targeted reforms and rules around the use of built-in fees along with improved transparency and meaningful disclosure are the best means to improve investment outcomes for Canadians.

2. About Primerica

Primerica is a leading distributor of basic savings and protection products to middle-income households throughout Canada. Our Canadian corporate group includes a mutual fund dealer ("PFSL Investments Canada Ltd."), a mutual fund manager ("PFSL Fund Management Ltd.") and a life insurance company ("Primerica Life Insurance Company of Canada"). Primerica has been serving Canadians since 1986. PFSL Investments has the largest salesforce of any independent mutual fund dealer in the country, with over 6,000 licensed mutual funds representatives ("representatives")[1]. It administers over $9 billion of client investments, the majority of which serve the savings needs of middle-income Canadians. Our life

[1] We have used the terms "representative" (which is how we refer to our advisors) and "advisor" (which is how the industry and the public refer to mutual funds representatives) interchangeably

insurance company contracts with 11,000 licensed life insurance agents, protecting Canadian families with over $100 billion of term life insurance in-force. As well, this company manages a segregated fund product with $3.2 billion of assets under management.

Our mutual fund dealer has an open shelf, offering funds from well-known managers. In addition, we offer a proprietary suite of mutual funds. All funds are vetted to ensure they meet the needs of the clients we serve. Over 85% of our assets under administration ("AUA") are in registered accounts. Our investment products and principles help middle-income Canadians establish a long-term savings plan for retirement, education and other needs. We work with middle-income Canadians to help them avoid the pitfalls of saving and investing: starting late, not saving enough, neglecting tax-advantaged opportunities, and buying and selling at the wrong times. We believe that we play a significant role in our clients setting and achieving their financial objectives by instilling a savings culture, and as a result, they are better prepared for their retirement and other life events. We do this with our advisors conducting face to face meetings at their kitchen table. Our advisors take a holistic approach to their clients' financial situation; it is far more than just making fund purchase and sale recommendations.

While the comments that follow to a great extent are specific to our business, we have reviewed comment letters by the Investment Funds Institute of Canada ("IFIC") and the Federation of Mutual Fund Dealers and concur with the points made in those letters.

3. The Success of Mutual Funds – And Mutual Fund Investors

Mutual funds make it possible for people of more modest means to participate in a professionally managed, well-diversified investment plan with the potential for superior returns – something that at one time only the wealthy could access. Mutual funds have successfully served investors for many years. From 1990 to 2017 amounts invested increased significantly from $100 billion to $1.4 trillion[2]. Mutual funds are purchased through a variety of channels, including direct from fund firms, discount brokerages, banks and independent advisors.

The 11th annual Pollara[3] survey of mutual fund investors in Canada, commissioned by IFIC, found that mutual funds continue to attain significantly more confidence (86%) than other investment vehicles such as stocks, GICs, bonds, and ETFs.

- According to the same study, retirement is the dominant motivation for people who purchase mutual funds.
- Eighty-eight per cent of respondents agree that they received a better return on their investments than they would have without an advisor.
- The study also found that in 2016, nine out of ten mutual funds were purchased through a financial advisor, compared to eight out of ten in 2011.

[2] IFIC INDUSTRY OVERVIEW, IFIC Industry Statistics, April 2017
[3] Pollara IFIC Survey, 11th Annual Pollara – Investment Funds Institute of Canada (IFIC) Mutual Fund Holder Survey: Confidence in Mutual Funds and Advisors Remains Very High, September 23, 2016

On May 23, 2017, the MFDA released its "MFDA Client Research Report: A Detailed Look into Members Advisors and Clients"[4] ("MFDA Research Report") which demonstrated the importance of mutual funds and the advisory sales channel to the middle income market. (Note that this does not include mutual funds sold through other channels). 80% of the 15.8 million Canadian households had $100,000 or less financial wealth which includes financial investments. Of those households, 8.9 million are represented though the MFDA channel, and 83% of those have $100,000 or less financial wealth. 27% of these households are represented through the independent advisory channel – firms such as ours – and 89% of the households in this channel have $250,000 or less financial wealth. From this data we can see that changes in regulation have the potential to disproportionately impact middle market investors.

4. Mutual Funds Are Highly Regulated

Mutual funds and their distribution are highly regulated through the rules and regulations of provincial and territorial securities commissions and self-regulatory organizations ("SRO"), the Mutual Fund Dealers Association of Canada ("MFDA") and Investment Industry Regulatory Organization of Canada ("IIROC"). Financial advisors are subject to licensing and market conduct regulations and oversight by regulators. Current CSA, MFDA and IIROC rules already contain significant provisions to protect investors. Existing regulations for the disclosure and management of conflicts in the distribution of mutual funds are extensive. A blanket ban on certain compensation models is not needed and could lead to unintended negative consequences for investors and the marketplace. We believe that specific changes would be more effective in curbing potential conflicts of interest and enhancing investor protection.

5. The Value of Advice

Independent studies have demonstrated the value that financial advisors bring to their clients. We have provided examples of these in Appendix 2. We believe that Primerica clients in particular have benefitted from the work of our representatives and the educational approach they use.

Advisors in the mutual fund industry take the time to understand their clients' entire financial situation. Much more than simply picking funds, advisor recommendations take into account financial goals, debt, spending, available income, cash flow, and tax saving opportunities. Just knowing where to start can be a challenge for many people. Advisors help clients overcome their inertia, identify better opportunities to save money and get a savings plan underway. Then, the ongoing discipline that Advisors bring to the relationship contributes significantly to their clients' success. Having someone follow up to ensure the savings plan is on track means the plan has a much higher probability of success. As we have seen over the past decade, markets can be volatile. Advisors help clients make better choices for their situation during times of significant market turbulence – buying into the market at the right times and not selling at the wrong times are particularly important. Basic dollar cost averaging principles can make a marked difference in both account values and client behaviour. Finally, advisors can help clients and their families through significant changes in their lives, often at a time when they are emotionally least able to make good financial decisions.

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[4] Compliance Bulletin #0721-C - MFDA Client Research Report, May 23, 2017

We mentioned that Primerica's clients in particular have benefitted from the work of our representatives. Our clients are largely in the middle income market, with small amounts to invest, at the start of their relationship with us. We do not impose minimum account sizes as we wish to foster a long-term investment relationship. In Canada, two factors are impacting middle income families when considering the importance of financial advice to them relative to those with a higher net worth. First, with Canadians living longer and at the same time having more responsibility for their financial well-being, the need for financial advice by middle income families has never been greater. Second, the ability and willingness of the financial services industry to provide advice to middle income Canadians is declining rapidly. Firms that have been unable to take advantage of economies of scale have chosen to impose minimum account sizes, some as high as $250,000, putting these out of reach of the average investor. Appendix 2 provides references to research on the impact of this trend.

The Consultation Paper notes that the impact of discontinuing embedded compensation on low to middle income households would be that some dealers may choose not to service these families (page 62). The Consultation Paper also recognized that some low to middle income investors will not be able to afford personal financial advice and that these investors will need to utilise online tools. "Some investors may be pushed into online advice relationships, other more simplified forms of advice, or the online/discount brokerage channel even though these services may not meet all their needs and even though they may prefer, but can no longer afford, face-to-face advice" (page 65).

The Consultation Paper suggests that emerging technologies such as Robo-advice is one way that the advice gap will be filled in the event of a decline of traditional advisory services. Certainly Robo-advice has its place in the market and it will continue to grow over time. However, it does have its limitations. It cannot effectively assess a family's entire financial situation. It is less effective at prompting individuals to invest the way we encourage or "nudge" them. Without this sort of personal interaction, many middle income clients may not even begin a basic savings and investing plan. The ongoing discipline that an advisor helps bring to an investor is significantly reduced with a Robo-advisor. The implications of significant life events may not be properly assessed using a Robo-advisor. We believe it is highly likely that investors will not be as successful, as measured by their total wealth accumulation, if the opportunity to obtain personal advice is removed.

Further, our markets are not ready for Robo-advice to take over significant portions of mutual funds sales.

- Investors surveyed by Pollara in 2016[5] overwhelmingly favoured purchasing mutual funds through an advisor. To quote Pollara, "Purchases of mutual funds on-line or through customer service representatives have never made significant inroads into the market and are currently just one-half of what they were in 2011". Generally speaking, most investors would not be comfortable buying investment products on-line or through automated advice, with comfort with on-line purchasing at 37% and with automated advice at 17%. While these numbers will change over time, drastic regulatory changes that will impact distribution of mutual funds will have a negative effect on investors.

[5] Pollara 11th Annual IFIC Investor Survey, http://www.pollara.com/11th-annual-pollara-investment-funds-institute-canada-ific-mutual-fund-holder-survey-confidence-mutual-funds-advisors-remains-high/, September 2016

- Speaking at a G20 conference in January, Mark Carney, the Governor of the Bank of England cautioned that the Robo-advice channel could pose systemic risk in financial markets if not properly monitored by regulators. Specifically, he said the technology used by Robo-advisor firms created a risk of moving significant numbers of clients towards certain assets at the same time, creating volatility and increasing asset prices in the short term. [6]

While the embedded compensation model may have imperfections, it has been a significant factor in the success of middle income Canadians in accumulating assets in well diversified and highly regulated products. Banning embedded commissions puts at risk the ability of middle income Canadians to continue to accumulate wealth at this rate. We believe that it is not only a disservice to the investing public, such a change has the potential for serious public policy consequences. High net worth investors will always have plenty of advisors willing to serve them. We believe middle income investors should have the same opportunity.

6. The Core of Our Business – Serving the Middle-Income Market

Our company was founded on providing advice and products that meet the needs of the middle income market. That focus continues today. While other companies are abandoning this market, it continues to be the core of our business. Our advisors use an educational approach with our clients, focusing on fundamentals to achieve a solid financial foundation. We believe the only way to do this effectively is with personal service. Our representatives provide this service in our clients' homes.

We are able to continue to serve the middle income market with personal advice in the face of due to several factors:

- A large client base over which costs are spread achieving economies of scale;
- the use of client-name accounts;
- a significant and continuing investment in technology;
- a compensation model with some up-front incentive while not charging clients up-front fees (see "Embedded Compensation – Serving Small Investors" below); and
- representatives that are growing their businesses (See "Renewing and Expanding the Number of Advisors" below).

Economies of scale, account structure and technology investments enable us to maintain a reasonable cost per account. The compensation model and growth of new Primerica representatives provides the incentive to provide personal advice and service to these clients.

Middle income Canadians should have the opportunity and choice to work with an advisor and it is our desire to continue to provide this service through our representatives.

7. Compensation and Conflicts

The Consultation Paper asserts that the mutual fund sales industry, which includes the related financial advice, has significant conflicts of interest that compromise the objectivity of the advice given to

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[6] Bank of Canada, Governor Carney Speech to G20, https://www.moneymarketing.co.uk/carney-warns-systemic-risks-robo-advice-fintech-boom/, January 2017]

investors, and increases the cost of advice and products sold to investors. It also suggests that embedded commissions preclude the need for fund managers to strive to achieve superior performance of their funds. We disagree with these assertions.

We understand the concerns expressed around perceived and potential conflicts of interest with compensation flowing from fund manufacturers to those making fund recommendations rather than from individuals purchasing the products. We agree it is important for investors to understand the flow of compensation. However, initiatives such as the very clear disclosure requirements of CRM2 have assisted clients in understanding fees paid to advisors. We do not believe that fund manufacturers paying dealers necessarily results in a negative impact on investor results. We have taken a number of internal steps to ensure that advisor and client interests remain aligned in the current embedded compensation environment.

As previously mentioned, we have a relatively open product shelf. While it is not possible for us to have every fund in Canada available to our clients, the number of funds available through our dealer is in the thousands. Generally speaking, the compensation paid by fund manufacturers is similar for similar products. There is no additional compensation to our representatives for recommending our proprietary funds over third party funds, or one third party fund over another. There are funds in the market that offer higher than average trailer fees. Our practice has been to not allow these funds on the product shelf as it would be very difficult to demonstrate that a fund recommendation by our representative was not influenced by the higher compensation. At the same time, the number of funds in the market with a higher trailer fee has been declining over the past three years.

While the conflict of having fund managers pay compensation still exists, its ability to influence behaviour becomes moot when there is a variety of fund managers and funds to choose from, and no compensation or incentives to representatives from recommending one fund over another. If representatives were not already looking to maximize client returns (and we believe most actually were) then once compensation conflicts are substantially removed, maximizing investor outcomes clearly becomes paramount when representative make recommendations. With the focus on fund performance, fund managers must strive for superior returns or they will lose assets. We have seen this in the market in general, and in funds flows to fund managers and funds in our own book of business in particular.

The Consultation Paper concentrates on the potential misalignment of interests between advisors and investors. It does not give credit for the significant alignment of interests between these groups. Ultimately investors expect to be successful and grow their savings. If investors are not achieving these results, then it is the advisor that will be held accountable. Advisors in this situation will be at risk of losing their clients. Often clients are well-known to their advisors and the personal nature of these relationships provides advisors an additional incentive to have good performance. Finally, as investors succeed, so do their advisors, through asset growth, client retention, additional amounts from their clients to invest, and referrals to new clients. To suggest there is not a significant alignment of interests between clients and their advisors, or to ignore it, is simply wrong.

8. Embedded Compensation – Serving Small Investors

We appreciate the CSA including in the Consultation Paper that commissions and ongoing asset based fees would continue to be allowed, and that fund managers would be allowed to redeem mutual fund units for these fees and remit the proceeds to dealers. It would need to be made clear to the investor the amounts they were paying and whom was being paid. We understand the intent is to remove the conflict of interest of manufacturers paying dealers and their advisors. Banning embedded commissions, however, would eliminate one compensation model that, up until recently, has been popular in the independent advisory channel: the Deferred Sales Charge ("DSC") model.

Although it has its critics, and does result in a small number of complaints from time to time, the DSC model works well, particularly for those with smaller amounts to invest. A lot of work goes into an advisor/client relationship, particularly up front when an advisor is getting to know a new client and their personal and financial situation, explaining his or her services to clients, educating the client on financial concepts, making recommendations for the way forward, and completing all of the documentation required to satisfy regulatory and dealer requirements. Without up-front compensation it may not be economically feasible to work with individuals that have modest amounts to invest. We believe the unintended consequence of a compensation ban is that smaller investors – which are the majority of Canadian households - will face significant increases in the cost of financial advice or simply be ignored altogether, an outcome which has significant public policy implications. There is already evidence in the marketplace of both of these outcomes when looking at the offerings of non-DSC based investment dealers.

The benefit of the DSC model is that it provides some up-front compensation to advisors while not reducing the amount available for clients to invest. The up-front compensation is financed by the fund manager and paid for through a reduced trailer fee. As an example, on a $10,000 initial trade, the compensation from fund manager to the dealer in the industry is generally 5% or $500. The dealer keeps in the range of 20% of this for its operation, 20% will go to the Branch Manager supervisor, and the remaining $300 will go to the advisor, out of which must be paid expenses such as office rent, supplies, travel, tax and similar costs. Without up-front compensation, there is generally a 1% trailer fee which provides a total of $100 of compensation to the dealer, Branch Manager and advisor spread over the first year. There is far less incentive to take on this client without the up-front compensation.

It is by no means certain that investors will incur a deferred sales charge. The DSC model works for investors when they are investing for the long term, particularly in RRSP accounts. Rebalancing can occur within a fund company's offerings without cost, and an annual 10% unit withdrawal free of deferred sales charges is usually available to enable investors to meet liquidity or systematic withdrawal requirements. Our firm's experience is that while deferred sales charges are incurred, the amount of these charges relative to the fund amounts being redeemed are relatively small on both an absolute dollar and percentage basis. The vast majority of redemptions at our dealer do not incur a deferred sales charge.

The MFDA Research Report[7] found that 42% of funds $100,000 and under had a DSC load, 6% had a Low Load, and 32% of funds between $100,000 and $250,000 had a DSC load while 6% had a low load. Clearly this model that provides some up front compensation while not reducing the amount to invest has a significant place in the market.

We have heard the argument that the DSC model is already in decline and that it no longer has a place in the market, and so it should not be a factor when considering whether to ban embedded compensation. The problem with this position is that it does not take into account firms that have made a business decision to focus on higher net worth investors.

[7] Compliance Bulletin #0721-C - MFDA Client Research Report, May 23, 2017

The Consultation Paper notes on Page 48 a public announcement by Investors Group in 2016 regarding their decision to discontinue the use of the DSC fee structure. It should be noted that the Dealer's 2016 decision was followed this year with their announcement that they will focus their business on high net worth clients, significantly downsizing their advisors and support staff. In an Investment Executive article, their CEO was quoted as follows: "We're moving more up-market". "We were probably working too hard for the smaller clients and now we're working for the right ones. We don't want to walk away from our smaller clients but they don't need that level of sophistication at that stage of their lives vs somebody who has accumulated significant wealth and needs to know that their retirement is going to fund the rest of their lives." While we respect their business decision, far from supporting the CSA's view that DSC is no longer relevant, it supports our case that it is very relevant for the very investors that mutual funds were designed to serve: those with more modest amounts to invest.

9. Renewing and Expanding the Number of Advisors

When considering the case for embedded commissions and DSC in particular, one significant point is rarely raised – the recruiting and development of new advisors. Our business model is based on bringing in new representatives and helping them to be competent and productive. They come from all walks of life and a wide variety of diverse backgrounds. Over half of the representatives entering our business are women. We are attracting millennials who are looking for an alternative to a job with a large corporation (which are becoming scarcer). Not only does this help renew an aging financial advisor force in Canada with an average age in the 50's, it helps Canadians of all backgrounds access much needed financial advice and products. Financial advisors are likely to serve their communities. Our mutual funds representatives reflect the face of Canadians and we are proud of our diversity.

Our representatives also have broad coverage of smaller, rural and remote communities. Just the distances involved in serving investors in these communities makes it difficult to obtain advisory services even now. A ban on embedded compensation would disproportionately disadvantage middle income Canadians in these areas.

Developing new advisors and servicing smaller accounts is complementary. A new advisor, under the supervision of someone more experienced, is more likely to put in the effort on a smaller account in order to gain experience and build the foundation of a book of business. Established advisors are far less likely to put in the effort to do this. Still, new advisors need to be compensated for their efforts. The DSC model works well for all concerned. The investors, who do not have large sums of money to begin with, are not put in a position of needing a significant percentage of the amount they have to invest to pay for advice; they are provided with the advice and the products that they need, and the advisors are compensated for their efforts. What is at stake is not only the ability to serve smaller investors, but the environment to attract new advisors and renew a rapidly aging advisory force.

10. Disproportionately Impacting Certain Business Models

We believe the proposal to ban the use of commissions will lead to a less competitive marketplace, as a ban would impact some business models significantly more than others. Financial advice and product sales to consumers can be provided through various channels, including face-to-face meetings, over the phone, and through the internet or other digital media. The Consultation Paper divided the distribution channels into the following categories: branch delivery, online/discount brokers, full-service brokers, financial planners/advisors and private wealth management (page 33).

Our concern is that banning embedded commissions results in favouring certain types of business models over others. This should not be the consequences of regulation, whether intended or not. Instead, every effort should be made to target the issues that have been identified – in this case conflicts – while allowing services valued by investors to continue. We understand and support rules and regulations in the financial service sector to protect the investing public, but believe they should target specific conduct rather than negatively impact broad sectors that are generally functioning well and providing a useful service to the investing public.

11. Canada's Financial Services Regulations Serve Investors Well

We believe that the current regulatory environment in Canada is serving investors well. Regulators in some other jurisdictions such as Australia and the United Kingdom determined it necessary to strengthen rules on compensation. However, this was in response to specific regulatory gaps or events that do not exist in Canada. Canada has robust regulation over the sale of mutual funds through CSA rules and the Self-Regulatory Organizations (IIROC and MFDA). It does not appear that a similar level of regulation existed in jurisdictions where it was determined that drastic action was required to protect the investing public. In its Financial Advice Market Review ("FAMR")[8], published in March 2016, the FCA reported that up to 16 million people could be trapped in a "financial advice gap" and that they need advice but can't afford it. The regulators acknowledge that the problem may stem from a ban in 2013 which stopped financial advisors from offering advice to customers and being paid by commissions from the product providers. They are considering ways to reverse the negative consequences on investors of decisions.

Mutual fund failures and harm to investors from funds themselves is virtually non-existent. While there are complaints as evidenced by the matters investigated by the Ombudsman for Banking, Savings and Investments and IIROC and MFDA cases, these are extraordinarily few in number as compared to the tens of thousands of advisors, millions of investors and tens of millions of fund positions. Using this model, investor have accumulated a significant percentage of the $1.4 trillion in mutual funds - savings which quite possibly would not have existed without funds and advisors.

12. Alternative Recommendations

Rather than an outright ban on embedded commissions, we believe there are a number of measures than can be implemented that will reduce the potential for conflicts of interest when product recommendations are being made to clients. We have already implemented some of these in our business and our clients are benefitting from them. The key concept behind many of these is looking at what drives advisor behaviour. When the compensation to the individual making the recommendation is the same for like products it will not drive a recommendation towards a certain product or products. The following recommendations will help reduce this impact of this conflict of interest.

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[8] FAMR progress report, Financial Advice Market Review (FAMR), March 2016

Cap Trailer Fees

Some mutual funds and fund companies carry a higher trailer fee, in some cases 25 basis points higher than generally available in the industry for a given asset category. This difference is high enough to potentially influence recommendations to investors, and, at a minimum, results in the perception of a conflict of interest. The industry is moving away from these higher trailer fees on its own. Elimination of the remaining higher trailer fee funds will remove that conflict.

We note that some fund categories carry a significantly different trailer fee than others, for example equity funds as compared to fixed income funds. While this sets the potential for conflicted recommendations, client circumstances are significantly different between individuals investing in these types of funds. As a result, we believe know your client requirements will overcome these conflicts.

Deferred Sales Charge Restrictions

We make extensive use of the DSC model. As noted earlier, it works particularly well for investors with lower amounts to invest and to support new entrants into the industry. Investor protection can be enhanced through the implementation of certain restrictions. The Paper notes the decline in the DSC model but to us it is unclear what is driving this – a decision to no longer offer the DSC option, or a move into higher net worth markets where clients can be effectively served with other compensation models. It is likely that both of these factors have had an impact.

Following are some suggested restrictions on the use of DSC:

- Once a DSC schedule has been completed on an account, the amount invested through a dealer is not put into a new DSC schedule at that dealer. A fee model with a 0% front end commission is to be used. This achieves several things. It removes the incentive to churn accounts, unnecessarily moving investors to other products solely to generate a commission for the advisor. The advisor is still being paid a trailer fee to provide service as needed. It limits the amount of time that an investor can be subject to a deferred sales charge, reducing the potential for investor "surprises" resulting in potential complaints. It recognizes and provides compensation for the often extensive up-front work required of advisors to establish a relationship with new clients to get to point of making recommendations.

- Limit DSC on older ages. Seniors are potentially more vulnerable to abusive practices. Their ability to save and make up for fees is usually limited. They may be required to use a significant portion of their savings on short notice to meet medical or other unanticipated events. Deferred sales charges would reduce the amount available and may lead to a complaint. We recommend limiting the use of DSC fees at ages which are appropriate to largely reduce the potential for these fees to be incurred. We note, however, that funds generally provide an annual withdrawal free of charge of 10% of the assets invested. Our experience has shown that for those investors relying on their funds for ongoing income, this provides them with sufficient money to meet their needs without incurring fees.

- Limit the use of DSC to an individual's time horizon. The DSC period would not be longer than the individual's time horizon when they would expect to require their money. This would significantly reduce the potential for DSC fees to be incurred.

- Enhanced disclosure. While there is already significant disclosure of DSC fees in Fund Facts and other documents, given the potential for such a fee to actually be incurred, it may be warranted to provide a separate disclosure of the DSC schedule to clients, and to have it acknowledged by them in writing or some other positive action such as a computer check box. Focussing on this important item should reduce the potential for surprises at a later date should deferred sales charges be incurred.

Enhanced Disclosure

The Consultation Paper discounts the effectiveness of disclosure in informing and educating investors. We believe that the validity of this comment depends on the nature of the disclosure. We recognize that mutual fund costs and compensation are complex subjects. Prospectuses, Annual Information Forms, Management Reports of Fund Performance and the like are challenging to read for the average retail investor. However, disclosure is changing. The Fund Facts document was a significant improvement in providing concise, clear disclosure. CRM2, with its one-page disclosure of the actual amount of fees paid by fund managers to dealers and fees paid directly to dealers, and the individual investment returns, was a further improvement. This disclosure is new, and we believe it is very effective in showing investors what they are paying, whom is being paid, and the returns on their investments.

A research study released by the Gandalf Group, "The Canadian Investors' Survey – An Opinion Research Study on Fees & Advisory Services"[9], found a high percentage of investors were reading at least some of the disclosure statements or reports provided to them (page 13). For those with assets less than $50,000, 46% read the statements or reports every time they received them, and 40% read them only some times when they received them. The combined percentages were higher for investors with greater amounts invested. This indicates that investors are paying attention to the disclosure documents they receive, and improved disclosure has an excellent chance of being reviewed by them.

The original intent in CRM2, among other things, was to show investors the flow of funds from fund managers to dealers – really to help address the conflict situation that is the subject of the Consultation Paper. IFIC recently announced support for CRM3, full disclosure of the actual amount of all costs incurred by investors. We support this initiative. As CRM3 is developed, its focus should be on simple disclosure of exactly what investor are paying, and clearly setting out the flow of funds that would be considered a conflict of interest. Combined with the existing CRM2 disclosure, this will give investors the information they need to assess potential conflicts of interest that that may exist with their advisor, dealer and/or fund manager. Provided prominently on one or two sheets of paper we believe it will be effective disclosure.

The longitudinal study commissioned by the British Columbia Securities Commission ("BCSC"), conducted by Innovative Research Group, recently completed the second phase of their research "Investor Readiness for Better Investing"[10]. The study examines BC investors who hold securities and

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[9] The Gandalf Group. *The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services*, On behalf of AGF Investment Inc., 2017. Survey conducted April 7, 2017 to May 5, 2, 017

[10] British Columbia Securities Commission (BCSC), Investor Readiness for Better Investing (Part 2), April 26, 2017

invest through an advisor, to understand and explain the effect of the CRM2 annual reports on the knowledge, attitudes, and behaviour of investors. The results were encouraging:

- Most people think their CRM2 reports were easy to understand (62%) and provided the information they need to understand fees associated with their investments (67%).

- Since the first part of the panel study, investors are more aware of the fees, both direct and indirect, after receiving their CRM2 reports (76% and 59% compared to 67% and 48% in November). Investors with small portfolios became substantially more aware of direct fees (up to 61% from 31% in November).

- Investors had slightly more knowledge that fees impact returns and that products can have different fees; those with small portfolios (<$50k) were much more likely to agree that fees can be negotiable (47%) and that similar products can have different fees (71%) than before receiving their CRM2 reports (32% and 49%).

Disclosure can also be improved on subsequent purchases. Key pieces of information can be provided succinctly to investors at the point of sale and during the course of the relationship with the investor.

13. Significant Change Warrants Careful Consideration

We support changes that strengthen client protection and increase investor knowledge; a ban on embedded compensation goes far beyond that. As noted earlier, such a ban has the potential of eliminating the ability of those with lesser amounts to invest to obtain tailored advice. We believe this result is a far worse outcome than the conflicts, real or perceived, in the current system.

We are pleased that the CSA is undertaking a multi-year research project to measure the impact of CRM2 and Point of Sale changes. Industry and regulators worked together for several years to bring forward these initiatives to improve the transparency and client knowledge of costs and their investment performance. Implementing this disclosure came at considerable cost and effort on the part of industry. Fundamentally changing the compensation structure before we know the actual impact of the CRM2 and POS will not allow industry and the regulator to determine what worked well and which aspect of the disclosure needs to be improved. We believe that before the CSA makes any decision on compensation models, we must wait until the research on CRM2 and POS is finished and the data analyzed.

Conflicts of interest also exist in fee arrangements. The banning of embedded compensation will not eliminate conflicts from the relationship that advisors, dealers and managers have in relationships with their clients. The objective of regulation should be to minimize the potential for conflicts to cause harm, either through targeted elimination or informing investors, while allowing the arrangements to continue where there is a significant alignment of interests.

Substantial rules to deal with conflict of interest situations already exist. IIROC Rule 29.1 requires that dealers and their representatives observe high standards of ethics and conduct in the transaction of their business and not engage in any business conduct or practice unbecoming or detrimental to the public interest. MFDA Rule 2.1.4 requires that material conflicts of interest must be addressed by the exercise of responsible business judgment influenced only by the interests of the client. It is important that existing rules be taken into consideration before introducing new regulations.

A targeted approach to managing conflicts of interest is most efficient, and we firmly believe that improved transparency through enhanced meaningful disclosure, and investor education are the answers to improving and managing conflicts of interest.

Conclusion

We support the CSA's intent to reduce the impact of conflicts of interest that may be harmful to investors. However, it is clear that mutual funds investors today benefit from the advice that comes with mutual funds in the advisory channel. There is no empirical evidence of harm to investors as a result of the current compensation structure. Enhanced transparency, choice for investors, and targeted rules and reforms to curb conflicts will go a long way to further improve investor experience for Canadians. We firmly believe that a one-size-fits-all ban on compensation for one financial savings vehicle is not necessary nor helpful to investors and harms far more than benefits investors. While a broad ban of embedded commissions may eliminate some (but not all) conflicts, it will also cause significant harm to investors with smaller amounts to invest by reducing or eliminating access to advice leading to significantly reduced savings. Not just a regulatory issue, this is a public policy issue that will impact Canadians' ability to care for themselves as they age and put additional pressure on governments already straining to support an aging population.

The CSA should not underestimate the potential harm from a ban of embedded compensation. To a great extent, the existing $1.4 trillion now invested in mutual funds was reached using this model. While the industry is changing, one of the reasons that investors are able to migrate to other platforms and fee structures is that they have accumulated significant wealth in mutual funds. New and small savers on the other hand may never take the step into the investment spectrum, leaving swaths of the mass market out of saving and investing.

The mutual fund product and the independent advice channel are highly regulated and provide significant investor protection. They were built for the investor with modest amounts to invest. We believe it is incumbent on industry and its regulators to ensure that it continues to serve this segment of the market well, with real choice to help them achieve their financial goals.

We appreciate the opportunity to comment on this important issue, and look forward to participating in any further public discussion on this topic. Should you have any questions or wish to discuss these comments, please feel free to contact us.

Sincerely,

John A. Adams, CPA, CA
Chief Executive Officer

APPENDIX I – Responses to Consultation Questions

CSA questions	Primerica response
1. Do you agree with the issues described in this Part (Part 2. A)? Why or why not?	We disagree with several assertions made in this Part: 1. *"Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors"*: While we don't disagree that embedded commissions could raise conflicts of interest, we believe that these can be managed through targeted reforms. In 2016 the MFDA conducted a review to assess compliance with certain sections of National Instrument 81-105 (Mutual Fund Sales Practices) and to identify any compensation or incentive practices that might lead to mis-selling or unsuitable advice. While they identified a small number of instances where there was concern about incentives and compensation practices related to mutual funds sales, the MFDA expressed a need to extend 81-105 requirements to investment products beyond mutual funds. Lack of similar regulation is creating compensation and potential sales biases. Banning embedded fees on mutual funds, without even considering extending existing regulations to other investment products and referral arrangements, is a dis-service to investors. 2. "*Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs"*: We believe that recent gains in disclosure are going a long way in increasing investor awareness, facilitating a more meaningful dialogue between investors and their advisors and empowering investors in choosing the best fee structure to suit their particular needs. The second part of a longitudinal study conducted by the BCSC found significant improvements in investor awareness of fees as a result of the recent implementation of CRM2. Specifically, since the first part of the panel study which was conducted pre-CRM2, "*investors are more aware of the fees after receiving their CRM2 reports (76% and 59% compared to 67% and 48% in November). Investors with small portfolios became substantially more aware of direct fees (up to 61% from 31% in November)*." According to the study, those with small portfolios (<$50k) were much more likely to agree that fees can be negotiable (47%) and that similar products can have different fees (71%) than before receiving their CRM2 reports (32% and 49%). These are early but encouraging results. We support IFIC's position that enhancing simplified and meaningful disclosure through CRM3 will improve investor knowledge and outcomes even more. 3. *"Embedded commissions paid generally do not align with the services provided to investors"*: We disagree with the assertion that benefits derived from advice are intangible.

	In Canada, advice is readily available because of the foundational principles of mutual funds – shared costs, risks and rewards – extend to advisor services. The latest research released by the Center for Interuniversity Research and Analysis of Organizations (“CIRANO”) in 2016, The Gamma Factor and the Value of Financial Advice, provides ample empirical evidence that advice and by extension fees for advice provide value for investors. The study found that, for identical households, those with an advisor for 4 years or less will have 69% more assets and 290% more with an advisor for 15 years or more.
3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.	The majority of mutual funds in Canada are currently sold with embedded commissions. This compensation method allows for economies of scale, enabling Dealers to compensate advisors upfront for serving even the smallest investors while also paying for operational costs of processing a transaction. The benefit to the investor is that the DSC model provides some up-front compensation for the advice that they receive without reducing the amount available to invest. The up-front compensation is financed by the fund manager and paid for through a reduced trailer fee. It is important to consider real numbers, rather than having this discussion in the abstract, to understand the potential impact of an embedded commission ban on services to small investors. As an example, on a $10,000 initial trade, generally in the industry the compensation from fund manager to dealers is 5% or $500. The dealer keeps in the range of 20% of this to offset its operational costs, with another 20% paid to the Branch Manager supervisor to offset their effort and costs, and the remaining $300 paid to the advisor. The advisor has to cover expenses such as office rent, supplies, travel and similar costs. Without up-front compensation, there is generally a 1% trailer fee which in this case would provide a total of $100 of compensation to the dealer, Branch Manager and advisor spread over the first year. This would leave no incentive to take on and serve small investors. The embedded commission structure allows Dealers such as PFSL, to compensate representatives upfront for providing service and advice to all clients regardless of size of account, while making use of efficiencies and economies of scale to offset Dealer costs. The DSC model works for our investors as they are often investing for the long term, particularly in RRSP accounts. Over 85% of our funds are in registered accounts with long term savings goals. Fund switches are generally allowed within a fund company’s offerings, and an annual 10% withdrawal is usually available to enable investors to meet income requirements, both without incurring deferred sales charges. Our firm’s experience is that while there are deferred sales charges being incurred, the amount of these charges relative to the fund amounts being redeemed are relatively small on both an absolute dollar and percentage basis. Within this context, we strongly believe that the embedded fee structure is appropriate and serves investors and the industry well.

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption: • mutual fund • non-redeemable investment fund • structured note • Should the product be subject to the discontinuation of embedded commissions? If not: a. What would be the policy rationale for excluding it? b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?	We strongly believe securities regulators need to mandate consistent rules across all financial products. We remain committed to the principles of timely, simple disclosure to investors to ensure that investors are well equipped to make well informed decisions about all the financial products they are purchasing. If embedded compensation is only prohibited for mutual funds, it would encourage some to sell products which allow embedded commissions. In their recent compliance reviews, the MFDA found that products and services that are not subject to 81-105 or parallel regulation were sold with high fees and little scrutiny. Our understanding is that the MFDA is raising this issue with CSA regulators and we strongly encourage the CSA to review conflicts of interests inherent in less regulated products and services and to level the regulatory landscape for all investment products in a measured, targeted manner. It should also be noted that only a handful ofinternational jurisdictions that reviewed a potential ban on embedded fees proceeded with this approach and all of those who banned embedded fees did so across a wide range of financial products and not just only on mutual funds.
7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund, security or structured note? Why or why not?	No. The current rules and regulations governing these payments are providing necessary protections and can be enhanced further through targeted reforms and meaningful disclosure. For low to middle income investors purchasing mutual funds, embedded fees provide optimal means to gain access to capital markets. 81-105 provides ample regulatory guidance and investor protection measures on mutual funds sales. Newly implemented disclosures are also helping to improve mutual funds sales practices and investor knowledge which will further curb real or perceived conflicts of interest. As well, a move to a full cost disclosure regime, or CRM3, will ensure that all costs and fees related to a mutual fund are well understood and fully transparent. Similar measure can be extended to other investment funds and securities.
11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.	While we don't believe that this approach would fully mitigate the impact of a ban on embedded commissions, it may reduce some investor aversion to paying upfront fees for investment services. This approach is not optimal for investors as they will lose a portion of their investable assets upfront and may have potential tax consequences. However, in the event of an embedded fee ban, it would be important to allow the described practice.
12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?	We continue to believe the proposal to ban embedded commissions in their entirety is not needed and will not improve the financial well-being of the majority of Canadians who are small investors in the middle income market. Prohibiting embedded commissions and requiring clients to negotiate fees will possibly result in worse investor outcomes as most investors will have a harder time understanding the net impact of different types of fees on their account performance. An outright ban on embedded fees will also reduce service and the availability of advice to these clients, resulting in less savings and worse investment outcomes. CRM2 became fully implemented in Canada in 2016 which increased the transparency of fees that mutual fund investors pay. The mutual funds industry wants to move to further enhance transparency by moving to a full cost disclosure regime, or CRM3. The effect of CRM2 on investor awareness and behaviour is already being noted through a longitudinal study conducted by the BCSC. It is paramount that regulators take an evidence based approach to regulatory reform on such an important structural issue. We strongly believe that the three-part study by the BCSC, with two parts already

	completed, should form part of the evidence considered before imposing a sweeping ban on embedded compensation. There is no evidence that embedded commissions are leading to substantial harm to investors and their investments. Conflicts and potential of harm can be mitigated through improved disclosure, transparency and targeted reforms. For example, banning DSC on sales to seniors may be an appropriate step.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?	Rather than banning embedded commissions outright, we recommend that following regulatory initiative, which we believe will be more effective and less disruptive in addressing the concerns expressed by regulators. Please also see “Alternative Recommendations” section of our letter for more detailed explanation for our recommendations:
	
	• Cap trailer fees to ensure that higher trailer fees for the same essential services don’t distort sales recommendations
	• Improved point of sale and ongoing disclosure, including a separate DSC schedule
	• Limit the use of DSC as follows:
	    o Once a DSC schedule has been completed on an account, the amount invested through the same dealer automatically goes into 0% front end commission
	    o Limit the use of DSC for senior investors
	    o Limit the use of DSC to an individual’s time horizon in order to reduce the incurrence of DSC charges

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular: • Will investors receive advice and financial services that are more aligned with the fees they pay? • What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors? • Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors? • What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors? • What effect will the proposal have on the cost and scope of advice provided to specific investor segments?	Embedded fees allow the mass market to access capital markets efficiently and cost effectively. A blanket ban on embedded fees will result in loss of access and service for those with small accounts while increasing the overall cost in the system as result of loss of some economies of scale that exist in today’s environment. • Investors with small accounts may not receive any advice while the overall cost of operation and compliance may need to be shouldered by smaller numbers of investors, therefore increasing overall cost of advice and service. • Investors surveyed by Pollara in 2016 overwhelmingly favoured purchasing mutual funds through an advisor. To quote Pollara, “Purchases of mutual funds on-line or through customer service representatives have never made significant inroads into the market and are currently just one-half of what they were in 2011”. Generally speaking, most investors would not be comfortable buying investment products on-line or through automated advice with comfort with on-line purchasing at 37% and with automated advice at 17%. While these numbers will change over time, drastic regulatory changes that will impact distribution of mutual funds will have a negative effect on investors. • Discretionary advice may increase in the higher income brackets as many firms that are moving toward wealth management may find it more lucrative to work in a fee based environment. However, for the mass market that is unlikely to be the case as discretionary advice will remain unaffordable for most. It is difficult to compare to other jurisdictions as the market and the circumstances are different in Canada. For example, in Australia, the

	mandatory nature of their national retirement savings program creates a different market and environment. • While a ban may push growth of the online discount brokerage channel, it is unlikely that the majority of the mass market will avail itself of this channel as their preference remains face-to-face advice as this stage.
17. Do you think this proposal will lead to an advice gap? In particular: • Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc. • Do you agree with our definition of an advice gap? • Should we differentiate between an advice gap for face-to-face advice and an advice gap generally? • What types of advice or services currently provided today would be most affected by the proposal? • Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap? • How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated? • Do you think that online advice could mitigate an advice gap? If so, how?	We believe banning embedded compensation will require many firms to fundamentally restructure their businesses, resulting in higher minimum account balances beyond the reach of thousands of middle income households, reduced access to financial professionals, reduced investor choices, and ultimately, lost opportunities to accumulate significant retirement savings for millions of Canadians in the low to middle income market. When firms provide a client with a product, there are other fixed costs associated with the sale of the products such as marketing expenses, compliance costs, customer-service call centres, online portfolio analytical tools, software applications available to advisors' representatives, and educational material. For smaller-size accounts typical of middle income investors the profitability of these accounts may not cover these other fixed costs. Primerica can serve small investors without sacrificing service because of economies of scale, significant investments in back-office technology to create efficiencies and a compensation structure that allows us to provide our advisors with some upfront compensation without directly charging our clients. The current compensation model allows those with modest means to participate in the financial markets through the use of a financial advisor. Research conducted by the Pierre Lortie from the University of Calgary School of Public Policy concluded that "in absence of bundling, the unavoidable consequence is that a combination of lower aggregate costs per investor and higher expected fee income will motivate financial firms (and the financial advisors in their employ) to target higher-net-worth investors and shun less wealthy households." • Lower net worth individuals will be impacted the most as many firms will implement minimum account sizes, precluding advice based services to this group. Rural and remote clients may also be impacted as without upfront compensation it may be less attractive to serve investors face to face if distance is involved. Finally, while millennials and younger generations may be more comfortable with technology and online based advice, various research reports point to the fact that the vast majority and especially those older are not comfortable investing without face to face advice. • We believe that the CSA's definition of advice gap is too narrow and does not capture the true value of face to face advice. • Loss of face-to-face advice at this point in time will translate to a general advice gap as the vast majority of mutual funds in Canada are sold through advisors, mainly with embedded compensation. Majority of Canadian investors still express concerns about investing through online methods. • Face-to-face advice and sales of mutual funds through advisors will be impacted the most. This also constitutes the vast majority of mutual funds sales in Canada. • We believe that CRM2 is already providing positive results in terms of improving client knowledge and understanding of fees they pay and compensation their advisors receive. We believe that before embarking on a

• Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?	wholesale ban on a widespread compensation method that will further increase cost on the industry and therefore on investors, we need to wait and evaluate the impact of CRM2, of other possible targeted reforms and consider a move to CRM3. • We have provided alternative approaches to mitigating concerns expressed by the CSA, both in our letter and in response to question 13, that don't involve a ban on embedded commissions. • Online advice will not be taken up by the majority of investors. Currently the vast majority (9 out of 10) of mutual funds are sold through an advisor. It would be naïve to assume that all of these sales could shift to fee based and online sales. Further, online channels do not offer the same "nudge" factor as a real life advisor. Nor would it address the "gamma factor" of value of advice as expressed by experts such as the CIRANO center. • Regulatory arbitrage could shift investors to seek advice through other channels that may not be impacted to the same extent by the proposed changes. However, the vast majority of Canadians still trust mutual funds as their preferred investment vehicle and the majority of investors buy their mutual funds through an advisor. The IFIC Pollara Poll has found year after year strong trust among investors and their advisors. We would not anticipate that all those disenfranchised by upfront and direct fees, or high minimum account sizes, would move to a different investment vehicle or outlet. Further, it is unclear how conflicts and high cost of ownership for investors would be addressed in these alternate channels. Limited shelf spaces focused on proprietary products, generally higher MERs in alternate investment vehicles such as segregated funds, should all be carefully considered when evaluating the ability of alternate providers to step in to close an inevitable advice gap in the event of an embedded fee ban on mutual funds.
18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular: Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	Over the past few years, many firms have chosen to change their compensation model for their advisors, and more companies will probably follow this trend. Some firms have made a business decision to change how they compensate their advisors. Each business model is unique and services a particular segment of the market. Regulating how firms compensate their advisors would choose winners and losers in the marketplace and negatively impact a competitive marketplace. It should be noted that firms that have changed their compensation away from embedded fees, have also limited their services to higher net-worth clients and larger accounts. While that is a legitimate business decision for some, we don't believe that a regulatory ban on certain types of compensation is the right public policy decision. Over time, technology assisted advice and distribution, along with more transparency will influence and change compensation structures in the industry. However, getting there should not be forced through a one-size-fits all regulatory rule.
20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada	Fee-based financial advice requires individuals to pay up front, usually out of their pocket, for advice. Many Canadians are not willing to pay upfront for financial advice. To operate a profitable business many fee-based advisors require minimum account thresholds before they engage with an individual – most thresholds are set between \$100,000 and \$250,000.

limiting the use of fee-based series by dealers? Potential impact on competition and market structure	Those identified as the mass-market in this Consultation Paper would not meet the required account minimums to work with a fee-based advisor. Banning embedded commissions would result in a significant portion of the mass-market not qualifying for personalised financial advice.
21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4?	We have reviewed and are in agreement with the response provided by IFIC.
22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular: Is there any specific operational or technological impact that we should take into consideration?	The Consultation Paper acknowledges that a transition to direct pay arrangements will likely require significant effort by industry. In the limited time available, we have had preliminary discussions with a few fund managers, specifically to process fee transactions on client-name business. Some already have the ability to process such transactions, but in some cases are doing so only on large dollar accounts. Other firms do not have this capability, and would have to build it at considerable cost, or no longer sell into this market. It is not clear whether an industry-wide solution would be available for fee-based, client-name accounts. While much more work would need to be done to assess the impact, the operational challenges of implementing such a system portends to increase cost, reduce investor choice, and eliminate service to large segments of the market.
23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today. • Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight? • To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?	Banning embedded compensation will not eliminate all conflicts of interest. IIROC recently published a review of compensation and conflicts and noticed that many dealers are providing additional incentives to representatives in the form of performance bonuses linked to fee-based assets. IIROC expressed concern that clients may be moved into fee-based accounts, whether or not such accounts are consistent with the customers' best interest especially for those who are "buy and hold" clients and who will be paying ongoing fees without receiving a comparable level of continuous service. So conflicts are not restricted to embedded fee structures. Firms will continue to need controls and oversight of their advisors regardless of the compensation model.
24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?	We believe banning embedded compensation will require firms to fundamentally restructure their businesses by establishing and collecting several types of fees from each client for services that are currently covered by the embedded fee model. Banning embedded compensation will not improve our firms' ability to service individuals and families with smaller amounts to invest. Embedded commissions allow Dealers to compensate their advisors who serve small clients upfront for their services. Further, larger pools of small investors allow for economies of scale for Dealers, therefore pooling the costs of services and operations. Banning embedded compensation challenges these business efficiencies.
26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the: • career path; • attractiveness of the job; • typical profile of individuals attracted to the career; • recruitment; and	Developing new advisors and servicing smaller accounts is complementary. A new advisor, under the supervision of someone more experienced, is more likely to put in the effort on a smaller account in order to gain experience and build the foundation of a book of business. Established advisors are far less likely to put in the effort to do this. Still, new advisors need to be compensated for their efforts. The DSC model works well for all concerned. The investors, who do not have large sums of money to begin with, are not put in a position of needing a significant percentage of the amount they have to invest to pay for advice, they are provided with the advice and the products that they

Relative attractiveness of careers in competing financial service business lines?	need, and the advisors are compensated for their efforts. What is at stake is not only the ability to serve smaller investors, but the environment to attract new advisors and renew a rapidly aging advisory force.
27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring: • access to advice for investors, • choice of payment arrangements for all investor segments, and • A level playing field amongst competing investment products?	Given that the mass majority of the current mutual funds sales are on an embedded fee basis, we don't believe that a blanket ban on the same can be mitigated in any meaningful way as it will cause a significant structural disruption of the industry. Instead, we would propose alternate approaches to addressing the concerns expressed by the CSA (see Question 13). With regards to a level playing field, this cannot be accomplished other than by imposing the same compensation ban on all other investment vehicles. We believe this to be beyond the purview of the CSA.
29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions?	We are supportive of the IFIC response to this question.
30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements, • To what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?; • does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and • What measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?	Economies of scale works both ways. While lower net worth investors may pay lower fees for essentially similar services due to lower amounts that they invest, therefore arguably being cross-subsidized by higher net worth accounts, higher net worth clients also benefit from the mass market participating as more participants paying for the same infrastructure reduces the cost for all participants. The current system functions well for investors, advisors and companies alike.

APPENDIX II – Additional Supporting Research

Value of Professional Financial Advice

- Most consumers are unable to make optimal financial choices by themselves (Campbell 2016).
- An experimental study on unadvised investment decision making[11] found that 75 per cent of investment decisions were suboptimal and that 98.6 per cent of respondents failed to make all five investment choices optimally (Chater et al. 2012).
- While poor financial decision-making cuts across socioeconomic categories, it is most pronounced among the poorest, oldest, youngest, least financially literate, and least educated consumers (Fischer and Gerhardt, 2007; Guiso and Jappelli, 2008; Kimball and Shumway, 2010; Klapper et al., 2013; Lusardi and Mitchell, 2007; Lusardi and Tufano, 2009).
- The latest findings of a longitudinal study by the CIRANO Institute found that for comparable households those with a financial advisor gain 69% more value for their investment assets. The additional value reaches 290% for a household with an advisor for 15 years or more (3.9 times the value of assets of the equivalent non-advised household). (Montmarquette and Viennot-Briot, 2016). Moreover, households that began to work with an advisor over the course of the study, did significantly better than households that did not (Montmarquette and Viennot-Briot, 2016).
- Low income individuals are observed to be highly responsive to advice with their financial behaviour improving more than that of high income households (Tang 2010).

Technical Expertise

- Advised portfolios are better diversified and have more tax effective investments (Kramer 2012; Shapira and Venezia 2001; Mayer 2011; Winchester 2011).
- Gerthardt and Hackethal (2009)[12] conclude that advisors promote appropriate asset allocation, a significant corrective function given the consensus that strategic asset allocation is "far more important than the subsequent (tactical) decision of which specific securities to pick in a particular asset class" (Chater et al. 2010, p. 56).
- Given that inefficient asset allocation costs tens of billions of dollars annually, this also has broader implications for economic welfare (Rehberg 2009, p. 3).

Behavioural Biases

- Persistent behavioural biases cause cognitive failures that impede decision-making competence (Lunn & Lyons, 2010).
- Indeed, individuals consistently make financial choices that are not in their best interest (Agarwal and Mazumder 2013; Campbell 2016).

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[11] Chater et al (2012) surveyed and conducted online experiments with 6,000 consumers from eight European Union Member States, half of whom had purchased bonds, stocks and shares, personal pensions, investment funds, mutual funds, ETFs, or life insurance products within the last five years. Other deposit products such as current accounts, savings accounts and tax-free savings account were excluded.

[12] This study used data from the accounts of 65,000 German bank customers to match 7,000 advised clients with a "non-advised twin" who, based on demographic and account information, was just as likely to have met with a financial advisor but had not, thereby addressing the potential problems of self-selection and endogeneity and allowing the authors to conduct a strong test of whether financial advisors influence investment activities and outcomes rather than vice versa.

- The United Kingdom's Financial Conduct Authority (FCA) (2013) notes that these cognitive failures are particularly severe when it comes to financial decisions. They manifest in common investment mistakes such as undervaluing asset allocation; holding losing stocks too long; and selling profitable stocks too soon (Kahneman and Tversky 2000; Kahneman 2011).
- Behavioural biases are often exacerbated when making unadvised investment decisions. Chater et al. (2010), for example, observed that individuals placed in this situation were "disproportionately averse to uncertainty, ambiguity, and product complexity" (Chater et al. 2010, p.8).
- Many biases can be overcome with experience and education (Latif et al. 2015, p.12). As such, financial professionals are less likely to commit common investor mistakes (Dhar and Zhu, 2006; Feng and Seasholes, 2005; Shapira and Venezia, 2001).
- In times of financial volatility or crisis (at the global or personal level) investors are prone to panic and poor decision-making (Haslem 2010). For example, imprudent decisions in the wake of the 2007 economic downturn cost investors an estimated $8 billion (Winchester et al. 2011).
- According to advisors, making emotional decisions is the number-one investor mistake and preventing clients from making these decisions is critical to success (Global Survey of Financial Advisors 2016, p.3, 13).
- Advisors have proven effective at tempering rash decision making (Haslem 2010).
- Investors working with a financial planner at the time of the economic downturn were "92 per cent more likely to maintain optimal portfolio composition" (Finke 2009, p. 180).
- Advised investors also avoid "the impulse to behave myopically" as they are twice as likely to make optimal long-term decisions and 1.5 times more likely to adhere to them than unadvised investors (Winchester 2011, p. 21).

The Nudge Factor

- The ability of advisors to encourage and instill positive financial behaviours such as goal setting and saving is known as the nudge factor (Chang 2005; Mayer 2011; Thaler and Sustein, 2009).
- Consumers who have received financial advice exhibit more positive financial behaviours than those who have not (Prelec and Loewenstien, 1998). For instance, advisors increase enrollment in automatic saving plans (Gerthardt and Hackethal 2009). Advised investors are also more likely to have a higher savings rate than that of comparable non-advised investors (The Investment Funds Institute of Canada 2012).
- A survey of advised investors in Canada found that more than 80 per cent of respondents credit their advisor for their ameliorated savings and investment habits (Pollara 2015).
- There are also broader economic welfare implications. The Conference Board of Canada (2014) estimates that if 10 per cent of unadvised Canadians obtained financial advice and increased their saving rates to match those of advised investors, household income and economic output would increase in the long term (p. 32).

Barriers to Access

- Income and net worth are positively correlated with seeking advice with affluent households using financial advice and products more than lower income households (Bluethgen, 2008; Finke and Langdon, 2012; Tang and Lachance, 2012).
- Higher financial literacy is also associated with accessing financial advice (Alessie et al 2007; Christelis et al., 2010; Lusardi and Mitchell 2008).

Individual-level Barriers

- Lack of knowledge or misconceptions about financial products and services also impede access as "households tend to avoid strategies for which they feel unqualified" (Campbell 2006, p. 1553).
- Financial advice is commonly perceived as unaffordable. Although the vast majority of financial advisors in Canada offer advice with no upfront cost, a 2013 survey of middle income Canadian households[13] found that 11% of respondents said they could afford financial advice services; 55% said they could not; and 34% said they did not know the cost of such services (Union des consommateurs 2013, p.83). The study concluded that "the impression of not having the means to pay for such services, and the feeling of not having sufficient assets to justify them" is a significant barrier to access (p.93).
- Winchester (2015) also identifies the opinion that financial advice is only for those with extra money to invest as a barrier. A study of low-income households[14] in Toronto found that 58.7 per cent of respondents did not have a savings account and only 1.6 per cent had an investment account. Respondents cited the following reasons for not saving: bank fees; no point in saving; weak interest rates; and lack of information (Latif et al 2015, 14).

Institutional-level Barriers

- Institutional factors also impact access to financial advice (Iannicola and Parker 2010). Han et al. (2007) describe the institutional effect as follows:

> "Asset accumulation is influenced by institutional arrangements that involve explicit connections, rules, incentives and subsidies. These institutional arrangements lead to different levels of access and incentives to accumulate assets for different segments of the population and may explain a significant part of the variance in personal saving and investment patterns" (p. 4).

- Business models, for example, often prioritize some consumer groups over others. The nature of the financial advice market is such that wealthy clients "produce a greater revenue on a per capita, per engagement or per hour basis" (Financial Planet 2012).
- Consequently, some firms may target high income earners to the exclusion of middle and low income consumers. This occurs directly and indirectly. A minimum account balance may be required to work with an advisor or it may be factored into firm referral practices (Iannicola and Parker 2010, p.39; Union des consommateurs 2013).
- Hackethal et al (2011), for example, found that financial advisors were less likely to be matched with younger, less experienced and less wealthy investors.
- Institutional level barriers in the form of regulations, or their application can also restrict access to financial advice. Competitive financial systems with market-based regulations are associated with lower barriers to access. The FCA's (2013) research on vulnerability in the financial service industry found that "inaccurate interpretation or overzealous implementation of rules" can prevent firms from meeting the needs of vulnerable customers" (p. 6).

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[13] 77.5 % of respondents had a gross annual income of over $30,000 and 53.2% over $40,000

[14] Low-income was defined as below $22,000 for households without children to support or below $44,000 for households with children to support.

Vulnerable Consumers

- Lack of access to financial advice both signals and perpetuates vulnerability (Thorensen 2008, p. 26).
- Poor decisions are costlier for some consumers than for others. Tight margins in low and middle income households mean that financial mistakes can have disproportionate consequences (Betrand et al. 2004; Cartwright 2008). Consider Cowell and Gardiner's (1999) finding that a £1 loss for a consumer with an income half the national average was equivalent to a loss of £2.50 suffered by a consumer with the national average income.
- Consumers are most vulnerable when individual-level and institutional-level barriers coincide (Financial Conduct Authority, 2015, p. 21).

Abandoning Smaller Investors

- Countries where financial advice has been unbundled from financial products, either as a result of market forces or regulatory fiat, have seen the opening of a large "advice gap" and an increase in the total cost of the services for a large proportion of retail customers. A significant number of middle income individuals who need the advice but do not own enough financial assets to make the provision of regulated financial advice an economic business proposition under a fee-for-advice pricing policy were effectively denied access to affordable financial advice. (Lortie 2016)
- After the UK decision was made to unbundle fees, the number of financial advisors fell from more than 40,000 in 2011 to just over 31,000, and has not recovered. Large banks, meanwhile, cancelled their financial advice services for clients that had only modest assets. The opening of investment accounts worth less than 100,000 pounds fell by half. (Lortie 2016)
- In March 2016 the Financial Conduct Authority issued a report on the UK's Financial Advice Market in light of concerns expressed about an advice gap and found that the implementation of their reforms has had positive results for the wealthy, stating that, although the changes have raised standards of professionalism and enhanced consumer protection, this high level of advice is "primarily accessible and affordable only for the more affluent in society." (FAMR 2016)
- The report states that before the reforms, the economies of scale at firms made it possible to serve consumers with "lower levels of affluence." However, post-reforms, most businesses have implemented portfolio minimums of more than £100,000 because the cost to provide advice and service an account has increased significantly. (FAMR 2016)
- To help individuals pay for up-front fees the UK government introduced rules to allow consumers to withdraw money from their pension to pay for financial advice. Customers are allowed to only withdraw £500 three times over their lifetime and no more than once per tax year. According to the government's analysis, face-to-face advice costs £150 per hour on average which leaves the consumer with roughly 10 hours of face-to-face investment advice over the course of their lifetime. (FAMR 2017)

Banning Commissions

- A review of financial advice services in Canada concludes that while advice is provided "based on and in view of closing a sale," it is nonetheless "efficient" (Union des consommateurs, 2013, p. 61).
- Commissions themselves have also been found to incentivize information provision and customer service (Inderst and Ottaviani 2012, p. 245).
- There is little to suggest that any alternative to a commission-based compensation model would reduce the provision of biased advice or improve consumer outcomes. No compensation scheme would be "behaviourally neutral" (Lortie 2016).

- Research shows that financial advisors on salary tend to promote proprietary funds (Gil- Bazo and Martinez, 2004; Synovate, 2011; ISA, 2014).
- Advisors with flat incentives have also been observed to be "less honest and transparent than expected" (Chater et al., 2012, p. 379). In fact, when advisor-client interests were aligned, incentivized advisors were found to "outperform advisors with flat incentives" (Chater et al., 2012, p. 379).
- Behavioural biases value short-term gains and perceive immediate losses as less desirable than future losses. Consequently, upfront costs increase the perceived (immediate) cost of financial advice and diminish its perceived (long-term) value. Chater et al.'s, (2012) experiment on advised investment decision-making found that twenty to thirty per cent of subjects were "excessively averse to an up-front fee" (p. 10).
- Recent Canadian data indicates that only 48 per cent of investors who use an advisor believe that they would continue to do so if they were required to pay a separate fee (Pollara, 2015).
- Banning commissions also has supply-side implications. Providing modest investors with low-cost advice can be a viable business model, if there is a sufficient volume of demand. When demand falls, providing financial advice at the same price is no longer possible. In the United Kingdom, following a ban on commissions in 2012, banks began to limit access to financial advice to clients with investment assets of more than 100,000 pounds (Lortie, 2016, p.23). The result of depressed demand and supply resulted in a 50 per cent decline in the number of new investment accounts under 100,000 pounds by 2014 (GfK NOP Ltd., 2014; Lortie, 2016, p.23).
- Similar outcomes in the Canadian context would be disastrous given that 79 per cent of all current investors are in the middle market and the vast majority (85 per cent) of investors enter the market with less than $25,000 in financial assets (Pollara, 2015).

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PEAK L'INDÉPENDANCE AU CŒUR D'UN RÉSEAU SOLIDE | INDEPENDENCE AT THE CORE OF A SOLID NETWORK

Le 9 juin 2017

« Transmis par courriel »

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Objet : Commentaires relatifs au document de consultation 81-408 des ACVM – Consultation sur l'option d'abandonner les commissions intégrées

Madame,

Nous vous soumettons nos commentaires relatifs au document de consultation 81-408 des Autorités canadiennes en valeurs mobilières sur l'option d'abandonner les commissions intégrées publiés le 10 janvier 2017.

<u>Partie 2</u>

1. Convenez-vous des enjeux exposés dans cette partie? Pourquoi?

Nous sommes d'avis que peu importe la méthode utilisée, il y aura toujours des enjeux. Il n'existe pas de méthode parfaite, toutefois il y a toujours des solutions pour atténuer les risques.

Dans cette partie du document on indique que les commissions intégrées donnent lieu à des conflits d'intérêts. En ce qui concerne les conflits d'intérêts relatifs au produit (ex. : fonds actions, fonds d'obligations et fonds équilibré) qui génère des revenus de commissions différents au conseiller, on pourrait atténuer ce risque par l'uniformisation de la rémunération du courtier peu importe le produit.

La rémunération découlant des commissions intégrées consiste en une option de rémunération qui en vaut une autre et qui répond à certains besoins d'investisseurs (ex. : accès au conseil pour les petits investisseurs et accès à la profession de conseiller en placement pour les jeunes entrepreneurs).

En ce qui a trait à la connaissance, la compréhension et le contrôle des coûts de la rémunération des courtiers chez les investisseurs, il s'agit d'un faux problème puisque les différentes options doivent être expliquées à l'investisseur avant la transaction d'une part et d'autre part, ces coûts apparaissent maintenant au le rapport annuel sur les frais et les autres rémunérations depuis l'instauration des règles du MRCC2.

En ce qui a trait au fait qu'il arrive parfois que les commissions intégrés ne concorderaient pas avec les services fournis aux investisseurs, cela s'appliquerait en général aux investisseurs qui possèdent un portefeuille important. À cet effet, on constate au cours des dernières années un déplacement des fonds à commissions intégrés des clients plus fortunés vers des comptes à honoraires contenant des fonds d'investissement de Série F. Cette anomalie est donc en train de s'atténuée par elle-même par la création de nouveau processus d'affaires qui permet la négociation des honoraires.

2. Existe-t-il d'autres enjeux ou problèmes importants liés aux commissions intégrées? Veuillez, si possible, présenter des données qui illustrent votre argument.

Un enjeu qui ne semble pas suscité l'intérêt qu'il mérite auprès des autorités réglementaires est celui de la relève chez les courtiers indépendants et qui est présent dans l'industrie. Il est certain que cette problématique ne se ressent pas de manière importante chez les courtiers détenus par des institutions financières (institutions de dépôt et assureurs) puisque ces derniers sont en mesure de rémunérer ces jeunes sur une base de salaire. Par contre, les jeunes entrepreneurs en finance auront la vie difficile si les commissions intégrés sont abolies considérant que la clientèle type d'un jeune débutant aura en général un âge près du sien et par conséquent peu d'investissement considérant qu'il est en début de carrière. Or, nous craignons fortement que l'abandon de commissions intégrées créera un vide chez les jeunes entrepreneurs qui désire faire carrière à titre de conseiller financier indépendant.

3. Les commissions intégrées comportent-elles des avantages importants —accès aux conseils, efficience et rentabilité des modèles d'affaires, concurrence accrue— qui l'emporteraient parfois ou toujours sur les enjeux ou les problèmes qui y sont liés? Veuillez, si possible, présenter des données qui illustrent votre argument.

Les commissions intégrées offrent une alternative aux petits investisseurs en leur donnant d'une part, accès aux marchés financiers réservés à une classe d'investisseur plus fortunés et d'autre part, accès au conseil d'un professionnel qui par ailleurs serait inaccessible en raison du coût prohibitif par rapport à leurs moyens financiers.

Cette opportunité permet donc aux petits investisseurs un accès à d'autres produits financiers que les produits bancaires traditionnels.

L'épargnant est de par nature plus attiré vers des produits dont les frais se paie indirectement plutôt que ceux qui l'oblige à payer directement. Dans cet ordre d'idée, la structure des frais intégrés facilite l'investissement du fait que les frais sont incorporés au placement.

Elle a par ailleurs permis à de nombreux petits investisseurs de créer des habitudes d'épargne résultant en un important patrimoine. L'abolition de ce mode de rémunération pourrait alors se traduire par réduction du taux d'épargne et un appauvrissement social.

Les commissions intégrées sont un mode de rémunération qui permet au courtier indépendant d'assurer la relève et ainsi permettre la croissance de jeunes entrepreneurs dans le domaine des services financiers. Par conséquent, cela encourage une saine concurrence aux institutions financières.

Partie 3

4. Dans le cas de chacun des produits d'investissement suivants, placés au moyen d'un prospectus ou sur le marché dispensé sous le régime d'une dispense de prospectus :

• OPC

• fonds d'investissement à capital fixe

• billet structuré

devrait-on abandonner les commissions intégrées? Dans la négative :

a. **Sur quel fondement devrait-il être exclu?**
Il y a aucune raison valable qui permettrait l'exclusion de produit d'investissement. Même que par souci de transparence et d'uniformisation, on devrait appliquer cette mesure aux nouvelles émissions de titres (actions et obligations) et aux produits bancaires et d'assurance qui sont également sujets à des commissions intégrées.

b. Quel serait le risque que des arbitrages réglementaires soient faits sur le marché dispensé si les commissions intégrées n'étaient abandonnées que pour les produits placés au moyen d'un prospectus?

Nous sommes d'avis que cette mesure pourrait créer le déplacement de fonds d'investissement vers d'autres produits non visés par cette réglementation et qui ne sera pas nécessairement dans le meilleur intérêt du client mais à l'avantage du conseiller, du courtier et de l'émetteur. Cette mesure aurait donc pour impact de créer d'autres conflits d'intérêts.

5. Y a-t-il des types particuliers d'OPC, de fonds d'investissement à capital fixe ou de billets structurés pour lesquels les commissions intégrées ne devraient pas être abandonnées? Pourquoi?

Non, pour les raisons citées à la question 4.

6. Y a-t-il d'autres types de produits d'investissement pour lesquels les commissions intégrées devraient être abandonnées? Pourquoi?

Dans le secteur de l'assurance, les fonds distincts devraient être sujets à cette même règle. Il serait trop facile pour un conseiller ayant un permis en assurance et qui désire maintenir ce mode de rémunération de déplacer ses fonds d'investissement vers des fonds distincts. Par ailleurs, le coût d'un fonds distinct miroir à celui d'un fonds d'investissement est plus élevé en raison de la prime relative à la couverture de la police qui est en ajout. En conséquence, ce déplacement ne sera pas nécessairement effectué dans l'intérêt du client.

Si le gouvernement qui régit l'industrie du placement croit à l'importance de démontrer de la transparence dans les produits d'investissement et à l'abolition des frais intégrés pour mitiger les conflits d'intérêts, il devrait mettre en vigueur cette réglementation à tous les secteurs d'activité de l'industrie incluant le secteur bancaire et celui de l'assurance.

En somme, l'abolition des frais intégrés tel qu'elle est présentée actuellement servira les intérêts des institutions financières (institution de dépôt et assureur) qui verront une augmentation de leur bénéfice au détriment du petit investisseur et des petites firmes de courtage indépendantes.

8. Devrions-nous envisager d'abandonner d'autres frais ou paiements relativement à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés, notamment :

a. le versement de sommes d'argent et la fourniture d'avantages non pécuniaires par les gestionnaires de fonds d'investissement aux courtiers et aux représentants en vertu de la partie 5 du Règlement 81-105;

b. les commissions d'indication de clients;

c. les commissions de placement?

Pourquoi? Ces types de frais et de commissions présentent-ils un risque d'arbitrage réglementaire et, dans l'affirmative, de quelle ampleur?

Les institutions qui distribuent leurs propres produits ont les ressources nécessaires pour en faire la promotion et l'éducation auprès de leur force de vente. L'abandon de ces paiements pourrait réduire la qualité des services offerts par les courtiers indépendants et les rendraient moins concurrentiel par rapport aux institutions.

9. Si le versement de sommes d'argent et la fourniture d'avantages non pécuniaires aux courtiers et aux représentants pour le soutien d'activités de commercialisation et de formation en vertu de la partie 5 du Règlement 81-105 sont maintenus après l'abandon des commissions intégrées, devrions-nous envisager de modifier la portée de ces versements et avantages? Dans l'affirmative, pourquoi?

Non.

11. Si nous décidions d'abandonner les commissions intégrées, devrions–nous autoriser les gestionnaires de fonds d'investissement ou les émetteurs de billets structurés à faciliter le paiement de la rémunération du courtier par l'investisseur en la prélevant sur l'investissement de celui-ci et en la remettant en son nom au courtier?

Oui, cela pourrait aider les petites firmes de courtage qui ne possèdent pas la structure administrative nécessaire pour effectuer ces paiements.

<u>Partie 4</u>

12. Compte tenu des données et des éléments probants fournis dans la présente partie, la proposition d'abandonner les commissions intégrées répondrait-elle aux trois principaux enjeux de protection des investisseurs et d'efficience du marché traités dans la partie 2?

Tel que mentionné précédemment, ce sont les petits investisseurs qui seront les perdant alors que les enjeux principaux sont déjà en train de se régler par eux-mêmes par l'application de MRCC2.

13. Pour répondre à ces préoccupations, les ACVM pourraient-elles prendre d'autres mesures que l'abandon des commissions intégrées, conjointement ou séparément?

Nous croyons que les frais intégrés fait partie des options offertes aux investisseurs. L'abolir serait d'éliminer un choix potentiel à l'investisseur. Si les ACVM déterminent que cette option comporte des faiblesses, alors que l'on établisse des règles et/ou des directives pour assurer la bonne utilisation de l'option des frais intégrées.

14. Le passage à des mécanismes de rémunération directe risque-t-il d'entraîner d'autres conflits d'intérêts qui ne seraient pas encadrés par la réglementation actuelle des valeurs mobilières?

La rémunération directe n'est pas une fin en soi pour le règlement de conflits d'intérêts, ce n'est qu'une option qui existe déjà avec ses points positifs et négatifs.

Par exemple, la rémunération directe qui pourrait amener des conseillers à multiplier les transactions dans le but d'augmenter leur revenu, tendance que l'on voyait rarement avec l'option de frais intégrés.

Question 15. Selon vous, quel effet l'abandon des commissions intégrées aura-t-il sur l'expérience des investisseurs et les résultats qu'ils obtiennent? Plus particulièrement :

• Les investisseurs recevront-ils des conseils et des services financiers qui concordent davantage avec les honoraires qu'ils paient?

Les investisseurs sont au courant des frais qu'ils assument et c'est encore plus vrai aujourd'hui avec la mise en application de MRCC2, soit le rapport annuel sur les frais et les autres rémunérations. Est-ce que l'abandon de commissions intégrées va faire en sorte que les frais payés par les investisseurs aux conseillers vont variés? Ce n'est pas ce que l'on constate lorsque les investisseurs adoptent le processus des comptes à honoraires qui sont négociés avec le client.

On pourrait en conclure que les conseils et services financiers concordent généralement avec les honoraires que l'investisseur paie.

• Quel effet la proposition aura-t-elle sur le développement des conseils automatisés? Cet effet est-il susceptible d'être avantageux pour les investisseurs?

Le conseil automatisé sera un outil intéressant qui aura pour objectif de servir les petits investisseurs qui accepteront de demeurer dans le marché sans le service de conseil. Toutefois, si l'on retourne quelques années en arrière lors de l'avènement des courtiers exécutant, nous n'avons pas ressenti une croissance exceptionnelle de ce service sans conseil auprès du public. Étant donné que cette clientèle ne sera pas en mesure de défrayer les honoraires minimum, il est fort possible que cet effet ne soit pas à l'avantage du petit investisseur car celui qui n'adhère pas à ce service se tournera vers les produits bancaires traditionnels et ne pourra pas profiter de conseil si ce n'est que de l'éducation aux variations du marché et l'habitude à l'épargne.

• Y a-t-il des chances que les conseils discrétionnaires gagnent en popularité au Canada comme cela a été le cas dans les autres marchés qui ont délaissé les commissions intégrées et, le cas échéant, ce changement serait-il positif ou négatif pour les investisseurs?

Le conseil discrétionnaire est déjà en forte croissance au Canada. À savoir si la croissance future sera attribuable au conseil automatisé, cela dépend de l'envergure ou de la popularité de ce nouveau service. Comme nous l'avons déjà mentionné, nous demeurons sceptiques sur la croissance que va engendrer de ce genre de service.

• Quel effet la proposition aura-t-elle sur la croissance du réseau des courtiers en ligne et des courtiers exécutants et le coût des fonds offerts dans ce réseau? Cet effet est-il susceptible d'être avantageux pour les investisseurs?

Nous ne croyons pas que la majorité des petits investisseurs vont se tourner vers un service automatisé sans conseil car la relation avec le conseiller fait partie intégrante du conseil et l'investisseur ne pourra retrouver celle-ci avec un ordinateur. Au point de vue transactionnel, les coûts seront réduits mais cela se fera au détriment du conseil.

• Quel effet la proposition aura-t-elle sur le coût et l'étendue des conseils fournis à des segments particuliers d'investisseurs?

L'intégration des commissions au fonds d'investissement a initialement été mise en place pour permettre aux petits investisseurs d'avoir accès au conseil et au marché financier tout comme les investisseurs plus fortunés. Cela a également permis à l'investisseur moyen de s'introduire progressivement à ce marché et connaitre autre chose que les produits bancaires traditionnels.

Le fait de régler la facture du conseiller soit au moment de la transaction ou soit sur une base d'honoraires mensuel ne plaira pas à tous les particuliers toute base de segments d'investisseurs confondus.

Il est clair que le conseiller indépendant ne sera plus en mesure de desservir le petit investisseur en raison des coûts qui seront supérieurs au bénéfice qu'il en retirera. Imaginons un conseiller qui doit se rendre à la résidence d'un client et passer plusieurs heures avec celui-ci pour établir son profil et sa situation financière, effectuer le travail de conformité et administratif pour effectuer un placement de 10 000$. Les frais d'acquisition reportés permet de générer une commission de 5% soit 500$ ce qui laisse un revenu acceptable au conseiller et assumer les frais inhérents. Cette proposition obligerait le conseiller à facturer 500$ lors de la transaction, ce qui est n'est pas raisonnable. Par ailleurs, la structure des comptes à honoraires engendre des coûts administratifs important qui ne pourront être absorbé par le petit investisseur. Par conséquent, le service conseil ne sera plus abordable pour ce dernier et l'abolissement des frais intégrés amènera un déplacement de cette clientèle vers les institutions financières dont le temps consacré au conseil est limité en raison notamment du nombre important de clients alloués par conseiller.

16. Quels sont les types de mécanismes de paiement susceptibles de découler de cette proposition, si elle est adoptée? Plus particulièrement :

• Les mécanismes de paiement proposés par les courtiers différeraient-ils selon le segment d'investisseurs? Dans l'affirmative, expliquez en quoi et pour quelles raisons.

Les clients plus fortunés auront tendance à utiliser un mode de rémunération à honoraires pour avoir accès à un service conseil continue tant au niveau des recommandations de placement qu'au niveau des autres services de conseils financiers personnels. Les clients moins fortunés et qui ont moins besoin de conseil pourrait tendre vers un mode de rémunération directe.

17. Pensez-vous que la proposition entraînerait une carence en matière de conseils? Plus particulièrement :

• Quels segments du marché risquent d'être touchés? Prière de considérer la segmentation en fonction du patrimoine, de facteurs géographiques (taille et emplacement de l'agglomération, par exemple, éloignée, petite, moyenne ou grande), de l'âge, des connaissances technologiques, du nombre de titres de fonds que détiennent les ménages, etc.

En général, ce sont les ménages qui possèdent des portefeuilles de moins de 100 000$ qui vont être touchés par cette carence en matière de conseil et la majorité d'entre eux n'auront plus les moyens de retenir les services d'un conseiller financier.

• Souscrivez-vous à notre définition de « carence en matière de conseils »?

Oui.

• Devrions-nous faire une différence entre la carence en matière de conseils « en personne » et la carence en matière de conseils en général?

Il y a évidemment une différence car le conseil en personne comprend une relation plus étroite avec l'investisseur et des conseils spécifiques adaptés à sa situation personnelle dont le coût est plus élevé. Cette carence en matière de conseils en personnes va définitivement viser le petit investisseur qui n'aura pas les moyens financiers pour se payer ce genre de service.

• Quels types de conseils ou de services actuellement offerts seraient le plus touchés par la proposition?

Les types de conseils le plus touchés ont trait à la planification financière (ex. : budget, planification de retraite, etc.), l'assistance au niveau fiscal et toutes autres demandes de nature financière en vue d'accompagner le client. Le conseil en personne de plus petit investisseur sera le plus touché par cette proposition et le conseiller devra réévaluer sa clientèle pour assurer sa rentabilité.

• Y a-t-il des interactions potentielles entre la présente proposition, les réformes en cours telles que la deuxième phase du MRCC et d'autres réformes éventuelles comme celles énoncées dans le Document de consultation 33-404 des ACVM qui pourraient avoir un effet sur l'importance d'une possible carence en matière de conseils?

Les recommandations proposées dans le document de consultation 33-404 sont orientées pour rehausser les obligations du conseiller envers son client : la connaissance du client par exemple au niveau fiscal, du profil de risque, la connaissance de tous les produits distribués par la firme qui d'ailleurs dans la situation d'un courtier indépendant qui distribue la plupart des fonds d'investissement au Canada n'est pas réaliste, l'obligation d'effectuer une mise à jour annuelle pour réévaluer la convenance, l'optimisation des produits. Ce rehaussement requiert du temps additionnel que le conseiller doit mettre à la disposition de tous ses clients et par le fait même l'amènera à réévaluer sa clientèle pour déterminer le segment d'investisseur qu'il est en mesure de servir. Conséquemment, le rehaussement des obligations tel que présenté dans le document de consultation 33-404 contribuera à laisser le petit investisseur à lui-même en ce qui a trait à l'investissement.

• Comment pourrions-nous atténuer une éventuelle carence en matière de conseils, de conseils en personne ou de services financiers?

L'innovation au niveau technologique pourrait atténuer la carence en matière de conseil dans la mesure où cette nouvelle technologie soit accessible à un prix abordable par les firmes indépendantes non contrôlés par les institutions financières.

• Pensez-vous que les conseils en ligne pourraient atténuer une carence en matière de conseils? Dans l'affirmative, expliquer de quelle manière.

Les conseils en ligne ne satisferont pas tous les investisseurs puisque cela ne peut pas remplacer la relation client/conseiller. Les clients n'y trouveront pas de réponses exhaustives qui sont particulière à chacun d'entre eux.

• Pensez-vous que le fait que les courtiers appartenant à une institution de dépôt ou à un assureur détiennent une part importante du marché de la distribution des titres de fonds au Canada influera sur la probabilité qu'apparaisse une carence en matière de conseils ou sur l'importance de celle-ci?

Cette carence de conseil sera plus présente chez les courtiers indépendants en raison que la relation client/conseiller est le plus souvent effectuée en personne et sur base de long terme.

18. Étant donné les changements que nous avons constatés dans le secteur ces dernières années (réduction des frais, introduction de séries de fonds pour les investisseurs indépendants, simplification des séries de fonds, réductions automatiques des frais, facilitation de l'accès aux options de souscription à honoraires, etc.), quelle est la probabilité que le secteur des fonds d'investissement délaisse les commissions intégrées en l'absence de mesures réglementaires? Plus particulièrement :

• Le secteur continuera-t-il à délaisser les commissions intégrées si les ACVM ne donnent pas suite à la proposition? Plus particulièrement :

Il est possible que certains fonds d'investissements indépendants maintiennent le mode de rémunération des commissions intégrés pour satisfaire les besoins des petits investisseurs ayant des relations avec des courtiers indépendants. Pour ce qui est des institutions financières, nous croyons que la décision est prise et qu'ils ne reviendront pas en arrière.

19. La figure 8 illustre-t-elle fidèlement les options de souscription offertes aux investisseurs selon le réseau, la taille du compte ou le type de société?

• Selon vous, les options de paiement et les modèles d'entreprise évoluent-ils en ce moment?

Au cours des dernières années, le modèle de la firme a évolué pour offrir les comptes à honoraires et offre également toutes les autres options de paiement. Ce n'est pas le cas pour toutes les petits courtiers indépendants en raison des coûts administratifs élevés.

• De quelle manière évolueraient-ils au fil du temps si les ACVM décidaient de ne pas mettre en oeuvre la proposition?

Il sera plus facile pour les plus petites firmes de maintenir leur rentabilité mais au cours des ans ils devront trouver le moyen de s'adapter aux nouvelles façons de faire surtout en ce qui a trait au comptes d'investisseurs plus fortunés.

21. Veuillez décrire les répercussions de l'abandon des commissions intégrées sur la concurrence et la structure du marché, et indiquer si vous acquiescez ou non à l'analyse présentée à la partie 4. Plus particulièrement :

• Quelle est la probabilité qu'apparaisse de l'arbitrage réglementaire sur les produits financiers similaires, tels que les fonds distincts et les produits d'institutions de dépôt, et quelle en serait l'ampleur?

Il est difficile d'en prédire l'ampleur, mais il est fort probable que les petits investisseurs en fonds d'investissement qui n'auront plus accès au conseil se retrouvent dans les produits d'institutions de dépôt et dans les fonds distincts.

• De quelle manière les courtiers en épargne collective et les agents d'assurance qui sont titulaires des deux permis seraient-ils touchés?

Il est possible que certains conseillers déplacent les fonds d'investissement de clients vers des fonds distincts, et cela ne se fera pas nécessairement à l'avantage de l'investisseur.

23. À l'heure actuelle, le paiement des commissions intégrées oblige le courtier et le gestionnaire de fonds d'investissement à mettre en oeuvre des mécanismes de contrôle et de surveillance (auxquels se rattachent des coûts de conformité) pour atténuer les conflits d'intérêts inhérents.

• Dans quelle mesure, le cas échéant, le recours aux mécanismes de rémunération directe par les représentants actuellement (par exemple, lorsqu'un représentant fournit des services selon un mécanisme de rémunération à honoraires) rend-il inutiles certains de ces mécanismes de contrôle et de surveillance?

Les contrôles mis en place pour la surveillance de la multiplication des transactions et les transactions générant des frais de rachat deviennent inutile dans le cas des comptes à honoraires.

24. Les commissions intégrées, en particulier les commissions de suivi, procurent une source de revenus stable aux courtiers et aux représentants. Si elles sont abandonnées, les mécanismes de rémunération directe compenseront-ils la perte de ces revenus?

La tendance que l'on constate actuellement est la croissance du mode de rémunération à honoraires. La perte de revenu sera créée par l'abandon de la clientèle de petits investisseurs et elle sera éventuellement comblée par la croissance d'une clientèle mieux nantie.

26. Quelles répercussions la proposition aura-t-elle sur les représentants du secteur, en particulier sur ce qui suit?

• le cheminement de carrière;

• l'attrait de la profession;

• le profil type de la personne intéressée par la profession;

• le recrutement;

• l'attrait relatif d'une carrière dans des branches d'activité concurrentielles des services financiers.

Il est fort probable que l'on voit un délaissement de la profession du-moins chez les jeunes entrepreneurs qui désirent agir en toute indépendance face aux produits financiers et gérer leur propre clientèle. La commission intégrée permet à celui qui débute dans l'industrie de générer suffisamment de revenu à court terme pour assumer ses dépenses et se créer une clientèle qu'il pourra servir au fil des ans. Cette proposition aura pour effet d'obstruer l'accès à la profession aux jeunes entrepreneurs qui ont des aptitudes à aider les gens à assurer leur avenir financier.

<u>Se référé également à la question 2</u>

En guise de conclusion, nous sommes d'avis qu'il serait prématuré d'abolir l'option des commissions intégrées avant d'évaluer les effets des modifications réglementaires du MRCC2 et de prendre sérieusement en considération les effets de cette proposition sur l'accès au conseil et aux marchés financiers pour les petits investisseurs ainsi qu'à la relève des jeunes entrepreneurs de services financiers.

Nous vous remercions de nous avoir donné l'opportunité de vous soumettre nos commentaires et soyez assurer de notre participation à toute autre consultation publique relatif à ce sujet. Si de plus amples informations vous sont nécessaires, n'hésitez pas à communiquer avec le soussigner.

Jean Carrier, CPA, CA

Vice-président Conformité

BRIDGEHOUSE

VIA E-MAIL
comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Autorité des marchés financiers
Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities Yukon
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

RE: Canadian Securities Administrators Consultation (CSA) Paper 81-408: -- Consultation on the Option of Discontinuing Embedded Commissions

Thank you for the opportunity to provide comments to the Canadian Securities Administrators Consultation Paper 81-408 regarding options for embedded compensation

Background for Bridgehouse Comments

Bridgehouse Asset Managers

Brandes Investment Partners & Co., operating as Bridgehouse Asset Managers ("Bridgehouse") is registered as Portfolio Manager and Exempt Market Dealer in all provinces and territories, Investment Fund Manager in Ontario, Quebec, and Newfoundland, and Mutual Fund Dealer in all provinces and

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territories of Canada (except Quebec). Bridgehouse acts primarily as manager to distribute independent multi-manager products and services to financial advisors through IIROC and MFDA.

Bridgehouse Perspective: Financial Advisors Can Help Clients Receive the Full Benefit of Investing
Bridgehouse chooses to distribute through financial advisors because we believe advisors are best qualified to determine individual investor needs/goals and to build clients' plans to achieve those goals. Advisors provide great value by aligning investor needs with available investment solutions and financial strategies. It is critical that investors who invest in our products and services do so based on what they can do for them over the long term. Any mismatch in expectations can prevent investors from receiving the full benefit of our products and of investing in general.

Bridgehouse does not have the expertise or the needed infrastructure (technology, systems, processes, compliance, professional skills and independence) to deliver objective advice to retail investors. We are an investment firm that must access distribution in order to offer retail investors our independent product. We recognize that distributing through advice channels is costlier than other channels, but we believe it is the best way for investors to receive the full benefit of investing. We consider embedded compensation as a way to compensate dealers for delivering investment management to investors so they can get the full benefit of investing.

To Bridgehouse, a trailer helps cover costs of delivering financial advice. We believe it is a mischaracterization to label them as "commissions" because they are intended to cover both hard and soft costs of investment distribution.

Bridgehouse Perspective: Investors Benefit from Access and Choice
Bridgehouse believes investors benefit from having product choice (including proprietary and third-party independent investment firms) and payment choice. We consider embedded compensation as one of several payment methods from which investors can select.

Bridgehouse Perspective: Investors Benefit from Active Investing
We observed a bias in CP 81-408 towards passive investing and ETFs, suggesting they are a good solution for investors because of their low cost. While they can be suitable for investors in specific circumstances, passive strategies and ETFs are not solutions for all investors. We highlight several concerns of many:

- Many Canadians will not have enough money and will need to take on calculated risk. Most passive solutions follow the markets so they can never generate any additional alpha by definition.

- Dependence on the index is great when it is going up as it has been (coincidentally with the surge in ETF and passive investing) since the depth of the drop in March 2009. This can't and won't continue forever.

- As we saw in August 2015, the underlying securities can get unmoored from ETFs causing investors to panic and sell.

While passive and ETF strategies are popular and low cost, they are not without their investment risk and they should be used within the context of a portfolio that compensates for their risks.

Bridgehouse Perspective: Investors Need Face-to-Face Financial Advice
In CP 81-408, we observed a bias towards robo advice mostly because of low-cost attributes. While simple, digital contact can be suitable for some investors, robo advice is not a solution for all investors. Much can be done digitally today, but a bias to robo advice ignores the complicated and emotional context of individual lives.

Bridgehouse is particularly attuned to the emotional aspects of investing through our involvement with the Brandes Institute that considers investor behavior implications, and our recent program exploring the impact of mental health in the financial advice relationship. Face-to-face financial advice is necessary to detect mental health issues such as addiction, depression, diminished financial capacity and other stress-related impacts.

We urge the CSA to recognize that robo advice is not a solution for many investors and it should not be a default recommendation because it is a low-cost delivery mechanism.

Bridgehouse Supports: Investment Fund Institute of Canada's (IFIC) Response to the Consultation
In addition to our comments, Bridgehouse supports and agrees with the comments provided by the Investment Fund Institute of Canada in their response letter dated June 9. 2017 to the Consultation

Bridgehouse Overall Comments

It is from the abovementioned perspective that we offer our comments. We have reviewed CSA CP (81-408) and in our view, the rush to discontinue embedded fees does not take into account shifts that are already underway and that will require time to come to fruition. We would encourage the CSA to:

1. **Promote investor choice with regard to investment product, financial advice and payment methods.**

2. **Allow market-led forces to shift compensation methods over time to avoid unnecessary dislocation and additional costs.**

3. **Allow CRM initiatives to come to fruition while continuing to concentrate on promoting disclosure.**

4. **Review feedback from CP (81-408) in conjunction with any proposed changes resulting from CSA Consultation Paper 33-404 (Proposal to Enhance the Obligations of Advisers, Dealers and Representatives toward Their Clients).**

5. **Seek harmonization of compensation models with regulators covering investment fund-like products to minimize regulatory arbitrage and protect Canadians from industry players seeking to hide from disclosure requirements.**

6. **Avoid causing onerous technological, operational, client communications implications and associated costs that negate any perceived positives of discontinuing this method of compensation.**

Part 2
Questions # 1
We disagree with the issues described in Part 2. Embedded compensation is a way for advisors to offer independent products and services (like those of Bridgehouse) to their clients. In a deeply concentrated industry, it is hard for independent investment management firms to gain access to distribution. We recognize that distributing through advice channels can be more costly than through other channels, but we believe investors can receive the full benefit of investing if they work with a financial advisor. We consider embedded compensation as our contribution to help dealers with the costs of delivering of investment management with advice so investors can receive the full benefit of investing.

By contributing to covering the costs of financial advice, Bridgehouse can actually focus more on our business as investment managers and delivering performance instead of taking on ancillary functions (even though we deem them vitally important) that are not among our core competencies.

Question #2
Yes. Products under other regulators are used as investments for estate and financial planning purposes. These products carry embedded commissions with varying disclosure requirements leading to regulatory arbitrage, investor confusion and an unfair playing field.

Question #3
The advantages and benefits of working with a financial advisor are well documented. Bridgehouse would like to highlight another benefit of working with a financial advisor. Through Bridgehouse's recent Mental Health and the Financial Advice Relationship Program, we have been working with advisors to explore the impact of mental health within the advice relationship. Financial advisors are on the front line of mental health issues helping clients grow and protect their wealth from the impact of addiction, depression, anxiety and diminished financial capacity.

Advisors do much more than advise on products; they work with investors who are experiencing unprecedented levels of stress and mental health issues. Financial advisors play a big support role keeping Canadians on financial track. This is an unstudied area for which advisors do not receive credit. Bridgehouse believes it is very important for the industry to appreciate the support advisors are providing. We are currently undertaking research in this area so we can bring these important financial advice contributions to light.

Part 3
Question #4
Embedded compensation should remain one of several payment methods available to investors. Investors should have payment choices on all investment products. We recommend the CSA maintain an embedded payment method and focus on seeking harmonization of compensation models of other regulators to make it easier for investors to understand their payment options.

Question #5 & #6
Embedded compensation should remain one of several payment methods available to investors. Investors should have payment choices on all products. Some mutual fund mandates require a long-term hold for investors to get the full benefit of the mandate. For example, the DSC payment series encourages longer holds and this payment is perfectly suitable for some investors provided they fully understand the payment method.

Question #7
Investors should have the choice of paying in a variety of ways. Embedded payments are a way for investors to benefit from financial advice and ongoing service without paying for those services upfront or out-of-pocket.

Question #8
Marketing and education practices under Part 5 of NI 81-105 enable financial advisors to gain in-depth industry knowledge and obtain their designation continuing education credits. These programs often provide the opportunity for investment managers to share insight and research with financial advisors relating to products, ethics and investors behaviour. Investment managers also gain feedback and information from advisors about their practices and their client interests and charges. These non-monetary benefits provide a practical and useful service to the industry.

Question #9
No. In our experience, value-added marketing and education practices enable advisors to learn about products and investment processes in depth so they are in a position to make good product suitability recommendations. These non-monetary benefits also create dialogue and a feedback loop between investment managers and advisors so we can better understand and serve advisors and their investors. Bridgehouse views this as a service to the industry. We do not anticipate business or track business results directly from these educational and non-monetary benefits.

Question #10
We do not know the answer to this question, but believe that it is worthy of investigation to see if the playing field is level.

Part 4
Question # 11
Currently, Bridgehouse offers an F Series for fee-based payment. We collect the amount on behalf of the advisor based on an agreed upon amount; however, this process is manual and has added to our cost structure. Managers are not equipped to accommodate a variety of dealer fee structures. It would be a manual process that we would be forced to charge back to the dealer.

Question #12
The data and evidence provided in Part 4 show more investors shifting to branch delivery from IIROC and MFDA advisors. This shift can limit product choice for investors because of the heavy push on proprietary product. Branch advisors and client liaison employees may not receive commissions but recent media investigations have exposed financial sales incentives in the form of bonuses and job retention.

Bridgehouse, along with other investment managers, is building awareness of fee-based payment series. Our marketing material and advertising include Series F and A in that order. (A check of advertising in Investment Executive, will confirm this trend.) We have also closed several series so we can offer clear payment choices

We are certain the industry marketplace will adjust compensation models to answer competitive pressures and the disclosure requirements of the CRM initiatives.

Question #13
We recommend the CSA maintain an embedded payment option and focus on seeking harmonization of compensation models of other regulators to discourage regulatory arbitrage and an uneven playing field.

Question #14
Dual-licensed advisors can shift their business to products with less disclosure requirements under other regulators.

Question #15
The CSA has outlined some of the possible impacts on Page 78. For mid and mass market, there is likely to be a basic fee for service and additional costs for additional services. While this piecemeal approach will work for some investors, it is at odds with holistic financial planning based on individual needs and it will hinder proper "Know Your Client" assessments resulting in less accurate product suitability recommendations. Investors may get what they want to pay for, but that may not be what they need.

We cannot forecast which channels will increase or decrease; however, we will project that price will be a driver for most Canadians. During good times, they may question the value of paying for advice;

however, if they only seek advice at certain times, they may not receive the full benefits of financial planning and investing.

Question #16
We cannot forecast which payment arrangements are likely to result if the embedded payment option is discontinued; however, we will re-iterate that price will be a driver and the price-mid and mass-market investors are willing to pay will not cover the costs for holistic financial planning and services. A cafeteria-style menu may emerge and investors, who need it, will not get the full benefit of investing.

Question #17:
This proposal will lead to an advice gap for mass-market, mid-market, rural investors and younger investors. Younger investors are likely to receive limited product choice based on the cheapest price (ETF and passive products) through robo advisors. With the lack of holistic/integrated financial plans and limited product choice, Canadians in these large groups will not have access to the full benefit of investing. They will not get access to the emotional support during the inevitable difficult spells of prolonged down markets or poor product decisions.

Using your definition of "advice gap," Bridgehouse purports there is a distinction between an advice gap generally and face-to-face advice. This proposal will affect the provision of services that can help Canadians get the full benefit of investing: holistic planning that considers investments along with other assets, long-term financial planning that takes into account accumulation/de-accumulation strategies, diversification/re-balancing strategies, tax planning, intergenerational and estate planning, charitable donation strategies, along with financial coaching and education that counters negative investor behavior, assistance with proper documentation, family matters, diminished financial capacity, avoiding frauds and scams and mental health challenges. These services come from a relationship. They can't be automated. And, Canadians may not think they need these services or even know they need them, let alone pay for them until something goes wrong, which, due to the stress and cycle of life, they inevitably do.

Question #18
The fund industry continues to adjust to competitive pressures and the shifting needs of financial advisors and investors as evidenced by fee reductions and a promotional focus on fee-based series.

We cannot speak for the industry, but without the proposal, Bridgehouse would retain embedded fees as one payment method so Canadians can chose a payment method that is appropriate for them.

Question #19
Figure 8 is quite accurate based on averages and a snapshot in time. It would be helpful and telling to look at Figure 8 filtered by new advisors in the industry under five years to understand who is servicing Canadians with smaller account sizes.

Payment options and business models are evolving as per our answer to Question #18. Anecdotally, we are seeing that fewer new advisors and younger people are able to build practices. These are often the people who start by servicing Canadians with smaller accounts and with whom they grow.

It is costly for advisors to service smaller accounts although many we speak with say they would like to. This is one of the reasons Bridgehouse recently launched the Morningstar Managed Investments Program, so advisors could service smaller clients more efficiently with a single ticket portfolio and an investor experience including an Investor Profile Questionnaire (determines objective, timetable and attitude to risk/reward) and an Investment Policy Statement that serves as an educational and discussion document.

Question #20
It takes time, but we expect more F series investments. The industry is still adjusting to CRM (looking at services and fees) and fee-based is a new payment method for mass and mid-market investors. For this reason, we encourage the CSA to allow CRM initiatives to come to fruition and allow the industry and investors to adjust.

Question #21
We believe this proposal will trigger industry consolidation. Product choice will be limited. Independent product will be avoided by a controlled distribution that will put an emphasis on supporting their proprietary product. Dual-licensed advisors have the option of focusing on insurance-based investments that fall under other regulation and do not carry the same disclosure rules.

Mid and mass markets will receive limited advice and will not get the full benefit of investing. Rural communities will not receive service. Financial decisions will be made piecemeal as opposed to holistically, decisions will be based on limited choice and price as opposed to what value and benefit they can bring to Canadians. Canadians will face more complication and stress and will not have the support to build a plan (accumulation/de-accumulation) that covers their longer age span and takes into account precarious work and varied income sources. None of this supports Know Your Client, product suitability or enables Canadians to get the full benefit of investing.

Question #22
The proposal will significantly increase the back office service processes at the investment manager in the following ways:

- The impact over any transition period required (potentially seven years or longer to allow existing DSC schedules to expire) will be to increase the operational effort required as processes that do not currently exist will need to be implemented to transition accounts from embedded commission structures to direct pay structures. These processes will require the relevant policy adjustments, books and recordkeeping and quality assurance oversight.

- The majority of investment managers do not currently have the processes in place to collect variable direct pay arrangements on behalf of the dealer. The reason for the proliferation of fund classes is an outcome of the lack of operational infrastructure to collect a variable fee at the fund level. Substantial technological investments (multi-millions) would be required to build such an auditable system and oversight process.

- The co-existence of the embedded process, direct pay collection process that the CSA has suggested and the transition process between the two for a period that will likely exceed 5 years could be financially and operationally crippling to all but the largest financial institutions.

Question #23
The payment of embedded commissions requires controls and oversights to ensure accuracy and alignment with what is disclosed in all regulatory documents. Any conflict issues are dealt with during the implementation and approval of a compensation arrangement, not as part of the ongoing process – so to directly answer the question – no, the transition to direct pay would not alleviate any substantive controls and oversight.

In an environment where embedded commissions would not exist and dealers were exclusively responsible for all payment arrangements from investors, the majority of mutual fund control and oversight processes remain in place. These processes govern the collection and processing of all expense – not just commissions – as well as the processes required to ensure that every investor is in the right pricing structure. If the CSA proceeds as indicated on page 22 of the paper to allow dealers to outsource the collection of investor payments to the investment fund managers, the oversight and controls would substantially increase. These processes would be included in corporate and potentially CRA audits to ensure proper collection and disbursements of commodity taxes. The better solution from an operational perspective is to either continue with the embedded commission structure or to have dealers collect their own payments.

Question #24
No and recent indications are they will part ways with advisors and investors who do not meet specific revenue-generating targets and quotas. The industry will not be able to onboard and support new and young advisors.

Question #25
As investment managers, we are not in a position to comment on compensation details of dealers.

Part 5
Question #27 & #28
We submit our answers to Question #27 and #28 by re-iterating our opening recommendations because the mitigation measures will cause dislocation add confusion and cost and will take longer the natural evolution of shifting already underway.

- Allow market-led forces to shift compensation methods over time to avoid unnecessary dislocation and additional costs.

- Allow CRM initiatives to come to fruition and continue to concentrate on promoting disclosure.
- Review feedback from CP (81-408) in conjunction with any proposed changes resulting from CSA Consultation Paper 33-404 (Proposal to Enhance the Obligations of Advisers, Dealers and Representatives toward Their Clients).
- Seek harmonization of compensation models with regulators covering investment fund-like products to minimize regulatory arbitrage and protect Canadians from industry players seeking to hide from disclosure requirements.
- Avoid causing onerous technological, operation, client communications implications and associated costs that negate any perceived positives of discontinuing this method of compensation.

Question #29
Anecdotally, we are seeing that fewer new advisors and younger people are able to build practices. These are often the people who service Canadians with smaller accounts and with whom they grow.

The industry will not be willing or able to onboard and support new and young advisors. Recent indications are they will part ways with existing advisors who do not meet specific revenue generating targets and quotas. Dealers will take on many new advisors, but the only ones who survive will be asset collectors with a selling mentality, which usually does not encompass skills associated with financial advice and planning, servicing and supporting clients.

New financial advisors could come up through the bank system which, according to recent media investigations, is not without its selling and quota pressures.

New advisors coming up through the insurance system will have the advantage of offering investment products wrapped in insurance contracts, which fall under different regulation and do not have the same disclosure requirements as the investment industry.

Question #30
We suspect there will be a significant cross-subsidy loss; however, dealers are in a better position to provide details.

Question #31
The industry is putting more of a focus on F series, fee-based payment methods for advisors and their clients who wish to pay in this manner. We recommend the CSA let this market-led shift occur. We suspect that an embedded payment option will still appeal to many Canadians, but if it does not, the industry will continue to shift to those competitive pressures.

Question #32
It's impossible to scope out the changes from an investment manager point of view because it is dependent on the dealer lead; however, it would affect every aspect of our business and we would not be in a position to collect fees for dealers.

We would need to change everything from standard product information, communication materials, technology, and training and perhaps even our business model because we would need to establish entirely new relationships with even existing dealers. We would require outside services and legal counsel. This conversion would overwhelm our business to the determent of health of our business because of the dislocation, cost, time and the forgoing of revenue generating activity.

But most of all, none of these activities would improve the position of investors because it would not contribute to them getting the advice, access and services that enable them to gain the full benefit of using our products and from investing in general.

Question #33
We oppose this proposal.

Question #34
We are in support of capping; however, if the CSA allows a market-led transition and allows the CRM initiatives to come to fruition, capping may not be necessary.

Question #35
The initiatives discussed go beyond the role of regulation and while the intention is honorable market-led initiatives and a focus on disclosure and literacy will help investors get the full benefit of investing.

Question #36
Market-led and competition supported by a focus on disclosure and literacy are the best ways to help investors get the full benefit of investing.

Summary:
We thank the CSA for undertaking this Consultation and we thank you for the opportunity to submit our comments. We would be pleased to provide additional information or participate in any further discussion.

Sincerely,

Bridgehouse Asset Managers

Carol Lynde
President and COO

Trois-Rivières, le 9 juin 2017

Me Anne-Marie Beaudoin
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Autorité des marchés financiers
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TRANSMIS PAR COURRIEL

Objet : Document de consultation 81-408 des ACVM

Madame, Monsieur,

Le présent mémoire constitue la position de Groupe Cloutier Investissements Inc. relativement au document de consultation 81-408 des ACVM concernant la proposition d'éliminer les commissions intégrées. Groupe Cloutier Investissements, est un courtier en épargne collective basé à Trois-Rivières, au Québec, fondé en 2007. L'entreprise est une filiale du Groupe Cloutier Inc., un agent général en assurance de personnes fondé en 1978 par M. Gilles Cloutier. Groupe Cloutier Inc. est l'un des plus importants cabinets de courtage complètement indépendants au Canada. Nous desservons plus de 1,200 conseillers, dont environ 250 possèdent un permis en épargne collective, situés principalement au Québec, en Ontario et dans les Maritimes. À travers ses filiales et les différents produits qu'il distribue, Groupe Cloutier gère un actif total d'environ 3 milliards de dollars.

Tout d'abord, nous souhaitons remercier les ACVM de l'opportunité qui est offerte à l'industrie d'offrir ses commentaires concernant cette proposition qui pourrait avoir des impacts majeurs pour l'ensemble des clients et de l'industrie. Nous souhaitons humblement apporter notre contribution au débat en tant que courtier totalement indépendant sans aucun lien de propriété avec un manufacturier.

Nous avons décidé de structurer notre mémoire en débutant par quelques remarques préliminaires afin de placer le débat dans son contexte. Par la suite, nous répondrons de façon détaillée à la plupart des questions soulevées par les ACVM dans le document de consultation.

Toutefois, avant de commencer, nous souhaitons apporter notre appui à deux mémoires déposés auprès des ACVM dans le cadre de la présente consultation. Tout d'abord, nous tenons à saluer la position adoptée par l'Institut des fonds d'investissement du Canada (IFIC). Nous accordons une grande crédibilité aux travaux effectués par l'Institut des fonds d'investissement du Canada (IFIC) sur le présent sujet. Nous avons pu prendre connaissance des arguments de l'IFIC et des propositions alternatives que l'organisme qui représente l'industrie des fonds d'investissements allait mettre de l'avant dans leur mémoire et Groupe Cloutier Investissements les appuie totalement. En second lieu, nous souhaitons appuyer la position prise par Pierre Lortie, Senior Business Advisor chez Dentons Canada LLP. La crédibilité de M. Lortie est sans conteste et les positions apportées dans son mémoire sont d'une clarté et d'une justesse remarquables.

La recherche de la « solution unique »
Nous avons déjà abordé ce sujet dans le cadre de la consultation 33-404 concernant les *Propositions de rehaussement des obligations des conseillers, des courtiers et des représentants envers leurs clients* des ACVM. Nous souhaitons réitérer ici la même position puisque nous croyons qu'elle s'applique aussi à la proposition de bannir les commissions intégrées.

Le secteur des valeurs mobilières est extrêmement vaste. On y retrouve autant des courtiers en placement dont l'offre de produits est très large que des courtiers en plans de bourse d'études ou en marchés dispensés dont la sphère d'activité est très pointue. Or, d'un point de vue global, il ressort du présent document de consultation que les ACVM tentent d'appliquer une formule unique à des modèles d'affaires complètement différents. Or, dans la réalité, le modèle du *one-size-fits-all* pourrait ne pas être souhaitable pour tous les modèles d'affaires. Par exemple, comment arriver à concilier à travers une réglementation unique des courtiers à escompte dont les clients ne bénéficient d'aucun conseil et des courtiers multidisciplinaires indépendants offrant une gamme élargie de service personnalisés touchant les investissements, l'assurance, la planification financière, etc.? Même dans un modèle de rémunération directe, les courtiers à escompte seront-ils autorisés à facturer des honoraires de conseil équivalents à ceux des réseaux avec conseil? Si oui, pourra-t-on considérer que la présente réforme aura réussi à régler l'enjeu soulevé par les ACVM comme quoi les clients ne reçoivent pas toujours un niveau de service à la hauteur des frais qu'ils payent? Chaque modèle d'affaires a ses propres particularités et il nous semble hasardeux d'appliquer la même solution à chacun d'entre eux.

Commentaire sur la mission des ACVM
Nous ne souhaitons absolument pas nous poser en donneurs de leçon, loin de là. Les régulateurs disposent de toute la latitude de mettre en place la réglementation qu'ils jugent nécessaire pour atteindre leurs objectifs. Cependant, comme la proposition actuelle constitue une véritable révolution qui aura des impacts majeurs à long terme sur toute l'industrie, nous avons cru bon l'analyser à travers le filtre de la mission des ACVM telle qu'on peut la consulter sur son site web :

« Doter le Canada d'un cadre de réglementation des valeurs mobilières qui protège les investisseurs contre des pratiques déloyales ou frauduleuses, tout en favorisant l'équité, l'efficacité et la vigueur des marchés financiers, grâce à l'élaboration du régime canadien de réglementation des valeurs mobilières (RCRVM), système national de ‘’réglementation, de politiques et de pratiques harmonisées en matière de valeurs mobilières. »[1]

Comme vous le verrez tout au long de ce document, nous convenons des enjeux identifiés par les ACVM. Nous divergeons toutefois d'opinion sur la nécessité d'éliminer complètement ces enjeux, surtout en considérant les conséquences que le bannissement pourrait avoir sur les clients et sur l'industrie. Nous sommes néanmoins d'accord avec le fait que le modèle actuel est perfectible et nous sommes totalement ouverts au dialogue. Ceci dit, le fait d'identifier des enjeux comme l'ont fait les ACVM était une première étape essentielle. Nous croyons toutefois qu'avant de mettre en place une réforme aussi explosive, il convient de faire la distinction claire entre les enjeux qu'il serait souhaitable d'éliminer et ceux qu'il serait impératif d'évacuer.

Une réforme d'une telle ampleur ne peut pas être considérée comme de la simple optimisation de réglementation. Les implications sont telles qu'elles risquent de bouleverser à long terme le visage de l'industrie. Conséquemment, toute réforme aussi majeure devrait impérativement s'inscrire dans la mission de l'organisme. Or, en analysant les enjeux identifiés par les ACVM, on doit tout d'abord se poser la question suivante : Les enjeux identifiés exposent-il des investisseurs à des pratiques déloyales et frauduleuses? Les conflits d'intérêts font partie de n'importe quelle industrie et ne pourront jamais être éliminés complètement. Toute mesure visant à les éliminer fera émerger d'autres types de conflits d'intérêts et nous exposerons en détail notre point de vue à ce sujet dans nos réponses aux questions posées par les ACVM. Toutefois, les conflits d'intérêts que les ACVM souhaitent éliminer par le bannissement des commissions intégrées sont-ils d'une telle ampleur qu'ils sont déloyaux ou frauduleux envers les clients? Nous croyons que non. Il en va de même à notre avis en ce qui concerne la complexité des produits. Le fait que les produits offerts comportent un grand niveau de complexité n'est peut-être pas souhaitable et certaines mesures peuvent certainement être implantées pour simplifier les structures, mais la situation actuelle n'est ni déloyale, ni frauduleuse. Finalement, est-ce que le fait que certains clients payent des honoraires qui ne sont pas en lien avec les services qu'ils reçoivent, notamment dans les réseaux sans conseil, fait des commissions intégrées un mécanisme de rémunération déloyal ou frauduleux? Encore, une fois, nous croyons que non. Certaines mesures ciblées peuvent être mises en place, mais de là à débâtir un système qui a bien servi les canadiens depuis des décennies, il y a un pas que nous ne croyons pas souhaitable de franchir.

Par ailleurs, en ce qui concerne la deuxième partie de la mission des ACVM, il convient de se poser la question à savoir si le bannissement des commissions intégrées contribuera

[1] http://www.autorites-valeurs-mobilieres.ca/presentation_des_ACVM.aspx?id=78

à favoriser l'équité, l'efficacité et la vigueur des marchés financiers. Pour l'efficacité, peut-être. Pour l'équité et la vigueur, nous sommes convaincus que non et nous expliquerons notre point de vue en répondant aux différentes questions soulevées par les ACVM. À l'instar des appréhensions des ACVM énoncées dans le document de consultation, nous croyons que le secteur dont nous faisons partie, les courtiers indépendants, sera fortement secoué par un bannissement des commissions intégrées comparativement aux réseaux intégrés et nous ne voyons pas en quoi cela contribuera à améliorer l'équité et la vigueur du marché. Au contraire, cela contribuera à avantager un réseau par rapport à un autre et risquera de diminuer la demande et l'offre de conseils financiers.

En résumé, les points soulevés par les ACVM sont totalement pertinents et méritent que l'on s'y attarde. Toutefois, nous exposerons dans le présent mémoire pourquoi nous croyons que les moyens proposés sont démesurés et risquent de créer d'autres situations encore moins souhaitables que les problèmes actuels que les ACVM tentent de régler.

Que veulent les clients?
Nous nous réjouissons de savoir que les ACVM prendront le temps de consulter les investisseurs pour tenter de comprendre leurs désirs à travers une étude réalisée par une firme indépendante. Nous croyons qu'il s'agit là d'un point de départ incontournable avant l'adoption d'une réforme ayant des implications aussi profondes autant sur les clients que sur l'industrie. Nous souhaitons à ce sujet partager quelques informations avec les ACVM.

Dans une étude publiée le 30 mai 2017 par le Gandalf Group[2] pour le compte de la compagnie Fonds AGF, on apprend notamment que :

- 55% des clients préfèrent payer pour les services qu'ils reçoivent à travers des commissions intégrées, comparativement à 33% qui préféreraient un mode rémunération direct comme celui proposé par les ACVM ;
- 46% des clients préfèrent un modèle de rémunération basé sur un pourcentage de leurs actifs contre 34% qui préfèrent une rémunération à l'acte ou basée sur un taux horaire ;
- 78% des clients étaient fortement en accord ou plutôt en accord avec le fait que les frais pour les conseils devraient être inclus à même le frais de gestion du fonds ;
- En ce qui concerne les impacts de l'imposition d'une méthode de rémunération directe, environ le quart des répondants (et environ le tiers de ceux qui avaient une opinion sur la question) ont indiqué que ce mode de rémunération les rendrait moins enclins à recourir à des services conseil en lien avec leurs investissements. Les résultats à cette question sont relativement uniformes peu importe la taille du portefeuille des clients ou leur niveau de littéracie financière. Ces résultats viennent corroborer l'expérience vécue au Royaume-Uni, en Australie et aux Pays-Bas où on

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[2] *The Canadian Investors' Survey, An Opinion Research Study on Fees & Advisory Services*, The Gandalf Group, http://tinyurl.com/y9qz9nwa, 30 mai 2017.

a pu constater que, surtout chez les clients de masse, un nombre non négligeable de ceux-ci ont refusé de passer au modèle de rémunération directe.

L'étude conclut donc que les clients sont généralement satisfaits du modèle actuel. Elle confirme par ailleurs les résultats de notre propre enquête menée auprès de plusieurs milliers de clients. Le nombre exact de répondants et notre méthodologie pourront être communiqué de manière confidentielle, mais le nombre de réponses reçues est statistiquement significatif. Nous avons posé la question suivante à nos clients :

Les Autorités canadiennes en valeurs mobilières mènent actuellement une consultation sur la manière dont les clients payent pour les services qu'ils reçoivent de la part de leur conseiller et de leur firme de courtage.

À l'heure actuelle, la rémunération que vous payez à Groupe Cloutier Investissements ainsi qu'à votre conseiller fait partie intégrante du frais de gestion que vous payez au(x) gestionnaire(s) des fonds que vous détenez. Par exemple, si vous détenez un fonds de la société Fonds ABF et que celui-ci est assorti d'un frais de gestion de 2,0% annuellement, une portion de ce frais total, par exemple 1,0%, est automatiquement versée à Groupe Cloutier Investissements et à votre représentant en contrepartie pour les services qui vous sont offerts et ce tant que vous détenez votre placement.

Les régulateurs envisagent d'interdire cette méthode et de la remplacer par d'autres modes de rémunération directe où vous auriez à payer directement le courtier et le conseiller. Nous préparons actuellement notre réponse à cette consultation et votre opinion nous intéresse grandement afin de déterminer la manière que vous préférez payer pour les services que vous recevez de la part de votre conseiller et de Groupe Cloutier Investissements.

Parmi les modèles de rémunération suivants qui sont envisagés par les autorités réglementaires, lequel préféreriez-vous?

- Je préfère que la rémunération de mon conseiller soit intégrée à même le frais de gestion du ou des fonds que je détiens (modèle actuel). Par exemple : Vous détenez un portefeuille de 10,000$ investi dans un seul fonds assorti d'un frais de gestion total de 2,0% dont 1,0% est consacré à la rémunération de Groupe Cloutier Investissements et de votre conseiller et 1% au gestionnaire du fonds. Le fiduciaire du fonds prélèvera automatiquement à même le fonds la somme totale de 200$ et distribuera la part revenant au conseiller, au courtier et au gestionnaire pour vous.

- Je préfère payer un tarif à l'heure pour les services rendus par mon conseiller et vendre certaines des unités que je détiens afin d'acquitter ces honoraires. Par exemple : Vous détenez un portefeuille de 10,000$. Votre conseiller vous informe qu'il a un taux horaire de 100$/heure. S'il effectue 1 heures de travail dans votre dossier, un rachat de 100$ sera placé dans votre compte afin d'acquitter ses honoraires. Le gestionnaire du fonds prélèvera quant à lui ses honoraires, par exemple 1,0%, ou 100$, à même le fonds. Vos coûts de détention totaux s'élèveraient donc à un total de 200$ annuellement.

- Je préfère négocier directement avec mon conseiller un honoraire selon un pourcentage de mes actifs et vendre de façon périodique certaines des unités de fonds que je détiens afin de payer ces honoraires. Par exemple : Vous détenez un portefeuille de 10,000$ et vous négociez un honoraire de 1,0% avec votre conseiller. Chaque année, un rachat de 100$, plus taxes, serait donc placé automatiquement dans votre compte de manière à payer ces honoraires. Le gestionnaire du fonds prélèvera quant à lui ses honoraires, par exemple 1,0%, ou 100$, à même le fonds. Vos coûts de détention totaux s'élèveraient donc à un total de 200$ annuellement.

Il convient de préciser que nous n'avons effectué, ni directement ou indirectement, quelque campagne de communication massive que ce soit au préalable visant à influencer les résultats du sondage. Nos conseillers ont été mis au courant de notre initiative que quelques heures avant que le sondage ne soit transmis aux clients et n'ont donc pas pu eux non plus tenter d'influencer les résultats. De plus, comme les choix de réponse étaient relativement longs, nous avons souhaité éviter un biais lié à l'ordre dans lequel les trois choix étaient présentés aux clients. Par conséquent, le sondage a été construit de manière à ce que les choix de réponse s'affichent dans un ordre aléatoire pour chaque répondant. Au final :

- 80% des clients ont déclaré préférer le modèle actuel avec les commissions intégrées ;
- 11% ont dit préférer un modèle de rémunération directe basé sur un pourcentage de leur actif sous gestion ;
- 9% ont dit souhaiter un modèle de rémunération directe basé sur un taux horaire.

Nous avons aussi posé quelques questions visant à qualifier les clients selon différents critères :

- Leur âge ;
- La taille de leur portefeuille ;
- La durée de leur relation avec leur conseiller ;
- Le niveau des explications reçues de la part de leur conseiller en lien avec le fonctionnement actuel de la rémunération ;
- Leur degré de satisfaction face au service reçu par leur conseiller et leur courtier.

Après analyse, aucun de ces facteurs n'a d'influence significative sur les résultats globaux du sondage, à l'exception des clients qui se disent insatisfaits des services reçus. Toutefois, même chez les clients qui ont attribué une note inférieure à 6 sur 10 quant à la qualité des services qu'ils reçoivent, les commissions intégrées demeurent l'option la plus populaire. En effet, 46% de ces clients sont en faveur du modèle actuel de rémunération intégrée, contre 23% pour la tarification directe en fonction de la taille du portefeuille et 31% en faveur du modèle de rémunération directe selon un taux horaire.

Ainsi, les données disponibles sur la question à l'heure actuelle semblent laisser présager que les clients sont entièrement satisfaits avec le modèle actuel et il ne semble pas y avoir d'appétit chez ceux-ci pour des réformes de l'ampleur de celle proposée par les ACVM.

État actuel du marché

Avant d'aller plus loin, il convient de rappeler certains faits concernant l'état actuel du marché de l'épargne collective au Canada :

- L'ACFM a effectué un vaste sondage[3] qui vient tout juste d'être publié. Les ACVM ont certainement reçu ces données, mais voici les faits saillants que nous y avons retenu :

    - 83% des clients des membres de l'ACFM ont un actif de 100,000$ et moins.

    - L'actif des courtiers membres de l'ACFM est réparti comme suit entre les différentes structures de frais disponibles :
        - 48% dans des fonds à frais d'acquisition reportés et à frais réduits ;
        - 43% dans des fonds à frais prélevés à l'acquisition (FPA) et dans des fonds sans frais d'acquisition. Le document nous précise aussi que dans la très grande majorité des cas, les fonds à FPA sont distribués avec un frais initial de 0%. Cette statistique se vérifie aussi au sein de notre propre bloc d'affaires ;
        - 9% dans des fonds dont la commission n'est pas intégrée au frais de gestion.

      Ces données sont importantes puisqu'elles dressent un portrait assez différent de celles présentées à la Figure 7 du document de consultation 81-408. Sur ce point, le détail de l'actif sous gestion de Groupe Cloutier Investissements ne concorde pas exactement avec les données de l'ACFM. Notre actif est davantage composé de fonds à FPA que l'ensemble des membres de l'ACFM. Compte tenu de la nature sensible de ces données, des informations plus détaillées pourront vous être fournies sous embargo à ce sujet.

    - Les fonds à frais d'acquisition reportés (FAR) sont utilisés principalement par les conseillers ayant un actif sous gestion (ASG) plus modeste. Ces fonds

[3] *MFDA Client Research Report – A Look Into Members, Advisors, Clients*, Mutual Funds Dealers Association of Canada, Mai 2017.

composent 53% de l'actif des conseillers avec un ASG inférieur à 500,000$ alors qu'ils représentent seulement 14% des actifs des conseillers avec un ASG supérieur à 50M$. Nous pouvons déduire de cette statistique que les fonds à FAR sont principalement utilisés par des conseillers en début de carrière de manière à leur permettre de générer un revenu suffisant pour survenir à leurs besoins dans les premières années de leur carrière.

  - Les fonds à FAR sont principalement utilisés pour les clients de masse. En effet, la proportion des actifs des clients avec un ASG inférieur à 100,000$ investis dans des fonds à FAR est de 42% alors qu'elle décroît jusqu'à 17% pour les clients avec 500,000$ et plus d'actif. On peut comprendre de ces données que les conseillers utilisent principalement les fonds à FAR pour arriver à dégager une certaine rentabilité même auprès des clients avec un actif plus modeste pour lesquels les autres structures de frais rendraient ces clients moins intéressants à servir du point de vue économique.

- Par ailleurs, en 2016, le Conseil des fonds d'investissement du Québec (CFIQ) a effectué une vaste enquête auprès des courtiers en épargne collective du Québec de petite, moyenne et grande tailles. Un total de 10 courtiers, dont Groupe Cloutier Investissements, regroupant un total de 4838 conseillers, soit 21% de tous les représentants en épargne collective au Québec ont répondu à ce sondage dont les principales conclusions sont :

  - 71% des représentants ont des revenus bruts (avant partage avec leur courtier) liés à l'épargne collective inférieurs à 41,935$ annuellement ;

  - Plus les conseillers sont jeunes, plus leurs revenus sont modestes ;

  - Les représentants de moins de 40 ans constituent 29% des conseillers, mais génèrent seulement 14% des revenus du secteur ;

Bref, ces deux études démontrent bien que le réseau des courtiers en épargne collective s'adresse en très grande majorité à des clients de masse ayant un portefeuille de moins de 100,000$. Parallèlement, les représentants qui les desservent génèrent majoritairement des revenus liés à l'épargne collective plutôt modestes, particulièrement chez les plus jeunes d'entre eux.

Un bannissement complet des commission intégrées aurait selon nous deux effets immédiats potentiellement très néfastes sur la demande et l'offre de service en lien avec la distribution de fonds d'investissement :

1. Les clients de masse risqueraient de ne pas vouloir payer directement la vraie valeur du conseil qu'ils reçoivent, et ;
2. Certains conseillers dont les revenus liés à la distribution de fonds d'investissement pourraient se désintéresser de la profession et se concentrer sur la distribution d'autres produits financiers.

Maintenant que nous avons apporté ces précisions qui permettent de mieux placer le débat en contexte, vous trouverez plus bas nos réponses à la plupart des questions soulevées par les ACVM dans le document de consultation 81-408.

Partie 2

1. **Convenez-vous des enjeux exposés dans cette partie? Pourquoi?**
   Nous convenons des enjeux exposés par l'ACVM. Ils sont réels, quoique parfois plutôt théoriques puisqu'ils ne se reflètent aucunement dans notre pratique. Nous pourrons d'ailleurs fournir aux ACVM certaines données sous embargo qui démontrent cette affirmation. Toutefois, nous considérons que ces enjeux ne doivent pas être abordés de façon isolée. La recherche de solutions à ces enjeux devrait s'accompagner d'une préoccupation de conserver un équilibre au système actuel qui permet aux clients, même les moins fortunés, de bénéficier d'un accès facile au conseil. Conformément à la mission des ACVM, les solutions proposées devraient aussi permettre aux firmes et aux conseillers d'œuvrer au sein d'une industrie concurrentielle qui donne l'opportunité à de nombreux modèles d'affaires différents de se côtoyer. Comme mentionné en préambule, les solutions proposées se doivent de faire une distinction entre les enjeux soulevés qui sont indésirables et ceux qui sont intolérables.

   Nous sommes d'avis que la solution proposée par les ACVM, bien qu'elle réponde aux trois enjeux identifiés, briserait le fragile équilibre existant entre l'offre et la demande pour les conseils financiers et qu'elle s'avère donc extrêmement risquée autant pour les clients que pour certains joueurs de l'industrie. Nous sommes tout à fait d'accord pour convenir que le modèle actuel est perfectible. D'autres mesures pourraient toutefois permettre d'atténuer, sans les éliminer complètement, les trois enjeux identifiés par les ACVM sans pour autant briser l'équilibre actuel des choses.

3. **Les commissions intégrées comportent-elles des avantages importants —accès aux conseils, efficience et rentabilité des modèles d'affaires, concurrence accrue — qui l'emporteraient parfois ou toujours sur les enjeux ou les problèmes qui y sont liés? Veuillez, si possible, présenter des données qui illustrent votre argument.**
   Les commissions intégrées comportent certes des avantages importants qui bénéficient directement aux clients. Dans certains réseaux, les conseillers doivent conjuguer avec un objectif de rencontrer jusqu'à 25 clients par semaine. Dans ce contexte, il est illusoire de penser qu'un conseiller pourra consacrer le temps et les efforts nécessaires à analyser un dossier, réfléchir à une stratégie financière répondant aux besoins de son client. Par ailleurs, les recommandations seront-elles neutres de tout objectif connexe de vente, comme par exemple, une marge de crédit?

   Pour une firme et un conseiller indépendants, les commissions intégrées éliminent cette contrainte et sont source d'indépendance dans la gestion des affaires quotidiennes. Par exemple, dans notre réseau, aucun conseiller n'est assujetti à des objectifs de ventes précis ou ne doit rencontrer un nombre précis de clients par semaine sous peine de subir des conséquences de la part d'un supérieur. Tous nos conseillers sont des entrepreneurs libres de disposer de leur temps. Ils auront donc toute la latitude voulue pour aborder certains sujets connexes avec leurs clients. Ils seront donc libres de se consacrer à certaines tâches connexes auxquelles il serait plus difficile de s'attarder dans un contexte de rémunération à l'acte ou par taux horaire. Par exemple, nos conseillers vont régulièrement :

- Effectuer une planification de retraite, des études des enfants ou de l'avenir financier d'un enfant handicapé ;
- Analyser plus en détail la situation fiscale du client de manière à bien choisir le véhicule de placement le plus adapté ;
- Instaurer un plan d'épargne étoffé en vue de réaliser certains objectifs précis ;
- Analyser le testament et le référer à un notaire si une situation pourrait donner lieu à des conséquences imprévues en cas de décès ou d'invalidité ;
- Analyser les états financiers d'une corporation et effectuer des recommandations ;

Ce sont en partie les commissions intégrées qui permettent cette latitude à nos conseillers en atténuant les pressions liées à la simple rencontre d'objectifs de vente ou de rencontres client et en permettant aux conseillers de se consacrer à des tâches qui apportent davantage de valeur ajoutée aux clients.

Par ailleurs, les commissions intégrées permettent à nos conseillers de réaliser d'autres tâches qui ne sont pas nécessairement en lien avec le dossier d'un client, mais qui bénéficient à la qualité du service qu'ils offrent ou encore à l'avancement de la profession. Par exemple, les conseillers pourront consacrer du temps à suivre des formations spécialisées, acquérir de nouvelles connaissances ou des certifications professionnelles additionnelles. D'autres choisiront de s'impliquer dans des associations professionnelles ou offriront des services d'éducation financière gratuitement auprès de certains groupes de clientèle. Or, il nous apparaîtrait difficile de facturer directement des clients particuliers pour ce temps consacré à l'avancement de la collectivité, à la formation du conseiller et à l'approfondissement de ses connaissances générales ou spécifiques. Les commissions intégrées procurent une source de revenus stable qui permet à ces conseillers de s'impliquer dans de telles initiatives. La présente consultation se veut d'ailleurs un excellent exemple. Nous avons constitué un groupe de réflexion *ad hoc* composé d'une dizaine de conseillers dans le cadre de cette consultation afin d'organiser une rencontre avec un représentant de l'AMF et lui présenter le fonctionnement et le point de vue des conseillers indépendants sur la question. Chaque conseiller a consacré une dizaine d'heures à cette initiative et, de l'avis de tous, cette rencontre fut des plus bénéfiques pour les deux parties. Or, sans commissions intégrées, il aurait été difficile pour ces conseillers de consacrer autant d'heures « non facturables » à cette activité.

Partie 3

4. Dans le cas de chacun des produits d'investissement suivants, placés au moyen d'un prospectus ou sur le marché dispensé sous le régime d'une dispense de prospectus :

- **OPC**
- **fonds d'investissement à capital fixe**
- **billet structuré**

Devrait-on abandonner les commissions intégrées? Dans la négative :

a. Sur quel fondement devrait-il être exclu?
b. Quel serait le risque que des arbitrages réglementaires soient faits sur le marché dispensé si les commissions intégrées n'étaient abandonnées que pour les produits placés au moyen d'un prospectus?

Nous croyons que tous les types de produits mentionnés ci-haut devraient être assujettis de la même manière au résultat final de la présente consultation.

8. Devrions-nous envisager d'abandonner d'autres frais ou paiements relativement à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés, notamment :

a. le versement de sommes d'argent et la fourniture d'avantages non pécuniaires par les gestionnaires de fonds d'investissement aux courtiers et aux représentants en vertu de la partie 5 du Règlement 81-105;

Premièrement, les versements d'argent ou de fournitures sont déjà très bien encadrés depuis le rapport de Mme Glorianne Stromberg publié en 1995. Ce rapport a permis de mieux encadrer ces activités et ainsi d'éviter les conflits d'intérêt qui pouvaient résulter de ces gestes.

Ceci étant dit, l'élimination des commissions intégrées entraînera un incitatif pour les réseaux intégrés d'augmenter les paiements entre filiales visant par exemple à financer des activités qui pourraient s'avérer déficitaires au niveau de la distribution. Par exemple, un réseau de distribution pourrait potentiellement offrir des honoraires de conseil à un tarif sous le prix coûtant alors que du même souffle le gestionnaire de fonds d'investissement lié pourrait augmenter légèrement son frais de gestion de manière à pouvoir financer les pertes du réseau de distribution. Le frais total payé par le client ne serait pas moindre, mais laisserait miroiter un honoraire de conseil plus bas. Ceci pourrait contribuer à dévaloriser la valeur du conseil aux yeux des clients et donner lieu à une guerre de prix inéquitable envers les réseaux de distribution indépendants qui, par nature, ne peuvent pas bénéficier de ce type de transferts entre filiales. Même dans un contexte où les commissions intégrées ne seraient pas abandonnées, nous invitons les régulateurs à analyser cette question avec attention afin d'assurer une certaine équité à travers l'industrie.

b. les commissions d'indication de clients;
Les commissions d'indication de clients sont courantes dans toutes les industries. Le secteur des valeurs mobilières est probablement une des industries où cette pratique est la plus encadrée. L'indication de clients est déjà traité avec beaucoup plus de transparence dans notre secteur comparativement à d'autres domaines. Nous sommes donc fortement opposés à toute initiative qui aurait pour effet d'interdire le paiement de commissions d'indication de client dans le secteur des valeurs mobilières.

9. Si le versement de sommes d'argent et la fourniture d'avantages non pécuniaires aux courtiers et aux représentants pour le soutien d'activités de commercialisation et de formation en vertu de la partie 5 du Règlement 81-105 sont maintenus après l'abandon des commissions intégrées, devrions-nous envisager de modifier la portée de ces versements et avantages? Dans l'affirmative, pourquoi?
Comme nous l'avons déjà mentionné plus haut ces activités sont déjà bien encadrées. De plus, la participation financière des gestionnaires de fonds d'investissement aux activités de formation permet aux conseillers d'obtenir de l'information de qualité et de la formation permettant de mieux répondre aux besoins des investisseurs.

10. En ce qui a trait aux paiements de transfert internes :

a. Le Règlement 81-105, qui régit les paiements au sein de fournisseurs de services financiers intégrés, assure-t-il un traitement égal entre les fonds en propres et les fonds de tiers?
À notre avis, la portée du Règlement 81-105 omet un risque important qui pourrait affecter l'équité dans l'industrie. En effet, comme mentionné à la question 8a, même dans la situation actuelle, rien n'empêcherait une institution financière intégrée de diminuer la portion rémunération liée à la distribution d'un fonds tout en augmentant le frais de gestion revenant au gestionnaire du fonds. Le gestionnaire pourrait ensuite compenser la diminution des revenus de la branche de distribution par des transferts entre filiales pratiquement indétectables. Dans un contexte où les commissions intégrées devaient être éliminées, rien ne nous permet de croire que cette situation serait éliminée.

Nous avons abordé le sujet à plusieurs reprises avec différents intervenants des ACVM lors de rencontres d'information, mais nous souhaitons réitérer ce point puisqu'il s'agit selon nous d'un risque tout à fait réel. Un exemple très concret de cette situation a été rapporté récemment dans un article du site conseiller.ca[4]. On y rapporte qu'un gestionnaire de fonds d'investissement disposant de son propre réseau de distribution et dont les produits sont aussi disponibles aux distributeurs indépendants a réduit la commission de suivi versée sur certains de ses fonds sans pour autant diminuer le ratio de frais de gestion total devant être

[4] http://www.conseiller.ca/nouvelles/commissions-la-td-a-t-elle-hausse-sa-part-au-detriment-des-conseillers-62730?courriel=yes

assumé par les clients. Concrètement, les clients ne retirent donc aucun avantage de cette situation puisque le ratio de frais de gestion demeure inchangé. Pour l'institution financière intégrée, lors que le fonds est distribué à travers sont propre réseau de distribution, elle n'encourt aucune perte de revenu global, puisque ses revenus sont simplement déplacés de sa filiale de distribution vers sa filiale de gestionnaire de fonds d'investissement. Toutefois, lorsque le même fonds est distribué à travers un distributeur indépendant, le revenu de l'institution financière intégrée va augmenter alors que celui du distributeur indépendant vient de diminuer.

Cet exemple concret implique deux conséquences potentiellement très dommageables pour les courtiers et les conseillers indépendants. Premièrement, en vertu de la récente réforme MRCC2, le montant de la rémunération versée à la branche distribution de cette institution financière s'en trouvera automatiquement diminué sur le relevé de compte transmis au client, laissant ainsi croire à ce dernier qu'il vient de profiter d'une baisse des frais alors que ce n'est pas le cas. En effet, la portion du frais de gestion versée au gestionnaire de fonds n'est pas divulguée sur le relevé du courtier. Ceci constitue une limite concrète de MRCC2 pour laquelle de nombreux acteurs de l'industrie avaient mis en garde les ACVM suite à la décision d'exiger uniquement la divulgation de la rémunération versée aux courtiers. Deuxièmement, même dans un contexte d'élimination des commissions intégrées, rien n'aurait empêché cette entreprise de réduire l'honoraire de conseil facturé au client tout en augmentant le ratio de frais de gestion du fonds. Dans un tel contexte, le courtier indépendant devrait faire un choix entre sacrifier une partie de son revenu afin de demeurer compétitif face au réseau de distribution de l'institution financière intégrée, ou encore accepter de perdre le client au profit de l'institution financière. Dans un cas comme dans l'autre, cela revient carrément à dévaluer la valeur du conseil qui est prodigué au client. Il nous semble très hasardeux de considérer l'implantation de réformes qui auraient pour effet de dévaluer la valeur du travail des acteurs de l'industrie, valeur qui est reconnue depuis des décennies.

b. Devrait-on abandonner les paiements de transfert internes à des courtiers membres de fournisseurs de services financiers intégrés qui sont liés à la souscription ou à la détention de titres de fonds d'investissement ou de billets structurés? Pourquoi? Dans quelle mesure les fournisseurs de services financiers intégrés font-ils directement ou indirectement des paiements de transfert internes à leurs courtiers membres et à leurs représentants afin de les inciter à distribuer leurs produits?

Afin d'éliminer le risque exposé à la question précédente, nous croyons effectivement que des actions devraient être prises afin de limiter les paiements de transfert internes à des courtiers membres de fournisseurs de services financiers intégrés. Toutefois, en pratique, nous doutons fortement de la capacité des ACVM de détecter et contrôler de tels paiements.

11. Si nous décidions d'abandonner les commissions intégrées, devrions–nous autoriser les gestionnaires de fonds d'investissement ou les émetteurs de billets structurés à faciliter le paiement de la rémunération du courtier par l'investisseur en la prélevant sur l'investissement de celui-ci et en la remettant en son nom au courtier?

Beaucoup de courtiers indépendants n'offrent pas de comptes nominés pour le moment. Les raisons sont relativement simples. Premièrement, tous les comptes enregistrés au Canada doivent être offerts par l'entremise d'un fiduciaire. Or, le nombre de fiduciaires intéressés à offrir ce service à des courtiers indépendants est extrêmement faible et le coût exigé est exorbitant pour les courtiers de petite ou moyenne taille. Notons aussi qu'une majorité de fiduciaires appartiennent à des compétiteurs intégrés. Ont-ils la volonté de favoriser l'émergence d'une compétition offrant plus d'options aux investisseurs ?

De plus, le nombre de fournisseurs de systèmes informatiques offrant les fonctionnalités nécessaires à la gestion des comptes nominés est très restreint et, encore une fois, les coûts associés à cette fonctionnalité sont inabordables pour les courtiers de petite ou moyenne taille. Bref, la plupart des courtiers indépendants de petite et moyenne taille au Canada ont pris la décision d'offrir presqu'exclusivement des comptes au nom du client.

Or, les systèmes informatiques disponibles aux courtiers pour la gestion des comptes détenus au nom du client ne permettent pas actuellement aux courtiers de déclencher des rachats automatiques dans les comptes des clients de manière à acquitter les honoraires de conseil. Rendre les systèmes compatibles pour effectuer ce genre d'opération nécessiterait des investissements colossaux non seulement pour les courtiers, mais aussi pour les gestionnaires de fonds qui devraient aussi adapter leurs systèmes de manière à ce que ces rachats initiés par les courtiers puissent être réglés sans avoir à exiger la signature des clients lors de chaque transaction.

Ainsi, si les ACVM devaient éliminer les commissions intégrées, il serait important et même essentiel que les gestionnaires de fonds soient autorisés à prélever les honoraires de conseil et à en remettre le produit aux courtiers.

Partie 4

Recherche de solutions

12. Compte tenu des données et des éléments probants fournis dans la présente partie, la proposition d'abandonner les commissions intégrées répondrait-elle aux trois principaux enjeux de protection des investisseurs et d'efficience du marché traités dans la partie 2?

Nous ne croyons pas que l'élimination des commissions intégrées permettrait nécessairement de répondre de façon optimale aux trois préoccupations soulevées par les ACVM, particulièrement en ce qui concerne les conflits d'intérêts. Nous croyons que les mécanismes de rémunération directe pourraient induire d'autres types de conflits d'intérêts qui ne sont pas davantage souhaitables.

Par exemple, une rémunération directe calculée en fonction d'un pourcentage de l'actif sous gestion pourrait potentiellement donner lieu aux conflits d'intérêts suivants :

- Certains conseillers pourraient être tentés d'offrir leurs services à un tarif très bas afin d'attirer des clients tout en leur offrant un niveau de service très faible en ne clarifiant pas au début de la relation le niveau de service qu'ils offriront à leurs clients ;

- Inversement, certains conseillers pourraient charger des tarifs excessifs ce qui aurait comme conséquence de pénaliser les petits investisseurs, qui ont le plus besoin de conseils, et ainsi limiter le développement de leur indépendance financière à long terme ;

- Certains conseillers pourraient être tentés d'offrir d'autres types de produits financiers ne convenant pas nécessairement aux clients, comme des fonds distincts ou des produits de dépôt, de manière à éviter d'avoir à négocier leurs honoraires de conseil avec les clients ;

- Les conseillers ayant un permis de planificateur financier (au Québec) pourraient être tentés de facturer un très faible honoraire de conseil relié à leurs activités en épargne collective, tout en facturant d'importants honoraires à travers leur pratique de planificateur financier qui se fait à l'extérieur de leur courtier en épargne collective. Ceci leur permettrait de maintenir un certain niveau de rentabilité en réduisant la portion de leurs revenus qui revient à leur courtier en épargne collective ;

En ce qui a trait à la tarification horaire, certains conseillers pourraient être tentés de gonfler artificiellement leurs heures facturables de manière à augmenter leurs revenus.

De son côté, la rémunération à l'acte pose déjà certains enjeux reliés à la multiplication des opérations du côté de la distribution de valeurs mobilières, donc son application au domaine des fonds d'investissement pourrait occasionner les mêmes problèmes potentiels.

Finalement, en ce qui concerne la possibilité d'imposer un frais initial en pourcentage du montant investi, l'impopularité actuelle de cette option déjà existante parle d'elle-même. En effet, même si les fonds à FPA sont en forte progression dans le marché, la quasi-totalité des dépôts qui y sont effectués le sont sans facturation de frais initial. Les clients sont extrêmement réticents à voir le montant initial de leur investissement amputé d'un montant équivalent à la rémunération qui sera versée au courtier. Les clients n'aiment pas le principe qu'ils doivent sacrifier les premiers points de rendement au profit de leur courtier avant que leur compte ne reprenne la valeur de leur investissement initial. Ce désintéressement par rapport à cette option devrait à notre avis être considéré comme un indicateur clair du manque d'intérêt des clients envers le mode de rémunération directe. Plusieurs de nos conseillers nous ont d'ailleurs mentionné que revenir à ce mode de rémunération nous ramènerait à l'époque des années '80 où le frais d'entrée était le seul mode de rémunération existant dans le marché.

Bref, nous en revenons au commentaire que nous avons formulé en préambule. Avant de prendre des mesures drastiques afin de régler les trois enjeux soulevés, il convient de se poser la question à savoir si ces enjeux doivent être impérativement éliminés à tout prix ou s'ils peuvent plutôt faire l'objet de mesures de contrôle qui permettrait d'en réduire la portée tout en assurant le maintien d'un certain équilibre entre l'offre et la demande de conseils financiers. Or, en plus de déstabiliser l'équilibre actuel du marché que nous avons décrit à la question 1, l'imposition d'une structure de rémunération directe pourrait contribuer à exacerber certains autres types de conflits d'intérêts.

13. Pour répondre à ces préoccupations, les ACVM pourraient-elles prendre d'autres mesures que l'abandon des commissions intégrées, conjointement ou séparément?

Nous sommes d'accord que le modèle actuel n'est pas totalement optimal et nous convenons des préoccupations soulevées par les ACVM. Cependant, comme mentionné dans notre préambule, un bannissement complet des commissions intégrées pourrait selon nous avoir des impacts très importants sur l'équilibre de l'offre et la demande pour des services conseil liés à la distribution de fonds d'investissement, plus particulièrement chez les clients de masse ayant moins de 100,000$ à investir. Ceci étant dit, nous croyons que d'autres solutions pourraient être envisagées conjointement avec une élimination partielle des commissions intégrées. Nous apportons ci-bas humblement quelques pistes de solutions qui devraient selon nous être envisagées au lieu d'imposer un bannissement total des commissions intégrées.

<u>Encadrement de l'utilisation des fonds à frais d'acquisition reportés</u>

À l'époque de la publication du document de consultation 81-407 en 2012, les fonds à frais d'acquisition reportés (FAR) n'étaient peut-être pas toujours utilisés de façon optimale par les représentants. Des clients dont l'âge ou l'horizon de placement ne convenaient pas nécessairement se retrouvaient parfois dans des structures de frais sans avoir bien compris toutes les implications au départ.

Toutefois, nous avons clairement senti que certaines mesures d'éducation mises de l'avant par l'ACFM entre autres ainsi que la mise en application de la réforme MRCC2 ont conscientisé grandement les conseillers et les ont incité à utiliser les fonds à FAR de manière plus optimale. En conséquence, chez Groupe Cloutier Investissements, nous sommes fiers de pouvoir affirmer que nos représentants se sont adaptés à ces nouvelles réalités et qu'à l'heure actuelle, ils font un usage tout à fait convenable des fonds à frais d'acquisition reportés (FAR). Des données plus précises pourront être fournies sous embargo aux ACVM (vu leur nature sensible du point de vue commercial), mais nous pouvons confirmer que les fonds à FAR représentent aujourd'hui une minorité des dépôts effectués par nos clients. On peut aussi clairement percevoir que lorsqu'ils sont utilisés, les FAR le sont dans les bonnes circonstances. On constate qu'une portion marginale des dépôts effectués par les clients âgés de 65 ans et plus est faite dans des fonds à FAR et, règle générale, lorsque ces clients y ont recours, c'est uniquement dans le but de générer une commission qui servira à rembourser des frais de transfert que ces clients ont dû assumer auprès d'une institution cédante. La situation est la même dans les comptes importants en termes d'actifs. La très grande majorité des dépôts effectués dans ces comptes sont effectués dans des fonds sans frais d'acquisition (*no load*), dans des fonds à honoraires ou dans des fonds avec frais prélevés à l'acquisition où le frais initial est établi à 0%. Bref, il est évident pour nous que le marché s'est autodiscipliné et a un recours beaucoup plus stratégique aux fonds à FAR.

Par conséquent, nous serions tout à fait en faveur de baliser par règlement l'utilisation des fonds à FAR. Que ce soit en termes d'âge du client, de type de compte (FERR, FRV), d'horizon de placement ou de taille de compte, nous serions tout à fait favorables à ce que chaque courtier soit tenu de mettre en place certaines limites qui énonceraient clairement dans quelle situation les FAR pourraient être utilisés. Cette façon de faire permettrait selon nous de maintenir l'équilibre fragile entre l'offre et la demande pour les conseils auprès des clients de masse.

Obligation pour le client de choisir la structure de frais désirée

Il semble évident que l'ensemble des intervenants du secteur a vu d'un bon œil l'arrivée du document *Aperçu du fonds* (AdF) au cours des dernières années. La standardisation du contenu et du format dans lequel l'information sur un OPC doit être présentée à un investisseur a selon nous bénéficié grandement à rehausser la compréhension de ces derniers des produits dans lesquels ils investissent leurs épargnes durement gagnées.

Bien qu'il existe de multiples séries de fonds ayant chacune des particularités au niveau fiscal par exemple, il n'en demeure pas moins qu'il n'existe que cinq (5) grandes catégories de structures de rémunération : 1) les fonds à FAR, 2) les fonds à frais d'acquisition réduits (*low load*), 3) les fonds à frais prélevés à l'acquisition (FPA), 4) les fonds sans frais d'acquisition et 5) les fonds à honoraires.

Nous croyons que les investisseurs et toute l'industrie bénéficieraient grandement de l'introduction d'une divulgation uniformisée relativement à la structure de rémunération choisie. Ceci pourrait se traduire concrètement par une divulgation tenant sur une seule page et formulée en langage simple et neutre qui présenterait les principales caractéristiques de chacune des cinq structures disponibles. Cette divulgation pourrait être intégrée à la fiche d'ordre des courtiers ou, pour les comptes détenus au nom du client, au formulaire d'ouverture de compte de chaque société de fonds. Le client devrait y indiquer clairement son choix sur le formulaire après avoir pris connaissance librement de chacune des options à sa disposition. Cette procédure pourrait être rendue obligatoire lors de chaque dépôt pour s'assurer que le client a été informé à chaque transaction des implications de ses choix.

Restreindre l'utilisation des commissions intégrées dans les réseaux où le conseil est présent

À l'instar de l'IFIC, nous croyons fermement que les commissions intégrées devraient être interdites dans les réseaux où le conseil n'est pas présent comme dans le réseau des courtiers à escompte par exemple.

Uniformisation des commissions intégrées

Le document de consultation 81-408 ACVM ainsi que plusieurs des études à l'appui laissent à penser que les recommandations formulées par les représentants sont influencées par le niveau de commissions associé à un produit. Bien que théoriquement cette affirmation puisse paraître plausible, nous tenons à préciser que cette situation ne se reflète absolument pas sur le terrain pour les représentants de Groupe Cloutier Investissements.

À titre d'exemple, la commission standard associée aux dépôts dans des fonds à FAR (excluant les fonds à frais d'acquisition réduits) est de 5,0%. Certains manufacturiers offrent des produits dont les frais de sortie pour le client s'échelonnent sur une période identique (soit 6 ou 7 ans), mais pour lesquels la commission initiale versée au courtier se situe plutôt entre 4,0% et 4,9%. En 2016, chez Groupe Cloutier Investissements, 57% des dépôts effectués dans des fond à FAR ont été effectués dans des fonds versant une commission initiale inférieure à 5,0%, et cela sans même considérer les fonds à frais d'acquisition réduits.

En ce qui concerne les commissions de suivi, il est généralement admis que les données du tableau ci-bas constituent le standard de l'industrie :

Type d'actif	Commission de suivi sur les fonds à FAR	Commission de suivi annuelle sur les fonds à FPA ou sans frais d'acquisition
Fonds à revenus fixe	0,25%	0,5%
Fonds d'actions	0,5%	1,0%

Les fonds constitués d'un mélange de titres à revenu fixe et d'actions sont plus difficiles à évaluer puisque le taux de commission de suivi n'est pas uniforme au sein de l'industrie. Nous avons analysé la composition de notre bloc d'affaires pour valider quelle proportion de celui-ci était détenu dans des fonds versant des commissions de suivi supérieures aux standards énoncés dans le tableau ci-haut. Nous avons pu déterminer que cette proportion s'élevait à moins de 5% de notre actif total.

En résumé, concrètement, il serait faux d'affirmer que nos représentants sont influencés par la commission reliée aux produits qu'ils distribuent. Non seulement recommandent-ils dans une très large majorité des fonds versant des commissions de suivi équivalentes aux standards de l'industrie, mais la majorité de dépôts effectués dans des fonds à FAR le sont dans des fonds versant une commission initiale inférieure au standard. Ces statistiques viennent contredire l'affirmation des ACVM comme quoi l'élimination des commissions intégrées aurait pour effet que les conseillers devraient accorder davantage d'attention aux frais et au rendement des produits qu'ils distribuent. En effet, dans le contexte des courtiers indépendants, les représentants qui y œuvrent sont tous des entrepreneurs indépendants dont les revenus ne sont absolument pas garantis et dépendent en bonne partie du taux de conservation de leurs actifs et de la performance des marchés. Plus les rendements de leurs clients sont bons, plus leurs commissions de suivi seront intéressantes. Du même coup, plus leurs clients seront satisfaits des services qu'ils reçoivent et plus les conseillers auront un taux de conservation élevé et plus leurs revenus annuels seront stables. Donc, les conseillers indépendants ont déjà un très grand incitatif à accorder toute l'attention aux frais des fonds et à leur performance.

Ceci étant dit, nous sommes d'accord pour admettre que du point de vue de la perception, il serait souhaitable qu'il existe une meilleure uniformisation des commissions au sein de l'industrie. L'uniformisation pourrait prendre trois formes principales dans les situations où il serait permis d'avoir recours aux commissions intégrées :

1) <u>Éliminer les disparités entre les gestionnaires de fonds</u>

Même si nous avons démontré que chez les représentants de Groupe Cloutier Investissements, le niveau de rémunération associé aux produits en particulier n'ont à peu près aucune influence sur les recommandations effectuées aux clients, nous croyons que l'industrie aurait tout à gagner d'uniformiser les taux de commissions versés par les manufacturiers à travers les différentes structures de rémunération. Ceci viendrait éliminer le biais théorique qui pourrait exister vers des fonds versant une rémunération plus élevée. Ceci permettrait aussi d'assurer une certaine équité entre les réseaux indépendants et intégrés en évitant que ces derniers ne soient tentés de diminuer la portion rémunération du courtier tout en augmentant la portion du gestionnaire de fonds, favorisant ainsi indûment les réseaux intégrés.

Nous comprenons que les ACVM ne sont pas confortables avec l'idée d'avoir à fixer un niveau acceptable de rémunération, mais ceci pourrait se faire de différentes façons, notamment en collaboration avec l'IFIC par exemple.

2) <u>Éliminer les disparités entre les types d'actifs</u>

Il est généralement admis que les fonds d'actions versent des commissions de suivi plus élevées que les fonds équilibrés qui, eux, versent des commissions de suivi plus élevées que les fonds à revenu fixe. Concrètement, il est impossible de déterminer si cette situation a un impact sur les recommandations effectuées par les représentants. Ce problème potentiel est cependant contrôlé par l'obligation existante pour les conseillers et les courtiers de respecter la règle de connaissance du client et l'obligation de convenance qui en découle. Ainsi, selon ces règles, les recommandations faites aux clients en termes de types d'actifs devraient normalement convenir à leur situation personnelle et financière ainsi qu'à leurs objectifs d'investissement.

Toutefois, toujours du point de vue de la perception, il nous apparaîtrait approprié de rechercher une solution visant à ce que le niveau des commissions de suivi d'un fonds ne soit pas associé au type d'actif dans lequel le fonds investit. Nous croyons que, de concert avec l'industrie, les ACVM devraient rechercher une solution afin d'uniformiser les commissions de suivi entre les différents types de fonds. Nous reviendrons plus loin dans ce mémoire sur l'impact sur les revenus et la rentabilité pour les courtiers et les conseillers indépendants de la récente transition vers les fonds à FPA. Toutefois, nous souhaitons préciser que cette uniformisation devrait se faire avec une préoccupation de ne pas provoquer un nouveau choc sur les revenus totaux des courtiers. Le taux de commissionnement uniformisé entre les différents types d'actif devrait être déterminé en ayant à l'esprit la recherche d'un équilibre afin d'éviter que le niveau des commissions de suivi moyen sur l'ensemble de l'actif sous gestion ne diminue drastiquement, ce qui affecterait de façon importante le niveau de rentabilité des courtiers et des représentants.

3) <u>Éliminer les disparités à long terme selon la structure de frais choisie</u>
En suite logique avec l'item précédent, nous croyons que l'industrie pourrait rechercher des moyens pour que les courtiers et les représentants ne soient pas incités financièrement à recommander une structure de frais au détriment d'une autre dans le cas où le recours à des fonds comportant des commissions intégrées serait approprié. Pour les fins du présent exercice, nous poserons les hypothèses suivantes afin d'illustrer les disparités actuelles :

- Règle générale, un fonds à frais d'acquisition reportés sera assorti d'une cédule de frais sur sept ans ;

- À l'expiration de la cédule de frais, la commission de suivi du fonds à FAR sera automatiquement ajustée selon la commission de suivi versée dans la structure à FPA du même fonds, comme le font plusieurs manufacturiers actuellement ;

- La structure à frais réduits est moins uniforme dans l'industrie, mais nous poserons l'hypothèse que le fonds versera une commission initiale de 2,5% et que la commission de suivi du fonds sera automatiquement ajustée selon la commission de suivi versée dans la structure à FPA du même fonds après trois ans.

Prenons pour exemple un fonds d'actions canadiennes afin d'examiner la rémunération totale versée à un courtier sur une période de sept ans en lien avec ce fonds. On prendra pour acquis que la commission initiale facturée dans un fonds à FPA sera de 0% :

Structure de frais	Commission initiale	Commission de suivi	Commission totale
Frais d'acquisition reportés	5%	3,5% (7 X 0,5%)	8,5%
Frais d'acquisition réduits	2,5%	5,5% (3 X 0,5% + 4 X 1%)	8,0%
Frais prélevés à l'acquisition	0%	7% (7 X 1%)	7%

Concrètement, la différence est minime et, rapportée sur une base annuelle, le revenu brut versé au courtier diffère de 0.07% à 0,21% selon les différentes structures de frais. Toutefois, la différence existe néanmoins et elle est beaucoup plus importante dans le cas d'un fonds à revenu fixe par exemple. Cependant, toujours dans un esprit de gérer l'apparence de conflit d'intérêts, nous serions ouverts à étudier toute proposition qui viendrait uniformiser la rémunération globale sur sept ans liée à la distribution d'un fonds.

Cette solution permettrait de reconnaître les fonds à FAR pour ce qu'ils sont réellement aux yeux de nos conseillers, soit une façon de devancer le versement de la rémunération en reconnaissance du fait que la charge de travail du conseiller nécessaire à l'analyse initiale d'un dossier et à la formulation de recommandations est plus importante que la charge de travail qui doit être consacrée au suivi du portefeuille du client.

Reconnaissance d'un statut particulier pour les conseillers indépendants

Les États-Unis accorderont à compter de janvier 2018 une possibilité de recourir à la dispense du *Best Interest Contract* où le courtier sera autorisé à continuer de recevoir des commissions intégrées sous réserve de plusieurs conditions. De son côté, l'Allemagne a introduit le concept du « conseiller à honoraires en matière d'investissement » où un conseiller doit obligatoirement s'enregistrer auprès de la BaFin pour obtenir ce statut et répondre à certains critères bien précis.

Dans un tel contexte, pourquoi le Canada n'envisagerait-il pas d'accorder un statut particulier aux conseillers œuvrant au sein d'un réseau indépendant? Nous n'avons pas la prétention de proposer ici un cadre précis et complet en la matière et nous convenons que la définition d'un réseau indépendant resterait à définir clairement, mais nous souhaitons simplement soulever l'idée générale de la reconnaissance d'un statut d'indépendant qui pourrait être assorti de certains critères minimum comme, par exemple :

- Agir pour le compte d'un courtier n'offrant pas de produits maison ou n'offrant aucun incitatif de quelque sorte à la recommandation de produits maison ;

- Offrir une gamme adéquate de produits financiers (ne pas limiter l'offre à seulement quelques familles de fonds) ;

- Engagement à recevoir une rémunération raisonnable.

La reconnaissance d'un statut de conseiller indépendant pourrait s'accompagner du droit de distribuer des fonds assortis de commissions intégrées. Cette solution aurait comme avantage d'éviter de faire basculer l'équilibre du marché en faveur des réseaux intégrés qui seraient moins désavantagés que les courtiers indépendants par une interdiction pure et simple des commissions intégrées.

De plus, en tant que courtier indépendant, il nous semble exagéré de répondre au conflit d'intérêts lié à la rémunération par une interdiction pure et simple alors que du côté des réseaux intégrés, les conflits d'intérêts liés à la distribution de produits maison ne pourront jamais être complètement éliminés, ils pourront seulement être atténués par une meilleure divulgation. Une reconnaissance du statut de conseiller indépendant au lieu d'un bannissement des commissions intégrées constituerait à nos yeux une mesure plus équitable.

14. Le passage à des mécanismes de rémunération directe risque-t-il d'entraîner d'autres conflits d'intérêts qui ne seraient pas encadrés par la réglementation actuelle des valeurs mobilières?
Nous vous référons à notre réponse à la question 12.

Changements dans l'expérience des investisseurs et les résultats qu'ils obtiennent

15. Selon vous, quel effet l'abandon des commissions intégrées aurait-il sur l'expérience des investisseurs et les résultats qu'ils obtiennent? Plus particulièrement :

- **Les investisseurs recevront-ils des conseils et des services financiers qui concordent davantage avec les honoraires qu'ils paient?**
  Comme nous considérons que dans notre réseau les clients reçoivent déjà des conseils et services financiers en lien avec la rémunération qui nous est versée, il nous est difficile d'être en accord avec une telle affirmation. Nous croyons plutôt que les lois du marché font que tôt ou tard, un client qui ne reçoit pas le niveau de service pour lequel il paye finira par prendre la décision de changer de conseiller. Il s'agit d'une réalité économique qui peut se vérifier dans n'importe quelle sphère d'activité.

  Par ailleurs, comme nous en avons discuté en préambule, une récente étude menée par l'Association canadienne des courtiers en fonds mutuels (ACFM) a démontré qu'au niveau pancanadien, 8,9 millions de ménages possèdent un compte auprès d'un courtier membre de l'ACFM. Parmi eux, 83%, soit 7,3 millions de ménages, ont des actifs financiers inférieurs à 100,000$. Il nous semble plutôt illusoire de penser que 100% de ces ménages accepteront de payer directement pour le coût des services conseil qu'ils reçoivent. L'expérience du Royaume-Uni, de l'Australie et des Pays-Bas où les commissions intégrées ont été éliminées démontre bien qu'une proportion non négligeable de ces clients refuseront de payer directement pour les coûts du conseil et se réfugieront plutôt vers des réseaux sans conseil, ce qui les privera des importants bénéfices pour les clients d'entretenir une relation à long terme avec un conseiller financier. Bref, même en considérant que ceux qui demeureront avec leur conseiller recevront des conseils qui concordent davantage avec les honoraires qu'ils paient, on ne pourra en dire de même de ceux qui se retrouveront sans conseiller.

- **Quel effet la proposition aura-t-elle sur le développement des conseils automatisés? Cet effet est-il susceptible d'être avantageux pour les investisseurs?**
  Le marché connaît déjà depuis quelques années un essor considérable au niveau technologique. On peut donc s'attendre effectivement à un développement accru des solutions automatisées. Toutefois, toute prédiction quant au comportement futur des clients étant hasardeuse, si l'on se fie à

l'expérience des courtiers à escompte qui occupent encore une faible part du marché après plus de 30 ans d'activité, la proportion des clients qui choisiront de faire affaire avec des réseaux entièrement automatisés risque de demeurer marginale. Nous croyons que l'avenir passe plutôt par la combinaison de ces solutions automatisées avec la prestation de conseils concrets de manière à établir une planification financière complète et globale pour les clients. Par ailleurs, dans une étude réalisée sur les robot-conseillers, c'est au Canada que l'on retrouve la proportion d'investisseurs la plus faible intéressée par ce service. Il y a aussi une dichotomie dans le postulat que les conseils automatisés prendront davantage d'ampleur car, de l'aveu même des ACVM, la littératie financière au Canada est faible. Donc, toute mesure ayant pour effet d'induire un déplacement des clients vers des réseaux offrant des conseils automatisés reviendrait à demander à des investisseurs n'ayant pas la connaissance nécessaire de gérer eux même leurs actifs.

- **Y a-t-il des chances que les conseils discrétionnaires gagnent en popularité au Canada comme cela a été le cas dans les autres marchés qui ont délaissé les commissions intégrées et, le cas échéant, ce changement serait-il positif ou négatif pour les investisseurs?**
  Il serait présomptueux de notre part de tenter de prédire le comportement des clients, mais il serait certainement plus intéressant pour les courtiers de plein exercice de promouvoir la gestion discrétionnaire qui facilite la gestion des comptes et réduit les coûts d'opération.

  Toutefois, ces courtiers ont généralement très peu d'intérêt pour les clients de masse et préfèrent davantage concentrer leurs efforts sur les clients fortunés chez qui la gestion discrétionnaire est déjà plus développée. Bref, pour les clients de masse, nous n'anticipons pas une hausse marquée de la popularité de la gestion discrétionnaire.

- **Quel effet la proposition aura-t-elle sur la croissance du réseau des courtiers en ligne et des courtiers exécutants et le coût des fonds offerts dans ce réseau? Cet effet est-il susceptible d'être avantageux pour les investisseurs?**
  Il va de soi que les clients ayant choisi ces réseaux ne l'ont pas fait pour la qualité des conseils qu'ils espèrent recevoir. Ce sont généralement des clients indépendants, bien informés et qui sont à même de prendre leurs propres décisions financières. Il apparaît donc illogique que ces clients payent des commissions de suivi du même ordre que celles qui sont versées dans les réseaux avec conseil. La proposition des ACVM risque donc d'être effectivement avantageuse pour les clients qui sont déjà dans ces réseaux.

  Comme mentionné précédemment, nous croyons aussi que certains clients de masse seront réticents à payer directement pour les conseils qu'ils reçoivent et se retrouveront donc dans ces réseaux de courtiers sans conseil alors qu'il serait très certainement plus avantageux pour eux de continuer de profiter des services d'un conseiller à long terme.

- **Quel effet la proposition aura-t-elle sur le coût et l'étendue des conseils fournis à des segments particuliers d'investisseurs?**
  Les États-Unis peuvent être considérés comme un laboratoire intéressant sur la question puisque le modèle de distribution à honoraires y est déjà très répandu. Dans une étude datant de novembre 2012 réalisée par Investor Economics[5], on apprend que 92% des clients ayant des actifs inférieurs à 100,000$ payent un honoraire de conseil supérieur à 1,0%. Cette proportion diminue à 75% des clients avec un actif supérieur à 750,000$ et à seulement 57% des clients affichant un actif de 1,500,000$ et plus. Ces données sont corroborées par de nombreuses autres études.

  Bref, on constate que plus le compte est modeste, plus l'honoraire de conseil est élevé. Il n'y a aucune raison de croire que la même situation ne surviendrait pas si un tel modèle était appliqué au Canada.

16. Quels sont les types de mécanismes de paiement susceptibles de découler de cette proposition, si elle est adoptée? Plus particulièrement :

- **Les mécanismes de paiement proposés par les courtiers différeraient-ils selon le segment d'investisseurs? Dans l'affirmative, expliquez en quoi et pour quelles raisons.**
  Comme mentionné en préambule, un résultat mené par le CFIQ a démontré que 71% des représentants ont des revenus liés à l'épargne collective inférieurs à 41,935$ annuellement. Il serait étonnant que les conseillers qui choisiront de rester actif dans le domaine de l'épargne collective acceptent de diminuer encore davantage les revenus qu'ils tirent de cette activité.

  Par conséquent, pour les clients avec des actifs plus importants, le modèle à honoraires basés sur un pourcentage de l'actif sous gestion des clients sera probablement celui qui attirera la plus grande partie du marché si la proposition des ACVM est adoptée telle quelle.

  Pour les clients de masse, l'effet est plus difficile à prévoir. Afin de conserver une certaine rentabilité et financer la charge de travail plus importante qui doit être consacrée à l'analyse initiale d'un dossier, les conseillers adopteront probablement une stratégie qui leur permettra d'atteindre cet objectif. Ceci passera donc probablement par une combinaison des possibilités suivantes :

  - Facturation à taux horaire pour le travail initial, combiné à un honoraire basé sur un pourcentage de l'actif sous gestion ;

[5] Monitoring Trends in Mutual Funds Cost of Ownership and Expense Ratios : A Canada – US Perspective, Investor Economics and Strategic Insight, Novembre 2012.

- Facturation d'un frais d'entrée initial, combiné à un honoraire basé sur un pourcentage de l'actif sous gestion.;

Bien évidemment, le client devra consentir acquitter ces frais initiaux plus importants et comme nous l'avons déjà exprimé à maintes reprises dans les questions précédentes, rien ne permet de croire que les résultats canadiens différeront de ce qu'on a pu constater en Australie, au Royaume-Unis et aux Pays-Bas où plusieurs clients ont refusé de payer directement pour les coûts du conseil. D'ailleurs, ces options existent déjà, mais les clients sont fortement réticents à les utiliser. Est-ce que des mesures coercitives pourraient augmenter l'intérêt des clients de masse pour ces solutions? Nous croyons que non.

17. Pensez-vous que la proposition entraînerait une carence en matière de conseils? Plus particulièrement :

- **Quels segments du marché risquent d'être touchés? Prière de considérer la segmentation en fonction du patrimoine, de facteurs géographiques (taille et emplacement de l'agglomération, par exemple, éloignée, petite, moyenne ou grande), de l'âge, des connaissances technologiques, du nombre de titres de fonds que détiennent les ménages, etc..**

  Comme nous l'avons déjà mentionné à plusieurs reprises, nous croyons que les clients qui seront les plus touchés par le bannissement des commissions intégrées seront probablement les clients de masse détenant moins de 100,000$ d'actifs financiers. Un tel bannissement entraînera à la fois 1) une diminution du nombre de clients qui seront intéressés à payer directement pour le coût des conseils qu'ils reçoivent, et 2) une diminution du nombre de conseillers qui seront intéressés de continuer à offrir de tels services si la rentabilité de leurs opérations s'en trouve diminuée par ces changements. Ceci créera donc un double déséquilibre au niveau de l'offre et la demande qui se traduira inévitablement à notre avis par une carence en matière de conseils pour les clients de masse.

  Par ailleurs, au niveau géographique, les clients des régions éloignées ont déjà moins d'accès physique au conseil car le nombre d'institutions financières et de conseillers indépendants desservant ces régions est souvent limité. Bref, l'offre est déjà restreinte pour ces clients. Si on rend la profession moins attrayante pour les conseillers, on ne fera qu'exacerber cette situation au détriment des investisseurs. Non seulement l'offre de conseils y sera réduite, mais des faits récents nous laissent aussi entrevoir qu'il y a un risque que d'autres conflits d'intérêts émergeront, principalement dans les réseaux intégrés, qui pourront affecter la qualité des conseils reçus par les clients. Tout d'abord, les pressions accrues sur la rentabilité augmenteront probablement les conflits d'intérêts liés à la distribution de produits maison. Ensuite, un autre conflit d'intérêt lié au type de produit recommandé pourrait être induit dans ces réseaux. En effet, les pressions sur la rentabilité pourraient inciter ces conseillers à sursimplifier leur offre de produits en axant davantage leurs recommandations sur des produits de dépôts qui sont plus simples à distribuer. On a pu voir de tels effets concrets dans le marché lors de l'introduction des règles de Basel III au Canada en 2015 qui sont venues forcer les banques à augmenter leurs liquidités dans le but d'assurer une meilleure stabilité financière à l'échelle mondiale. Le résultat net de cet exercice fut que les institutions de dépôts ont diminué leurs ventes de fonds communs de placement de 20% entre mars 2015 et mars 2016 alors que dans le reste du marché, la diminution fut seulement de 2%. Il est difficile de ne pas établir un lien direct entre la nécessité des grandes institutions financières d'augmenter leurs réserves en capital et le fait que leurs clients ont acquis davantage de produits de dépôt dans l'année suivant l'introduction de cette réforme. Bref, l'histoire récente nous enseigne de quelle façon les réseaux intégrés risquent de réagir face à une baisse de rentabilité dans la distribution de fonds communs de placement et il est difficile de conclure que cela risque d'être à l'avantage des clients.

- **Souscrivez-vous à notre définition de « carence en matière de conseils »?**
  Oui.

- **Devrions-nous faire une différence entre la carence en matière de conseils « en personne » et la carence en matière de conseils en général?**
  Cette question sous-tend que le conseil en personne pourrait être remplacé par d'autres types de conseil, principalement automatisé. Comme nous l'avons déjà fait mention, nous croyons que l'industrie offrant du conseil aura tout intérêt à intégrer dans une certaine mesure l'automatisation de manière à pouvoir centrer ses efforts sur les types de conseils qui créent davantage de valeur pour les clients : stimuler le taux d'épargne et instaurer une discipline envers un plan financier établi. Des efforts en ce sens ont déjà été faits dans les dernières années et nous sommes à l'aube de l'arrivée de nouvelles technologiques impliquant des signatures électroniques qui permettront de faciliter les transactions dans les comptes des clients et de réduire le nombre de dossiers incomplets (*not in good order, ou NIGO en anglais*).

  Toutefois, nous demeurons sceptiques face à la capacité éventuelle des robots-conseillers à gérer les émotions des investisseurs et instaurer le respect du plan financier établi initialement. Peut-être que l'avenir nous démontrera le contraire, mais il semble peu probable que les robots-conseillers puissent développer un pouvoir de persuasion assez fort auprès des clients pour arriver à ces objectifs, principalement en période de crise.

- **Quels types de conseils ou de services actuellement offerts seraient le plus touchés par la proposition?**
  Il est évident que s'il devait y avoir une pression à la baisse sur la rentabilité des activités de distribution de fonds d'investissement, les conseillers qui choisiront maintenir leurs opérations dans cette sphère d'activité devront probablement réattribuer leurs efforts. Nous croyons qu'encore une fois, les clients de masse

subiront les plus grandes conséquences de cette situation car deux situations pourront principalement survenir :

1) Les analyses initiales et les plans financiers risquent d'être moins détaillés et les efforts seront davantage concentrés sur la simple construction d'un portefeuille de placement, ou ;

2) Les conseillers continueront d'offrir un service d'établissement d'un plan financier, mais auront plutôt recours à des portefeuilles ou des produits sursimplifiés qui pourraient ne pas toujours convenir aux clients.

- **Y a-t-il des interactions potentielles entre la présente proposition, les réformes en cours telles que la deuxième phase du MRCC et d'autres réformes éventuelles comme celles énoncées dans le Document de consultation 33-404 des ACVM qui pourraient avoir un effet sur l'importance d'une possible carence en matière de conseils?**

  Les interactions les plus importantes seront certainement avec le Document de consultation 33-404. Si d'un côté on exige des courtiers et des conseillers un rehaussement des exigences en matière de connaissance des produits, de connaissance du client et d'évaluation de la convenance et qu'en même temps on met en place un bannissement des commissions intégrées risquant d'affecter à la baisse le ratio des revenus par dollar d'actif sous gestion, les conséquences pourraient être catastrophiques. Cette situation ne peut mener qu'à une diminution de l'attrait de la profession et à une plus grande consolidation au sein de l'industrie.

  Il faut aussi réaliser que les revenus de notre industrie sont ultimement défrayés par les investisseurs, peu importe de la façon dont ceux-ci payent pour les conseils. Une augmentation des coûts d'opération sera éventuellement transférée aux investisseurs. Si l'objectif des ACVM est d'assurer un service de qualité à un coût raisonnable, une réflexion doit être faite sur l'efficacité des mesures de conformité mise en place et à être implantée dans un contexte de protection des investisseurs.

- **Comment pourrions-nous atténuer une éventuelle carence en matière de conseils, de conseils en personne ou de services financiers?**

  Nous croyons qu'une carence en matière de conseils est inévitable si un bannissement des commissions intégrées est adopté.

  Il serait tout à fait utopique de penser qu'une telle réforme pourrait éventuellement augmenter l'accès au conseil pour les clients alors que ce devrait plutôt être l'objectif recherché par les ACVM et autres institutions publiques.

- **Pensez-vous que les conseils en ligne pourraient atténuer une carence en matière de conseils? Dans l'affirmative, expliquer de quelle manière.**
  Veuillez vous référer à la 3e sous-question de la question 17 concernant ce point.

- **Pensez-vous que le fait que les courtiers appartenant à une institution de dépôt ou à un assureur détiennent une part importante du marché de la distribution des titres de fonds au Canada influera sur la probabilité qu'apparaisse une carence en matière de conseils ou sur l'importance de celle-ci?**
  L'expérience du Royaume-Uni nous enseigne que beaucoup des grandes institutions financières ont décidé d'abandonner le secteur des clients de masse. Même si cela ne devait pas survenir au Canada, nous croyons que les clients de ces réseaux intégrés pourraient subir les contrecoups d'autres conflits d'intérêts potentiels comme ceux liés à la distribution de produits maison ou ceux liés à la recommandation de produits de dépôts qui sont plus simples à distribuer et qui permettent aux institutions financières d'augmenter leurs réserves de capital.

Évolution du secteur indépendamment de la décision des autorités de réglementation d'abandonner les commissions intégrées

18. Étant donné les changements que nous avons constatés dans le secteur ces dernières années (réduction des frais, introduction de séries de fonds pour les investisseurs indépendants, simplification des séries de fonds, réductions automatiques des frais, facilitation de l'accès aux options de souscription à honoraires, etc.), quelle est la probabilité que le secteur des fonds d'investissement délaisse les commissions intégrées en l'absence de mesures réglementaires? Plus particulièrement :

- **Le secteur continuera-t-il à délaisser les commissions intégrées si les ACVM ne donnent pas suite à la proposition?**
  Il convient de rappeler les résultats de la récente étude de l'ACFM concernant la composition du marché des courtiers en épargne collective au Canada. La clientèle des courtiers membres de l'ACFM est composée à 83% de ménages ayant moins de 100,000$ en actifs financiers. Les clients de masse constituent le pain et le beurre des courtiers membres de l'ACFM. Comme nous l'avons répété à maintes reprises au sein du présent document, nous croyons qu'il sera extrêmement difficile de faire migrer ces clients vers un concept de rémunération directe. Plusieurs clients risquent de refuser ce changement et il est probable qu'un certain nombre de conseillers abandonneront ce secteur d'activité par manque d'attrait financier. Bref, pour les clients de masse, nous serions étonnés de voir une forte progression du nombre de ces clients qui abandonneront la rémunération intégrée si les ACVM ne vont pas de l'avant avec la présente proposition. Même s'il c'était le cas, cette transition s'accompagnerait probablement par une hausse du coût du conseil pour les clients de masse de manière à conserver un certain niveau de rentabilité pour

les conseillers et les courtiers auprès de ces clients.

Ceci étant dit, si les ACVM ne bannissent pas les commissions intégrées, nous nous attendons à continuer de voir une certaine diminution du recours au fonds à frais d'acquisition reportés (FAR) au cours des prochaines années, puis à une stabilisation de leur utilisation par la suite. Nous avons déjà vu dans les cinq dernières années une diminution marquée du recours à ces fonds et nous pourrons fournir des informations plus détaillées à ce sujet aux ACVM de manière confidentielle. Cette baisse peut s'expliquer par plusieurs facteurs, dont l'arrivée du MRCC2 et l'introduction de nouveaux produits orientés vers les clients fortunés qui ont permis aux courtiers en épargne collective d'accéder à des comptes plus importants qui étaient difficilement accessibles auparavant. Nous pouvons maintenant affirmer que les fonds à FAR sont utilisés dans des contextes bien précis qui se prêtent à ce type de produits.

19. La figure 8 illustre-t-elle fidèlement les options de souscription offertes aux investisseurs selon le réseau, la taille du compte ou le type de société?

Notre perspective est celle d'un courtier en épargne collective indépendant membre de l'ACFM. La figure 8 présentée dans le document de consultation ne correspond pas à notre réalité ni à celle décrite dans la récente analyse de l'ACFM. La figure 8 semble laisser croire que les courtiers indépendants ne s'intéressent pas aux clients ayant moins de 100,000$ à investir. En réalité, notre situation est extrêmement proche des conclusions de l'ACFM qui démontre que 83% des clients de leurs membres sont des clients de masse. Nous pourrons fournir sous embargo certaines données plus confidentielles sur la composition exacte de notre bloc d'affaires et sur la répartition des dépôts entre les différentes structures de frais disponibles.

- **Selon vous, les options de paiement et les modèles d'entreprise évoluent-ils en ce moment?**

  Oui, les options de paiement évoluent actuellement. Toutefois, nous vous référons à la question 11 concernant les difficultés pour les courtiers indépendants de petite et moyenne taille d'offrir des comptes nominés qui permettent une gestion plus facile de la rémunération à honoraires. Pour contrer cette difficulté, la plupart des sociétés de fonds offrent maintenant des séries de fonds disponibles dans des comptes au nom du client et pour lesquelles elles offrent d'effectuer la facturation des honoraires de conseil établis entre le client, le conseiller et le courtier. L'introduction de ces séries a donc accru le recours aux fonds assortis d'honoraires de conseil au courant des dernières années pour les clients possédant des investissements supérieurs à 100,000$.

  Par ailleurs, de plus en plus de sociétés de fonds offrent désormais des programmes incitatifs de tarification préférentielle offerts automatiquement à tous les clients possédant des fonds à frais prélevés à l'acquisition (FPA). Dès qu'ils atteignent un certain niveau d'actif, les gestionnaires vont accorder à ces clients des réductions progressives de leur ratio de frais de gestion.

- **De quelle manière évolueraient-ils au fil du temps si les ACVM décidaient de ne pas mettre en œuvre la proposition?**
  Toute prédiction étant hasardeuse, nous entrevoyons une stabilisation dans l'utilisation différentes options de rémunération au cours des prochaines années. Les fonds à frais d'acquisition reportés (FAR) risquent de continuer de se concentrer principalement sur les petits portefeuilles pour lesquels l'âge et l'horizon de placement des clients conviennent à ce type de fonds.

  Les fonds avec frais prélevés à l'acquisition (FPA) assortis d'un frais initial de 0% risquent de continuer de prendre de plus en plus de place pour les comptes supérieurs à 50,000$. Nous entrevoyons aussi que les sociétés de fonds continueront de développement leurs structures de tarification en offrant davantage de programmes de tarification préférentielle tel que discuté à la sous-question précédente.

  De leur côté, les séries à honoraires risquent d'attirer de plus en plus de capitaux pour les clients ayant des actifs plus importants à investir grâce notamment à la flexibilité dans l'établissement des honoraires de conseil.

20. **Nous constatons que la distribution de séries à honoraires demeure relativement limitée au Canada par rapport à d'autres marchés. Existe-t-il des obstacles propres au Canada (sur le plan structurel, opérationnel ou réglementaire, ou du point de vue de la demande des investisseurs, par exemple) qui limitent l'utilisation de ces séries par les courtiers?**
    Nous avons expliqué les contraintes importantes pour les courtiers indépendants de petite et moyenne taille à la question 11. Cependant, l'arrivée de séries où les sociétés de fonds offrent de gérer la facturation des honoraires de conseil au sein des comptes détenus au nom du client risque de contribuer à l'essor de ces séries pour les clients détenant des actifs plus importants.

Répercussions potentielles sur la concurrence et la structure du marché

21. **Veuillez décrire les répercussions de l'abandon des commissions intégrées sur la concurrence et la structure du marché, et indiquer si vous acquiescez ou non à l'analyse présentée à la partie 4. Plus particulièrement :**

- **Pensez-vous que la proposition aura des répercussions sur le niveau de regroupement ou d'intégration au sein du secteur? Qu'en est-il de la concentration des actifs des investisseurs du marché de masse placés dans des produits gérés par des courtiers appartenant à des institutions de dépôt?**
  En général, nous sommes en accord avec les prévisions des ACVM concernant les répercussions d'un bannissement des commissions intégrées. Nous croyons effectivement que cette situation entraînera inévitablement une consolidation dans l'industrie et une disparition éventuelle des plus petits courtiers indépendants qui n'arriveront pas à maintenir un niveau de rentabilité suffisant pour justifier la poursuite de leurs activités. Cette consolidation est d'ailleurs déjà

bien entamée. Le nombre de courtiers membres de l'ACFM est passé de 220 en 2002 à 103 en 2015, alors que le nombre de conseillers inscrits a bondi de 55,000 à 83,000 pendant la même période. Dans les dernières années, la consolidation s'est faite sentir surtout chez les petits courtiers. Toujours au niveau de l'ACFM, le nombre de courtiers ayant moins de 100M$ d'actif sous gestion est passé de 70 en 2009 à seulement 34 en 2015.

Nous croyons que les grandes institutions financières et les assureurs tenteront de profiter de ces changements afin de créer ou de faire croître leur propre réseau de distribution interne, au détriment du secteur des indépendants. À preuve, on a pu voir à ce niveau l'acquisition au cours des dernières semaines du Groupe Financier Horizons, un important courtier multidisciplinaire indépendant, par Great-West Life. De leur côté, Industrielle Alliance ont aussi procédé à de multiples acquisitions au cours des dernières années.

Dans ce contexte, la concentration des actifs des clients du marché de masse dans des produits maison ne peut qu'augmenter. En effet, leur exposition accrue à des réseaux où sont présents d'importants conflits d'intérêts liés à la distribution de produits maison ne peut qu'exacerber ce phénomène.

À ce titre, ces répercussions sont en contradiction avec la mission des ACVM citée en préambule de favoriser la vigueur des marchés financiers. Plus spécifiquement pour le Québec nous croyons que ces répercussions sont aussi incompatibles avec la mission de l'Autorité des marchés financiers[6] qui est d'entre autres exercer son mandat de manière à :

- Promouvoir une offre de produits et services financiers de haute qualité et à un prix concurrentiel pour l'ensemble des personnes et des entreprises dans toutes les régions du Québec;

- Assurer la mise en place d'un cadre réglementaire efficace favorisant le développement du secteur financier et permettant l'évolution des pratiques de gestion et des pratiques commerciales dans ce secteur;

- **Quelles répercussions d'éventuels regroupements pourraient-ils avoir sur les résultats obtenus par l'investisseur et l'efficience du marché?**
  Nous croyons avoir bien décrit les répercussions potentielles sur le fonctionnement des marchés dans les questions précédentes. De façon plus générale, les règles de l'offre et la demande nous enseignent que la baisse du nombre de fournisseurs au sein d'un marché se traduit rarement par des bénéfices pour les clients. Il est aussi difficile de penser qu'une diminution de la concurrence pourrait améliorer l'efficience des marchés.

[6] https://lautorite.qc.ca/grand-public/a-propos-de-lautorite/mission/

- **Selon vous, quelles occasions la mise en œuvre de la proposition offrirait-elle et quels défis poserait-elle aux divers groupes de parties prenantes du secteur?**
  Puisqu'il s'agit de notre marché, nous concentrerons nos commentaires sur les répercussions que nous entrevoyons sur les courtiers indépendants.

  - **Les courtiers indépendants;**
    Les défis d'adopter un modèle prévoyant uniquement de la rémunération directe seraient nombreux et très importants. Plusieurs ont déjà été abordés dans les questions précédentes, mais nous allons tenter d'effectuer un résumé des principaux enjeux :

    Réticence des clients
    Essentiellement, les clients peuvent être classés en trois groupes selon leur réaction à l'introduction d'un bannissement de la rémunération intégrée.

    Nous croyons qu'un premier groupe de clients cesseront carrément leur relation avec un conseiller. Comme nous l'avons déjà mentionné, l'expérience de l'Australie, du Royaume-Uni et des Pays-Bas nous enseigne qu'un nombre non négligeable de clients ont refusé de payer directement pour les services et conseils qu'ils reçoivent. Nous ne voyons pas de raison pour laquelle le même phénomène ne se produirait pas au Canada advenant le bannissement des commissions intégrées. De plus, vu l'impopularité auprès des clients de masse des modèles de rémunération directe qui existent déjà au Canada, nous ne voyons pas comment des mesures coercitives permettraient d'augmenter la part de marché de cette structure de rémunération chez ces clients.

    Un deuxième groupe de clients acceptera probablement d'adopter ce modèle de rémunération directe, sans toutefois accepter de payer le coût réel des services qu'ils reçoivent. En effet, il faut garder à l'esprit que les conseils financiers entraînent des bienfaits indéniables, mais intangibles à court terme. Il est donc d'autant plus difficile de convaincre un client que la valeur ajoutée qu'il recevra à travers le versement d'honoraires pourra être constatée uniquement à long terme. Sans entrer dans les grandes théories de la finance comportementale, il est indéniable que, par exemple, le fait d'acheter une voiture ou une résidence procure au client une satisfaction immédiate. Le client peut toucher et constater visuellement la valeur du bien qu'il souhaite acquérir et décider relativement aisément si le prix demandé est juste. La situation est moins évidente avec les conseils financiers, surtout lorsqu'une relation d'affaires débute dans un cycle de marchés baissiers. Comment convaincre un client de la justesse des honoraires qu'il paye à son courtier lorsqu'il constate que ses placements ont fait un rendement de -3% par exemple? Par conséquent, les conseillers seront certainement confrontés à certains clients qui accepteront de payer seulement une partie des coûts réels des services qu'ils reçoivent. Les conseillers auront alors trois choix : 1) refuser de servir ces clients, 2) accepter de diminuer leurs honoraires tout en réduisant le panier de services réel qu'ils offrent à leurs clients, ou 3) accepter de diminuer leurs revenus tout en continuant à offrir le même niveau de service, ce qui revient à dévaloriser la valeur de leurs conseils.

Finalement, le troisième groupe de clients représentera la situation idéale pour les courtiers et représentants indépendants, soit les clients qui accepteront de payer la vraie valeur du conseil. Des consultations auprès de nos conseillers nous laissent croire que cette situation devrait être moins problématique auprès des clients fortunés. Ces clients sont en effet habitués de payer des honoraires à leur comptable, leur fiscaliste ou leur avocat. Toutefois, auprès du marché de masse, on s'attend à retrouver moins de clients de ce type. Malheureusement, on doit rappeler à nouveau que les clients du marché de masse représentent 83% des clients des courtiers membres de l'ACFM.

Bref, la réaction des clients des premier et deuxième groupes se traduira inévitablement par des pertes de revenus pour les courtiers. Toutefois, au-delà de la perte de revenus, il faut aussi considérer l'impact sur les clients de se retrouver dans des réseaux sans conseil ou offrant des conseils limités. La valeur du conseil a été bien démontrée par les études de Claude Montmarquette du CIRANO et de Pierre Lortie de la School of Public Policy de l'Univesrité de Calgary et les données empiriques démontrent que les bienfaits croissent avec la durée de la relation avec un conseiller financier. Ainsi, toute diminution du recours ou de l'accès au conseil s'accompagnera inévitablement de conséquences importantes au niveau des finances publiques qu'il est impératif de considérer dans le cadre de la présente consultation.

Concurrence indue des réseaux intégrés

Nous avons exposé aux questions 8a et 10a la possibilité réelle qu'auront les réseaux intégrés de diminuer les honoraires de conseil facturés aux clients tout en augmentant le ratio de frais de gestion de leurs produits maison, conservant ainsi le même revenu total pour la société-mère. Nous tenons à d'ailleurs à rappeler l'article récent paru dans le site conseiller.ca[7] faisant état d'un cas réel survenu récemment au sein d'un réseau intégré.

Or, par définition, les courtiers indépendants ne peuvent compter sur cette réattribution des revenus entre filiales et pourraient donc faire les frais de cette stratégie. Cette situation pourrait occasionner une guerre de prix très dommageable pour les courtiers indépendants et contribuer à dévaluer indûment la valeur accordée au conseil financier.

Relève et recrutement

La question de la relève et du recrutement est un enjeu absolument crucial

[7] http://www.conseiller.ca/nouvelles/commissions-la-td-a-t-elle-hausse-sa-part-au-detriment-des-conseillers-62730?courriel=yes

pour les courtiers indépendants. Le modèle d'affaires des courtiers indépendants est souvent basé sur le développement de relations avec des conseillers ayant un profil entrepreneurial. Nos conseillers travaillent souvent individuellement et non au sein de succursales ayant pignon sur rue. Ils sont à la fois libres et responsables de développer leur clientèle à leur rythme et selon leurs propres objectifs. Nous n'imposons à ces conseillers aucune cible de rentabilité ou d'objectifs en termes de ventes ou de rencontres clients. Ces conseillers doivent assumer des charges et des risques importants pour se lancer en affaires. Par exemple, ils doivent la plupart du temps assumer eux-mêmes les charges suivantes qui sont généralement prises en charge par les grandes institutions financières dans les réseaux intégrés :

- Frais de location de bureau ;
- Frais généraux de fonctionnement (internet, téléphonie, stationnement, papeterie, frais postaux, etc.) ;
- Frais technologiques mensuels du courtier ;
- Frais reliés à l'acquisition d'un logiciel de gestion de la clientèle (CRM) ;
- Salaire d'une ou plusieurs adjoint(e)s ;
- Assurance responsabilité ;
- Coûts relatifs à la formation continue ;
- Frais de permis annuels et cotisations aux associations professionnelles ;
- Frais de déplacement (beaucoup de conseillers rencontrent leurs clients à domicile) ;
- Coûts reliés à l'achat de clientèle ;
- Coûts reliés au marketing ou à la publicité de leur entreprise ;

En contrepartie de cette importante prise de risque de la part de ces conseillers, ils obtiennent généralement une plus grande part des revenus bruts versés aux courtiers que ce qu'ils obtiendraient au sein d'un réseau intégré. De plus, ils demeurent propriétaires de la clientèle qu'ils développent, ce qui confère à leur achalandage une valeur marchande non négligeable dont ils pourront bénéficier au moment de leur retraite. En effet, il faut savoir que dans la plupart des réseaux indépendants, les conseillers sont strictement rémunérés en fonction d'un pourcentage des revenus bruts générés. Les conseillers ne touchent généralement pas de salaire de base ou de salaire minimum garanti et n'ont pas accès à un régime de retraite offert par leur courtier. Bref, les conseillers qui se retrouvent dans les réseaux indépendants ne doivent pas avoir peur du risque et doivent faire preuve d'un esprit entrepreneurial supérieur à la moyenne.

Dans le modèle actuel, il est donc déjà difficile de recruter des gens ayant un tel profil et qui ne recherchent pas nécessairement une sécurité d'emploi. Rappelons l'étude de 2016 du CFIQ citée en préambule qui nous apprenait que peu importe la tranche d'âge, 71% des conseillers des courtiers sondés génèrent un revenu annuel brut inférieur à 41,935$ en lien avec leurs activités en épargne collective. Parmi les courtiers sondés, on trouvait des courtiers indépendants, des courtiers dits « captifs » dont les conseillers distribuent uniquement des produits maison et des courtiers « mixtes » dont les conseillers distribuent à la fois des produits maison et des produits externes. Ce sondage a aussi permis de brosser le portrait suivant à propos des jeunes conseillers au Québec :

- Les conseillers de 18 à 29 ans constituent 11% des représentants inscrits au Québec, mais génèrent seulement 2% des revenus totaux des courtiers ;

- Les conseillers de 30 à 39 ans constituent 18% des inscrits, mais comptent pour seulement 12% des revenus totaux des courtiers.

Bref, les conseillers de moins de 40 ans constituent 29% de la force de vente, mais génèrent seulement 14% des revenus totaux. Cette statistique illustre à elle seule la difficulté pour un jeune conseiller de faire sa place au sein d'un réseau indépendant, même dans un contexte où de multiples structures de rémunération sont disponibles.

Dans un contexte de bannissement des commissions intégrées, les nouveaux arrivants dans le secteur indépendant auront énormément de difficulté à générer des revenus qui leur permettront de subvenir à leurs besoins. Analysons un exemple concret. Il est généralement admis que pour un conseiller en début de carrière, arriver à un monter un actif sous gestion de 2 millions de dollars dans sa première année d'exercice tient de l'exploit. Supposons qu'un jeune conseiller y parvienne en gonflant son actif sous gestion de 166,667$ par mois au courant de sa première année d'exercice et qu'il réussisse à négocier une moyenne d'honoraires de conseil de 1,0% sur son bloc d'affaires, versé sur une base mensuelle. Arriver à négocier un honoraire moyen de 1,0% relèverait aussi de l'exploit pour un jeune conseiller sans expérience qui pourrait avoir de la difficulté à justifier un même niveau d'honoraires qu'un conseiller plus expérimenté jouissant d'une plus grande expérience et d'une crédibilité mieux établie. Supposons aussi que ce conseiller aura négocié une entente avec son courtier lui permettant de toucher 75% des revenus bruts générés, ce qui est aussi un scénario optimiste dans le cas d'un conseiller sans expérience. Au terme de sa première année, ce conseiller aura généré un revenu imposable de 8,125$, auquel il devra soustraire les frais de fonctionnement énumérés ci-haut. Dans un scénario où les commissions intégrées existent, le conseiller aurait pu recommander dans certaines situations s'y prêtant des fonds avec frais d'acquisition reportés (FAR) qui lui auraient permis de générer un revenu immédiat plus intéressant et davantage conséquent avec la charge de travail requise pour analyser et monter les dossiers de tous ses nouveaux clients. Si on utilise les résultats du sondage de l'ACFM, on constate que les conseillers ayant un actif sous gestion de moins de 2 millions de dollars ont recours aux fonds à FAR dans une proportion de 53%. En appliquant cette donnée à notre exemple et en posant les hypothèses suivantes :

- Les fonds à FAR versent une commission de suivi moyenne de 0,375% ;
- Les fonds à FPA versent une commission de suivi moyenne de 0,75%.

Le même conseiller aurait plutôt été en mesure de générer un revenu annuel total d'environ 84,500$. Comme mentionné précédemment, une telle performance serait tout à fait exceptionnelle pour un conseiller dans sa première année d'activité. Néanmoins, cet exemple illustre bien l'impact concret d'un bannissement des commissions intégrées sur l'entrée en carrière.

On peut aussi facilement imaginer l'avenir qui attend le réseau indépendant si nous ne sommes plus en mesure d'attirer de jeunes talents dans notre industrie. Concrètement, la proposition des ACVM d'abolir les commissions intégrées signifie ni plus ni moins que la disparition éventuelle du modèle d'affaires de nombreux courtiers indépendants qui devront complètement changer leur approche pour attirer les jeunes dans leur réseau. Cette nouvelle approche devra probablement inclure un salaire de base garanti ou des avantages financiers en début de carrière qu'ils n'offrent pas à l'heure actuelle. Malheureusement, force est d'admettre que les courtiers indépendants ne disposeront probablement jamais des mêmes ressources financières que les grandes institutions de manière à attirer les meilleurs talents. Les plus petits joueurs n'arriveront probablement pas à survivre et seront probablement avalés par de plus gros courtiers ou par des réseaux intégrés, accentuant ainsi davantage la vague de consolidation que connaît notre industrie depuis plusieurs années. Bref, ce changement créera une onde de choc irréversible à long terme et déplacera encore davantage l'équilibre du marché en faveur des grandes institutions financières.

Systèmes informatiques

Évidemment, qui dit changement au niveau de la façon de rémunérer les conseils dit aussi changements importants aux systèmes informatiques des courtiers. Comme mentionné à la question 11, ceux capables de gérer efficacement des comptes nominés où la rémunération à honoraires est de beaucoup facilitée sont encore moins nombreux et le coût des modules de gestion des comptes nominés est souvent très important pour les courtiers de petite et moyenne taille. Donc, il est évident que la gestion à honoraires entraînerait une hausse généralisée des coûts des systèmes informatiques pour les courtiers qui travaillent actuellement principalement avec des comptes au nom du client.

Par ailleurs, les fournisseurs de ces logiciels ont dû investir des sommes colossales au courant des dernières années simplement pour réussir à les mettre à niveau avec les exigences de la réforme MRCC2. Le bannissement des commissions intégrées forcerait aussi les fabricants de ces logiciels à investir d'importantes sommes pour mettre à jour leurs logiciels, principalement pour y intégrer de nouvelles options de facturation comme par exemple la facturation à un taux horaire qui n'est actuellement pas disponible dans la plupart des systèmes les plus courants. Tous ces investissements se traduiront inévitablement par une hausse du coût des logiciels pour les courtiers indépendants.

Déplacement de la dépendance envers les commissions de suivi

Comme mentionné à la question 13, nous avons connu au cours des cinq dernières années une baisse marquée de la vente de fonds à frais d'acquisition reportés (FAR) en raison de multiples facteurs, dont l'évolution récente de la réglementation. Ce phénomène est observable dans l'ensemble de l'industrie. Les FAR sont aujourd'hui beaucoup mieux utilisés et c'est toute l'industrie qui s'en trouve gagnante.

Toutefois, concrètement ce déplacement des ventes a transformé en profondeur l'industrie de façon plus silencieuse. Alors que la rentabilité des courtiers indépendants était auparavant basée essentiellement sur le volume des ventes qui généraient d'importantes commissions au moment du dépôt, elle est maintenant davantage basée sur l'actif sous gestion qui génère des commissions de suivi stables et prévisibles. Cependant, comme nous en avons fait la démonstration à la question 13, sur une période de 7 ans, un fonds d'actions à FAR générera des revenus bruts totaux de 8,5% alors que le même fonds à frais prélevés à l'acquisition (FPA) versera de son côté 7,0% puisque dans la très grande majorité des cas, ces dépôts sont effectués sans commission initiale. Bien que mineure, la différence existe. Cependant, lorsqu'un fonds à revenu fixe est vendu en FPA plutôt qu'en FVD, la différence est majeure sur 7 ans :

Structure de frais	Commission initiale	Commission de suivi	Commission totale
Frais d'acquisition reportés	5%	1,75% (7 X 0,25%)	6,75%
Frais d'acquisition réduits	2,5%	5,5% (3 X 0,25% + 4 X 0,5%)	5,25%
Frais prélevés à l'acquisition	0%	3,5% (7 X 0,5%)	3,5%

Il est donc facile de constater que cette transition marquée vers les fonds à FPA a déjà eu pour conséquence de faire baisser de façon très importante le ratio revenus par dollar d'actif sous gestion autant pour les conseillers que les courtiers indépendants. Tous les joueurs se sont adaptés pour le moment, mais nous souhaitons porter à l'attention des ACVM que la pression sur la rentabilité des courtiers et des conseillers indépendants ne peut pas être infinie et que si le bannissement des commissions intégrées est adopté, le ratio de revenus par dollar d'actif sous gestion pourrait devenir insuffisant pour assurer une rentabilité auprès de plusieurs courtiers indépendants. Cette situation résulterait en une combinaison de consolidation en faveur des réseaux intégrés et de baisse d'offre pour les clients du fait que certains conseillers et courtiers choisiront d'abandonner leurs activités liées à l'épargne collective ou encore de ne pas s'engager dans cette carrière.

Vente des blocs d'affaires
Une des principales préoccupations de nos conseillers, à juste titre, se veut au niveau de la valeur de leur bloc d'affaires. Comme nous l'avons exposé plus haut dans cette question, les conseillers qui choisissent le réseau indépendant sont des entrepreneurs qui font le choix de développer leur propre clientèle et d'assumer d'importants risques financiers en échange d'une possibilité de bâtir leur propre entreprise et de lui donner une certaine valeur. Toujours selon le sondage mené par le CFIQ auprès de 10 courtiers en épargne collective actifs au Québec, les conseillers de 50 ans et plus représentent près de 50% des inscrits. Naturellement, nous devrions donc assister au cours des 10 à 15 prochaines années à un volume très important de transitions de blocs d'affaires pour ces conseillers. Ceux-ci ont consacré des décennies à bâtir une clientèle et à investir dans l'achat de blocs d'affaires dans le but de donner une valeur à leur entreprise et ainsi pouvoir la revendre au moment où l'heure de la retraite aura sonné. Malheureusement, cette réforme constitue pour eux un renversement de situation aussi complet qu'inattendu dans les dernières années de leur carrière.

Typiquement, dans le marché actuel, une clientèle d'épargne collective peut se revendre selon un multiple des commissions de suivi annuelles générées par le bloc d'affaires. Ce multiple s'établit généralement entre 2 et 5 fois les commissions de suivi. Plusieurs facteurs viendront influencer sur le choix final du multiple qui sera utilisé pour évaluer la valeur de la clientèle :

- Profil démographique des clients ;
- Niveau de conformité des dossiers ;
- Utilisation d'un système de gestion de la clientèle (CRM) ;
- Support sur lequel sont stockés les dossiers des clients (papier ou informatique) ;
- Durée et solidité de la relation entre le conseiller vendeur et ses clients ;
- Degré et durée du support offert par le vendeur dans la transition qui suivra la transaction ;

Ainsi, un conseiller qui a bâti une clientèle avec un actif sous gestion de 20M$ et qui génère par exemple en moyenne 0,75% en commissions de suivi annuelles sur cet actif pourra espérer vendre son entreprise entre 300,000$ et 750,000$ en fonction des critères d'évaluation ci-haut. Il est à noter que la totalité de ce revenu sera considérée comme du gain en capital pour le conseiller vendeur. Or, si les ACVM prennent la décision de bannir les commissions intégrées, cela soulèvera de très nombreuses questions et incertitudes en lien avec la valeur des blocs d'affaires :

- Sur quelle base sera calculée la valeur des blocs d'affaires compte tenu que le concept de commissions de suivi n'existera plus?

- Est-ce réaliste de penser que les facteurs multiplicateurs demeureront les mêmes, mais que les commissions de service seront remplacées simplement par le volume des honoraires généré par la clientèle?
    - o Dans un tel cas, comment un jeune conseiller en début de carrière qui veut acheter une clientèle pourra-t-il justifier des honoraires de conseil équivalents à ceux du conseiller vendeur qui possède des décennies d'expérience?

- Comme nous l'avons exposé tout au long du présent document, nous croyons qu'il y a de fortes chances qu'un bannissement des commissions intégrées diminuera le ratio de revenus par dollar d'actif sous gestion qui sera généré par les conseillers et les courtiers indépendants. Dans un tel cas, est-il réaliste de s'attendre à ce que la valeur des blocs d'affaires des conseillers ne soit pas affectée à la baisse?

- Si la valeur de son bloc d'affaires diminue de façon importante, quel incitatif aura un conseiller à le vendre? Ne sera-t-il pas plus rentable de le conserver et d'offrir seulement un niveau de service minimal aux clients en espérant que ceux-ci acceptent la situation le plus longtemps possible? Une telle situation ne serait-elle pas un nouveau type de conflit d'intérêt au désavantage du client?

Bref, nous souhaitons conscientiser les ACVM qu'en bannissant carrément les commissions intégrées, cela aura des impacts importants et immédiats sur la valeur des blocs d'affaires que des conseillers indépendants ont envisagé depuis des décennies comme étant leur fonds de pension. Ce changement des règles du jeu en cours de partie aurait des conséquences injustes pour des gens qui ont consacré la totalité de leur carrière à aider les canadiens à établir et respecter un plan financier à long terme.

- **Quelle est la probabilité qu'apparaisse de l'arbitrage réglementaire sur les produits financiers similaires, tels que les fonds distincts et les produits d'institutions de dépôt, et quelle en serait l'ampleur?**
  À la question 17, nous avons évoqué les conséquences de l'entrée en vigueur des règles Basel III en 2015 et leur impact immédiat sur la vente de fonds communs de placement dans les réseaux intégrés. Concrètement, si la réglementation vient réduire l'attrait pour les réseaux intégrés de vendre des fonds communs de placement par rapport à des produits de dépôt, il est évident que cela pourrait créer un incitatif à orienter les ventes vers les produits les plus rentables pour l'institution.

En ce qui concerne les fonds distincts, nous croyons que l'initiative récente du CCRRA visant à harmoniser les règles entourant la distribution de fonds distincts avec celle encadrant les valeurs mobilières préviendra en grande partie ce phénomène d'arbitrage.

- **De quelle manière les courtiers en épargne collective et les agents d'assurance qui sont titulaires des deux permis seraient-ils touchés?**
  Tel que mentionné au point précédent, nous croyons que l'initiative récente du CCRRA visant à harmoniser les règles entourant la distribution de fonds distincts avec celle encadrant les valeurs mobilières préviendra en grande partie ce phénomène d'arbitrage.

- **La proposition favorisera-t-elle l'émergence de nouveaux fournisseurs à faible coût sur le marché? Pour quelles raisons et de quelle manière?**
  Il y a fort à parier qu'effectivement, l'offre de service à faible coût s'en trouvera stimulée. Mais il serait illusoire de penser que les mêmes services pourraient continuer d'être fournis tout en réduisant les coûts. Une réduction de coût s'accompagnera inévitablement par une réduction du niveau de service. Dans un contexte où la valeur ajoutée du conseil sur une longue période est démontrée empiriquement, est-ce souhaitable au niveau des politiques publiques d'adopter des mesures qui pourraient avoir pour effet de restreindre l'accès au conseil au profit d'une réduction minime en dollars réels sur les honoraires reliés au petit investisseur?

- **L'interaction entre la présente proposition et les celles énoncées dans le Document de consultation 33-404 des ACVM vous incite-t-elle à changer vos réponses aux questions ci-dessus et, le cas échéant, de quelle manière?**
  Comme mentionné précédemment, le Document de consultation 33-404 ne fait qu'amplifier nos réponses puisque si ces propositions étaient adoptées, elles auraient certainement pour impact d'augmenter les coûts d'opération des courtiers et des conseillers. Donc, en combinaison avec une élimination des commissions intégrées qui viendrait réduire les revenus totaux de l'industrie, les conséquences seraient potentiellement catastrophiques.

- **L'abandon des commissions intégrées aurait-il pour effet de réduire le nombre de séries de fonds et la complexité des frais comme nous le prévoyons?**
  La réponse à cette question est purement mathématique. Si on interdit d'offrir des séries à FAR, à FPA ou à frais réduits, la résultante ne peut être qu'une réduction du nombre de séries offertes.

  Toutefois, nous croyons que l'incertitude qui plane depuis plusieurs années sur l'avenir des commissions intégrées a contribué dans une certaine mesure à la multiplication des séries de fonds aujourd'hui dénoncée par les ACVM. En effet, les premières consultations sur le sujet datent déjà de 2012 et, depuis, les différents acteurs de l'industrie ont chacun tenté de se positionner en prévision de leur interprétation de ce qui attendait de l'industrie. On a donc vu apparaître plusieurs concepts différents qui sont venus complexifier les séries disponibles sur le marché aujourd'hui. Nous croyons que lorsque des directives claires auront été énoncées par les ACVM, le marché risque de procéder lui-même à un nettoyage de ces séries.

- **Les fournisseurs de services financiers intégrés seraient-ils avantagés du fait qu'ils peuvent faire de la vente croisée et de l'interfinancement entre leurs secteurs d'activité? Dans l'affirmative, de quelle manière?**
  Nous avons déjà exposé de nombreux exemples en ce sens tout au long du présent document.

- **Quels effets le développement des conseils en ligne pourrait-il avoir sur la concurrence? Sont-ils susceptibles d'être importants et positifs?**
  Plus la relation avec un conseiller s'allonge, plus ce dernier ajoute de la valeur au client. Nous sommes tout à fait à l'aise à ce que la technologie puisse venir aider les clients. Toutefois, les conseils en ligne ne pourront jamais avoir le pouvoir de persuasion d'un conseiller en chair et en os lorsque vient le temps de stimuler le taux d'épargne d'un client ou encore de le recentrer sur les objectifs à long terme de son plan financier en période de crise. Bref, le conseil en ligne pourrait ne pas être bénéfique pour tous les clients et nous invitons les ACVM à voir plus loin que le simple coût de la prestation du conseil. Nous croyons que l'emphase devrait être mise sur les bénéfices qu'apporte l'accès au conseil et que les politiques mises en place devraient plutôt aller en ce sens.

23. À l'heure actuelle, le paiement des commissions intégrées oblige le courtier et le gestionnaire de fonds d'investissement à mettre en œuvre des mécanismes de contrôle et de surveillance (auxquels se rattachent des coûts de conformité) pour atténuer les conflits d'intérêts inhérents.

- **Le passage à des mécanismes de rémunération directe rendrait-il inutiles certains de ces mécanismes?**
  Oui, la rémunération directe rend principalement inutile les mécanismes de contrôle en matière de prévention du phénomène de multiplication des opérations. La multiplication des opérations se traduisait autrefois principalement par des transferts entre familles de fonds à partir de fonds à frais d'acquisition reportés (FAR) vers d'autres fonds à FAR. Toutefois, cette surveillance requiert assez peu d'énergie de nos jours puisque ce phénomène a presque complètement disparu.

  Au contraire, le mécanisme de rémunération directe imposerait d'autres mécanismes de vérification s'il devenait le seul mode de rémunération admissible. Par exemple, dans un mode de rémunération à taux horaire, comment un courtier pourrait-il s'assurer qu'un conseiller ne facture pas un client de manière abusive pour des heures non travaillées? Dans un modèle de rémunération à l'acte, comment faire pour déterminer si une transaction a bien été faite dans l'intérêt du client ou dans le seul but de générer un frais de transaction?

24. Les commissions intégrées, en particulier les commissions de suivi, procurent une source de revenus stable aux courtiers et aux représentants. Si elles sont abandonnées, les mécanismes de rémunération directe compenseront-ils la perte de ces revenus?

Ce point a été discuté abondamment tout au long du présent document. Toutefois, nous croyons que le scénario le plus optimiste qui pourrait être envisagé serait une stabilisation des revenus par rapport à la situation actuelle. De façon réaliste, nous nous attendons à une baisse notable du ratio des revenus par dollar d'actif sous gestion. Et nous souhaitons rappeler que la baisse du recours au fonds à frais d'acquisition reportés (FAR) des dernières années a déjà engendré une importante baisse de ce ratio au cours des dernières années.

26. Quelles répercussions la proposition aura-t-elle sur les représentants du secteur, en particulier sur ce qui suit?

Nous avons déjà couvert cette question au sein d'un item consacré à la relève à la question 21. Nous souhaitons quand même ajouter quelques commentaires complémentaires.

- **le cheminement de carrière;**

  À l'heure actuelle, beaucoup de nouveaux conseillers se joignent à nous après avoir passé quelques années dans des réseaux « captifs ». Dans ces réseaux, les conseillers sont payés à salaire ou à commission, mais la clientèle appartient généralement au courtier et non pas au conseiller. Après quelques années, certains conseillers souhaitent démarrer une carrière dans le courtage indépendant dans le but de créer leur entreprise et devenir propriétaire de leur clientèle afin de pouvoir un jour en tirer une certaine valeur au moment de leur retraite. Comme expliqué à la question 21, si la valeur des blocs d'affaires diminue, moins de conseillers seront tentés de se joindre à des courtiers indépendants.

- **l'attrait de la profession;**

  Nous avons déjà discuté de ce point à la question 21. En résumé, nous croyons que le bannissement des commissions intégrées rendrait le courtage indépendant beaucoup moins attrayant pour les jeunes, ce qui favoriserait indûment les réseaux intégrés dans le recrutement des meilleurs talents. Ces réseaux disposent de ressources financières importantes pour offrir des salaires fixes et autres garanties à des conseillers en début de carrière, ce qui n'a jamais fait partie des modèles d'affaires des réseaux indépendants.

- **le profil type de la personne intéressée par la profession;**

  L'ajout de barrières à l'entrée pour les gens désirant intégrer la carrière dans le réseau indépendant incitera probablement les candidats ayant un profil d'entrepreneur à choisir d'autres sphères d'activités liées à la finance plutôt que de se lancer dans le domaine de l'épargne collective. Ils pourraient se tourner davantage vers l'assurance de personnes, l'assurance collective, le courtage hypothécaire, etc. Ainsi, le domaine deviendrait plus attrayant pour les candidats recherchant une certaine stabilité d'emploi, ne désirant pas nécessairement avoir à faire de la prospection de clients et favorisant un revenu garanti à une rémunération variable à commission.

- **le recrutement;**
  Nous avons déjà traité amplement du sujet. Toutefois, nous souhaitons simplement rappeler que, pour les courtiers indépendants du Québec, le recrutement s'en trouve déjà extrêmement compliqué depuis la dernière année. En effet, le Québec était la seule province au Canada qui autorisait les transferts en bloc entre courtiers en épargne collective, à condition que chaque client en soit informé à l'avance et qu'il se voie offrir une opportunité de refuser le transfert. Cette mesure a notamment permis à Groupe Cloutier Investissements de se développer depuis 2007. Nous avons ainsi procédé à près de 250 transferts en bloc au cours de ces années pour des conseillers qui avaient différentes raisons de vouloir quitter leur ancien courtier.

  Dans le modèle actuel imposé par le Règlement 31-103, les transferts en bloc sont maintenant désormais interdits. Cette mesure équivaut concrètement à nier le droit de propriété sur la clientèle qu'ont toujours eu les représentants œuvrant dans les réseaux indépendants. Nul besoin de dire qu'il est maintenant extrêmement compliqué pour un conseiller qui sert par exemple 300 clients en épargne collective de prendre la décision de changer de courtier puisqu'il doit obtenir la signature de ses 300 clients avant même de remettre sa démission, faute de quoi il sacrifiera une importante part de ses revenus pendant plusieurs mois. Certains conseillers acceptent donc maintenant de demeurer avec un courtier où ils sont mal servis vu la complexité du processus de transfert, ce qui ne contribue certainement pas à offrir aux clients un service de meilleure qualité.

  Bref, nous ne voulons pas faire des transferts bloc de clientèle en épargne collective un enjeu de la présente consultation, mais nous invitons les ACVM à prendre en considération le fait que le recrutement chez les courtiers indépendants du Québec a déjà été compliqué de manière importante au cours des dernières années et qu'un bannissement des commissions intégrées risque simplement d'amplifier davantage cette situation.

Partie 5

28. Quelles autres mesures les ACVM devraient-elles envisager en vue d'atténuer les conséquences involontaires susmentionnées?

Nous croyons que les ACVM devraient plutôt envisager des mesures alternatives comme celles proposées à la question 13 plutôt que de considérer des mesures d'atténuation. Les mesures d'atténuation proposées par les ACVM auront pour effet de décaler dans le temps les conséquences du bannissement des commissions intégrées, mais elles n'auront pas pour effet d'en réduire l'impact ou les conséquences à long terme, principalement pour les courtiers indépendants de petite ou moyenne taille.

30. En ce qui a trait à la perte d'une forme d'interfinancement provenant des investisseurs fortunés au profit des investisseurs moins aisés dans le même fonds à la suite du passage aux mécanismes de rémunération directe :

- **dans quelle mesure (en la quantifiant, si possible) cette perte augmenterait-elle le coût de la prestation de conseils et de services aux investisseurs moins aisés dans le cadre des mécanismes de rémunération directe?**
  Comme mentionné à la question 15, une étude d'Investor Economics[8] remontant à 2012 a comparé la situation du Canada et des États-Unis en lien avec les coûts de détention des fonds dans les deux pays. On fait mention des honoraires de conseil moyens facturés dans des comptes constitués de fonds communs de placement en fonction de la taille du portefeuille. On y apprend que les clients dont le portefeuille est inférieur à 100,000$ payaient un honoraire de conseil moyen de 1,48% annuellement alors que les clients ayant un portefeuille supérieur à un million de dollars payaient en moyenne 1,08% par année.

  Toute comparaison étant imparfaite, on peut toutefois constater qu'il existe un écart de 0,4% entre les clients de masse est les clients les plus fortunés. Ce chiffre constitue probablement un point de départ dans l'analyse des répercussions potentielles pour les petits clients qui accepteraient de payer directement la vraie valeur des conseils qu'ils reçoivent.

- **quelles mesures pourraient atténuer les effets potentiels de la perte de l'interfinancement sur les courtiers, les représentants et les investisseurs?**
  Nous ne croyons pas qu'il existe de mesures concrètes qui pourraient atténuer les pertes de revenus pour les courtiers et les conseillers découlant de l'élimination de l'interfinancement entre clients aisés et clients de masse.

31. Quelles mesures les participants au secteur des fonds pourraient-ils adopter de façon proactive pour atténuer les conséquences involontaires pouvant découler de l'abandon des commissions intégrées?
Nous avons déjà proposé une série de mesures alternatives à la question 13 qui pourraient être envisagées.

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[8] Monitoring Trends in Mutual Funds Cost of Ownership and Expense Ratios : A Canada – US Perspective, Investor Economics and Strategic Insight, Novembre 2012.

34. Comme il est exposé dans l'Annexe B, les ACVM n'ont pas retenu l'option du plafonnement des commissions intégrées, soit comme solution autonome aux enjeux principaux exposés dans la partie 2, soit comme mesure provisoire en vue de l'abandon des commissions intégrées. Les ACVM devraient-elles poursuivre leur réflexion sur un plafonnement des commissions à titre de mesure transitoire? Pourquoi?

Nous avons exposé notre point de vue sur la solution du plafonnement des commissions à la question 13. Nous invitons fortement les ACVM à reconsidérer leur position sur le sujet. Nous prenons acte des réticences énoncées par les ACVM envers cette solution, mais nous croyons qu'il s'agirait d'une solution mitoyenne qui, sans régler en totalité les trois enjeux principaux identifiés par les ACVM, permettrait d'en atténuer la portée sans chambouler complètement l'équilibre qui existe actuellement entre les modèles d'affaires existant dans le marché.

Partie 6

35. Veuillez indiquer si vous estimez que les mesures analysées ci-dessus pourront, individuellement ou collectivement :

- **régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2;**

  Nous convenons que les mesures analysées ne permettent pas de régler complètement les trois enjeux identifiés par les ACVM. Toutefois, nous sommes fortement persuadés que, collectivement, elles permettront d'en atténuer grandement la portée. Nous croyons toutefois que d'autres solutions dont nous avons discuté à la question 13 méritent d'être envisagées afin de perfectionner le modèle actuel.

  Nous sommes cependant tout aussi convaincus que, pour tous les intervenants, y compris les clients, il est hautement préférable de continuer à tolérer en partie ces enjeux si le prix à payer pour les éliminer complètement est d'instaurer des mesures drastiques qui pourraient avoir des conséquences irréversibles sur la demande et l'offre de services aux clients de masse. Ces clients ont souvent un plus faible niveau de littéracie financière et sont donc ceux qui pourraient bénéficier le plus des bienfaits à long terme d'une relation avec un conseiller financier. Ce sont aussi ces clients de masse qui sont les plus dépendants des programmes de soutien publics et, si leur santé financière devait se dégrader collectivement dû au manque d'accès à des conseils financiers personnalisés et de qualité, c'est l'ensemble de la société qui pourrait en subir les conséquences à long terme.

De plus, nous souhaitons réitérer que la solution du bannissement complet des commissions intégrées proposée par les ACVM ne se fera pas sans créer d'autres problèmes qui, dans certains cas, pourraient s'avérer encore plus indésirables que les enjeux de départ identifiés par les ACVM, notamment :

- Amplification des conflits d'intérêts liés à la distribution des produits maison ;
- Amplification du phénomène d'arbitrage réglementaire par le recours à des produits de dépôt dans des situations où ces produits ne conviennent pas ;
- Autres conflits d'intérêts identifiés à la question 12 en lien avec les différents mécanismes de rémunération directe ;
- Consolidation accrue en faveur des réseaux intégrées ;
- Perte de parts de marché accélérée pour les courtiers indépendants.

Nous réitérons donc notre invitation aux ACVM d'agir avec la plus grande prudence afin d'éviter de chambouler complètement l'équilibre actuel qui semble exister au sein du marché.

36. Existe-t-il des solutions ou des mesures de rechange, sur le plan réglementaire ou sur le marché, susceptibles de régler les trois enjeux de protection des investisseurs et d'efficience du marché et les enjeux sous-jacents exposés dans la partie 2? Dans l'affirmative, veuillez fournir des explications.

Nous avons déjà émis d'autres suggestions à la question 13.

Conclusion

En conclusion, nous tenons à rappeler aux ACVM que nous sommes d'accord avec les enjeux qu'ils ont soulevé en lien avec les commissions intégrées. Toutefois, nous divergeons d'opinion quant aux conséquences réelles sur les clients qu'impliquent ces enjeux. Par conséquent, nous croyons que la proposition de bannir les commissions intégrées constitue une mesure drastique pour régler des problèmes plutôt théoriques. Cette proposition aurait des impacts majeurs autant sur les clients, surtout ceux de masse, que sur l'industrie, principalement pour les courtiers indépendants.

Il est impératif de bien évaluer les conséquences qu'aurait un tel bannissement et d'évaluer s'il serait réellement préférable de vivre avec ces impacts plutôt qu'avec les enjeux identifiés par les ACVM comme point de départ de la présente consultation. Nous réitérons notre position comme quoi il existe une multitude de mesures alternatives autres que le bannissement complet des commissions intégrées qui permettraient d'atténuer les enjeux ciblés par les ACVM tout en permettant de préserver l'équilibre existant actuellement entre la demande et l'offre de conseils financiers. Il nous apparaît capital de préserver et promouvoir l'accès au conseil par les clients. De telles mesures permettraient autant aux ACVM qu'à l'ACVM de respecter leur mission respective.

En terminant, nous tenons à remercier à nouveau les ACVM d'avoir donné l'opportunité aux parties prenantes de s'exprimer sur cet enjeu déterminant pour l'avenir de l'industrie. Nous souhaitons aussi remercier l'Autorité des marchés financiers, plus particulièrement M. Hugo Lacroix, Directeur principal des fonds d'investissement, et M. Mathieu Simard, Conseiller expert, Fonds d'investissement, pour leur ouverture et leur disponibilité tout au long de ce processus.

Veuillez agréer, Madame, Monsieur, nos salutations les plus distinguées.

François Bruneau, B.Sc., MBA
Vice-président administration – Investissement
Groupe Cloutier Inc.

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VIA EMAIL

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention: The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 81-408 –
Consultation on the Option of Discontinuing Embedded Commissions

Franklin Templeton Investments Corp. ("FTI") is writing to provide comments with respect to the Canadian Securities Administrators ("CSA") Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (the "Consultation Paper").

FTI is currently registered in most provinces and territories in Canada as an adviser, investment fund manager, mutual fund dealer and/or exempt market dealer. FTI is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin, Templeton, Franklin Bissett, Franklin Mutual Series, Franklin Templeton and Franklin Quotential funds and institutional accounts. In Canada, FTI has almost 500 employees providing services to nearly 500,000 unitholder accounts and over 100 pension funds, foundations and other institutional investors.

The discontinuation of embedded commissions would have a significant effect on the Canadian investment fund industry and, therefore, FTI appreciates the opportunity to provide feedback regarding this very important topic. FTI is a member of the Investment Funds Institute of Canada ("IFIC"). We have reviewed and generally support the comments made by IFIC in its letter dated June 9, 2017. In addition, FTI wishes to provide its own comments with respect to the Consultation Paper.

In our submission, we highlight our concerns with various aspects of the Consultation Paper. Next, we address the possible consequences of discontinuing embedded commissions. We also offer some alternatives for the CSA to consider. FTI believes there are other options that would address the perceived issues outlined in the Consultation Paper without having the negative consequences that may occur if embedded commissions are banned. Finally, we describe additional research that we believe should be undertaken by the CSA before any decisions are made regarding possible regulatory action. Although the CSA cites various inputs it obtained in formulating the Consultation Paper, given the significant impact a ban on embedded compensation would have on the Canadian investment fund industry, we believe additional evidence and research is needed. The CSA request that industry stakeholders provide analysis and perspectives that wherever possible, is evidence-based, data-centric and Canadian-focused; while we are happy to be actively engaged in the process, it is our view that the CSA should be responsible for providing the necessary level of research and evidence to warrant any regulatory changes.

First, we articulate some key principles that inform our comment letter.

General Comments

FTI believes in the following key principles.

- *Best interests of investors is paramount* – FTI strongly believes that the best interests of investors should be the primary consideration in determining what, if any, regulatory initiatives the CSA decides to pursue. We believe the best interests of investors includes having various options/choices available to them.

- *Transparency* – FTI believes in the need for full and effective disclosure of information to investors, including the components of a mutual fund's management expense ratio ("MER") and the compensation paid to dealers. Much of this information is already provided in a mutual fund's simplified prospectus, annual information form, fund facts, financial statements and/or management reports of fund performance. Furthermore, several recent regulatory initiatives, including the Client Relationship Model ("CRM2") and Point of Sale ("POS") have improved the disclosure available to investors. FTI supports regulatory initiatives that improve the disclosure provided to investors. If the CSA believes that existing and new forms of disclosure are not providing investors with the information they need to make informed decisions, we urge the CSA to review these disclosures with a view to improving them before other regulatory actions are considered or taken.

- *Investor choice* - FTI believes that, if provided with complete transparency about an investment product and a full explanation of their options/choices, investors should, with or without the assistance of an advisor, be allowed to make their own choices regarding the type of fund, class or series and purchase option that is most suitable for their individual circumstances. This includes the ability to choose a series of an investment fund with embedded compensation.

- *Value of investment funds* – For many years, investment funds have been the preferred investment vehicle for Canadian investors because of the advantages they offer. Investment funds provide investors with access to professional investment management, broad diversification, transparency and a strong regulatory framework at a reasonable cost. The investment fund industry has continued to innovate to provide investors with the options/choices they need to achieve their financial goals. Such innovation includes series and fee structures that are suitable for many different types of investors.

- *Value of financial advice* – FTI believes in the value of financial advice. Most retail investors should seek financial advice and such advice should play a critical role in investors' investment decision making. Studies have shown that investors who have access to financial advice believe they have better financial outcomes[1] and the advice from financial advisors generates significant benefits to investors in terms of more disciplined savings behaviour and higher overall higher asset.[2] We believe such advice is more important than ever given the increasing number and complexity of financial products and the fact that Canadians are increasingly responsible for their own retirement savings.[3]

<u>Concerns with the Consultation Paper</u>

While the CSA states in the Consultation Paper that it has not made a decision to discontinue embedded commissions, FTI is concerned that various comments made by the CSA in the Consultation Paper evidence a bias in favour of the elimination of this

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[1] POLLARA Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry" (2016) Report prepared For: The Investment Funds Institute of Canada.
[2] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016.
[3] Pierre Lortie, "A Major Setback for Retirement Savings: Changing How Financial Advisers Are Compensated Could Hurt Less-Than Wealthy Investors Most", *University of Calgary School of Public Policy Research Papers*, Vol. 9, Issue 13 (April 2016).

practice. The Consultation Paper discounts the experience of other jurisdictions and the impact of other current regulatory initiatives such as CRM2 and POS. The Consultation Paper also puts the onus on industry participants to disprove the CSA's position that regulatory action should be taken, but FTI believes that further research should be undertaken by the CSA and evidence obtained to prove that a ban on embedded compensation is the appropriate regulatory action. The discontinuation of embedded commissions is the most radical way to address the issues identified by the CSA in the Consultation Paper and, in our view, other more appropriate alternatives that would promote investor protection and choice have not yet been fully considered.

FTI also has some specific concerns with the Consultation Paper. Those concerns include:

- *Alignment of interests of industry participants* – FTI does not agree that there is a misalignment of interests between investment fund managers, dealers and representatives and investors. In manufacturing and selling investment products, investment fund managers and dealers have a strong interest in ensuring that the products they offer are suitable for investors and meet their investment objectives. The ability of an investment fund manager to compete in the industry is dependent on maintaining its assets under management ("AUM") on a long-term basis, which makes it important that the products it offers perform well and in a manner consistent with how they are offered. Furthermore, investment fund managers and dealers are both incented to offer products that perform well over time since their compensation is directly related to the performance of the product. We believe the objective of investment fund managers, dealers and representatives and investors in offering, selling and/or holding investment funds that perform well and in a manner consistent with how they are offered are aligned.

- *Regulatory interference in registrants' compensation* – FTI does not believe it is the role of regulators to interfere with the commercial bargain between registrants and investors. Furthermore, the CSA is contemplating intervening in only one segment of the investment industry without regulating the compensation models established for many competing products/services (e.g., fee based platforms). This would put investment funds at a competitive disadvantage to other financial products and would create the potential for regulatory arbitrage. This type of approach would put regulators in the position of affecting investor choice, access to advice and competition.

- *Bias in favour of passively managed funds* – FTI believes the Consultation Paper also evidences a bias in favour of passively managed funds.[4] FTI acknowledges that there are benefits to both actively and passively managed investments and we believe that such investment strategies can complement each other in an investor's portfolio. However, we do not believe it is the role of regulators to

[4] For example, at pgs. 54-55 of the Consultation Paper, the CSA discusses a shift to passively managed funds if embedded commissions are discontinued. This is repeated later at pg. 62.

advocate for, or shift the regulatory landscape in favour of, a particular style of investing. In fact, passive investing may create certain risks for capital markets.[5]

- *Embedded compensation does not inhibit competition or act as a barrier to entry* – FTI does not agree with the CSA's assertion that the elimination of embedded commissions would attract lower-cost product providers to the Canadian mutual fund market. The Canadian investment fund market is already a very competitive industry and has seen new entrants in recent years. Moreover, we fail to see how embedded compensation acts as a barrier to entry. Since embedded compensation is paid out of the management fee charged by an investment fund manager, new market entrants are not at a disadvantage to existing market participants (i.e., they can create products with similar characteristics). In fact, we believe the bigger challenge for both existing and new entrants is having their investment funds included on dealers' platforms. Overall, we believe that fund management costs are on the decline as Canadian investment fund managers have been reducing their management fees to stay competitive.[6] The elimination of embedded compensation may actually decrease competition since it would be more difficult for independent fund managers and independent fund distributors to compete with integrated financial service providers. This would ultimately lead to less investor choice.

- *Investment fund managers are not incented to rely more on embedded commission payments to dealers than on generating performance to attract and preserve AUM* – The CSA believes that investment fund managers are more incented to rely on embedded commissions than on generating performance to attract and retain AUM. FTI disagrees with the CSA's position. We believe fund flows from out-performance far outweigh any additional fund flows resulting from incenting dealers with embedded compensation. In addition, the reality is that historical discrepancies in embedded commission structures have largely disappeared in response to market forces and perceptions and nearly all investment fund managers now offer similar embedded commission structures on their products. Therefore, there is no incentive for dealers to choose one company's product over another based solely on higher embedded commissions. Instead, dealers are much more concerned about the performance of the investment funds they recommend to their clients.

- *Discontinuing embedded commissions would not result in a decrease in fund management costs* – FTI does not agree with the Consultation Paper's suggestion that the elimination of embedded commissions may cause investment fund managers to focus more on fund fee levels, which will put pressure on them to reduce fees. As noted above, the Canadian investment fund industry is very competitive and market forces have already resulted in decreasing fund management costs.[7] It is very possible that investor costs could actually increase if embedded compensation is banned since there would be no limit on the fee

[5] One example is cited in John Sedgwick, "Shift to passive could be 'real problem' for governance", *Ignites Asia*, March 15, 2017.
[6] Investor Economics, *Investor Economics Insight*, July 2016.
[7] Ibid.

charged by dealing representatives to their clients for the advice they provide. Dealers' fee based platforms already charge fees that are greater than embedded compensation levels; since such platforms have minimum charges, they can be detrimental to clients who do not meet the minimum account size.

Possible Consequences to Banning Embedded Compensation

The Consultation Paper lists certain unintended consequences the discontinuation of embedded commissions could have for retail investors and the investment fund industry. FTI believes there is a real possibility these consequences would occur if the CSA decides to move forward with regulatory action. FTI believes that banning embedded compensation would likely have the following consequences:

- *Reduction in access to advice* – It is unlikely that lower-wealth investors and investors who are just beginning to save for future events (e.g., home, retirement, childrens' education, etc.) have the means to enter into direct pay arrangements with their dealing representatives. The Consultation Paper notes that most households purchase their funds through a deposit-taker or insurer owned dealer.[8] Discontinuing embedded commissions could accelerate that trend, thereby minimizing the role played by independent fund distributors. While the Consultation Paper suggests that these impacts could be mitigated by innovations in technology, we fail to see how online advice alleviates the burden on dealers and their representatives; the current regulatory environment imposes the same obligations on dealers and their representatives regardless of the form the advice takes. Dealers could also increase their minimum account sizes and/or impose other conditions or restrictions on their clients, thereby limiting investors' choices.

- *Limiting investor choice* – As stated above, FTI believes that the best interests of investors is paramount but that includes access to the broadest choice of investment options (including payment arrangements) possible. If investors are provided with complete transparency regarding the payment options/choices available to them, they should then be allowed to choose what is most suitable for their individual circumstances. Although there are alternative compensation arrangements such as commissions on trades, hourly rates, flat fees, fee-based arrangements, the majority of investors are currently invested in mutual funds with embedded compensation.[9] Discontinuing embedded commissions would reduce the options/choices available to investors and would eliminate the option that has historically been used most frequently. FTI believes that such action cannot be in best interests of investors.

- *Lower savings* – In an era where the availability of employer sponsored pension plans is on the decline and investors must increasingly bear the burden of saving for their own retirement, discontinuing embedded commissions could have a

[8] At pg. 30, the Consultation Paper states deposit-taker and insurer owned fund dealers dominate fund distribution in Canada.
[9] At pg. 46, the Consultation Paper states that, at the end of 2015, trailing commission paying purchase options made up 67% of assets.

significant impact on investors' savings. If investors are either unwilling or unable to invest in mutual funds because of more limited payment options, it could result in an overall lower savings rate leaving investors less prepared for retirement and less able to achieve other financial goals they have.[10]

- *Higher cost of advice* – In addition to reducing access to advice and limiting investor choice, discontinuing embedded commissions could increase the cost of advice for investors. In transitioning to direct pay arrangements, dealers may have to increase their costs to deal with lower-wealth clients (the group of investors who have the greatest need for investment advice). There is no guarantee that direct pay arrangements would result in lower costs. Although fund MERs may decline, the actual cost of advice could increase when the dealers' costs are added.[11]

- *Regulatory arbitrage* – FTI is concerned about the uneven playing field and regulatory arbitrage opportunities that would be created by the discontinuation of embedded commissions. This potential exists with products and services covered by securities regulation as well as other competing financial products. A ban on embedded compensation represents regulatory intervention into only one segment of the investment industry, leaving other products/services not subject to the same regulatory requirements.[12] Apart from products and services covered by securities regulation, competing products offered by the banking and insurance industries would also be at a competitive advantage and, since such products are not regulated by CSA members, there is less likelihood that regulation will be done in a coordinated fashion. Note that securities regulators released final amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* implementing CRM2 in 2013 while the Canadian Council of Insurance Regulators only announced in 2016 that they would publish a consultation paper to consider new disclosure requirements for segregated funds.[13] This lack of coordination creates regulatory arbitrage opportunities and leaves investment funds at a competitive disadvantage.

- *Reduction in competition in the investment fund industry* – In the Consultation Paper, the CSA contends that embedded compensation acts as a barrier to entry and that its elimination may attract new industry participants. FTI believes the opposite trend could easily occur. As acknowledged by the CSA in the Consultation Paper, the transition to direct pay arrangements would involve substantial changes to current dealer business models. The impact could be magnified for independent fund distributors. The CSA's own research reveals that most households purchase funds through a deposit-taker or insurer owned

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[10] Pierre Lortie, supra note 3.

[11] Brondesbury Group, "Mutual Fund Fees Research", Spring 2015. In the Brondesbury Group's review of research, one of their conclusions is that, while removing commission lowers product cost, advisory fees may rise as a means of paying for the cost of the service.

[12] Mutual Fund Dealers Association of Canada, "MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients" (May 2017) (the "MFDA Report").

[13] Megan Harman, "Insurance regulators contemplate new disclosure requirements for seg funds", *Investment Executive*, March 30, 2016.

dealer. Discontinuing embedded compensation could accelerate that trend, which could result in an increase in conflicted advice. Independent fund managers like FTI, who rely on third party dealers to distribute their funds, would be impacted because of fewer available options for the distribution of their products. Ultimately, this would limit investor choice in the number and types of products that are available to them. By taking regulatory action, the CSA would be favouring certain business models, which is not the role of regulators.

- *Significant costs for registrants* - Discontinuing the practice of embedded commissions would be a significant change for investment fund industry participants. It would require administrative, operational and systems changes for both investment fund managers and dealers. These changes are in addition to changes that have been made by registrants to comply with CRM2. The CSA also assumes investment fund managers would be willing to pay for the costs associated with facilitating investors' direct payment of dealer compensation through payments taken from the investor's investment. Furthermore, registrants would be burdened with additional costs if/when the CSA adopts some or all of the targeted reforms described in CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards Their Clients* (the "BIS Consultation Paper"). The cost to comply with new regulatory requirements continues to increase for registrants. Ultimately, such costs would be borne by investors. Therefore, FTI believes a comprehensive cost-benefit analysis of recent regulatory initiatives is needed (see comment below).

Both options offered in the Consultation Paper to mitigate the negative consequences are transition periods which allow for a phased implementation of any regulatory action discontinuing embedded commissions. FTI believes that neither one of these options adequately address the unintended consequences that could result from a ban on embedded compensation. Instead of transition periods, FTI urges the CSA to consider other alternatives.

Alternatives

In the Consultation Paper, the CSA states that its goal is to ensure that any regulatory action it takes will provide a Canadian solution to challenges specific to the Canadian market, will result in more positive outcomes for Canadian investors and will minimize disruption for market participants. FTI believes there are other alternatives that address the perceived issues identified by the CSA in the Consultation Paper - the adoption of one or more of the following alternatives could lead to more positive outcomes for Canadian investors while minimizing disruption for market participants and investors and avoiding the unintended consequences that could result if embedded compensation is banned.[14]

[14] As noted earlier, FTI believes that it is not the role of regulators to interfere in the commercial bargain between registrants and investors. FTI also believes that banning embedded compensation is not a proportionate response to the perceived harm identified by the CSA in the Consultation Paper. If the CSA insists on proceeding with some form of regulatory action, there are other alternatives that would be less disruptive for market participants and the investing public, including: (i) standardizing the amount of trailing commissions (which largely exists now); and (ii) placing restrictions on the use of the deferred sales charge ('DSC") option.

- *Dealers to provide an explanation of fee and purchase options and obtain an acknowledgment signed by clients at the time of purchase* – FTI believes that investors should be able to choose the series and purchase option most suitable for their individual circumstances. However, investors should make an informed decision. For this reason, FTI suggests that dealers provide an explanation of the various fee and purchase options to their client before a trade is made on the client's behalf. Such explanation could also include a description of the services provided by the dealer (see comment below). Following the explanation, the investor would have the opportunity to choose the series and purchase option most suitable for them. This option would be similar in many respects to the direct pay arrangement described in the Consultation Paper in that investors would be given an upfront explanation by the dealer and would have to acknowledge this. This alternative would increase investor awareness and understanding and would align the option chosen by the investor with the services provided by the dealer. FTI believes that most dealers are already having these conversations with their clients and explaining the various options.

- *Dealers to provide a list of services for which they receive an ongoing trailing commission* – One of the concerns expressed in the Consultation Paper is that embedded commissions generally do not align with services provided to investors. For the reasons noted above, we do not agree. Dealers and their dealing representatives provide many different services to investors – such services go well beyond investment recommendations and include financial, tax, succession, estate and retirement planning, insurance consulting and advice (if dually licensed) and/or financial education. Furthermore, it is important to understand that trailing commissions paid to dealers cover much more than the advice provided by dealing representatives to investors – such costs include administrative, operational, systems, compliance and regulatory costs. FTI encourages the CSA to consider having dealers provide a list of those services to their clients so that investors have a better understanding of the services they receive in exchange for the compensation dealers receive. Being provided with a list of services would increase investor awareness and understanding and, together with the cost disclosure now mandated by CRM2, would provide a mechanism for investors to measure the value of the services they receive. FTI believes that disclosure of services should not be limited to compensation received for investment funds; such disclosure should extend to all investment products/services offered by dealers to their clients and for all investment fund compensation structures.

- *Introduce more flexibility into securities laws to allow DIY investors to purchase investment funds directly from fund managers* – The current regulatory structure requires all investment fund trades to be made through dealers and for dealers to discharge their know your client and suitability obligations prior to placing a trade on behalf of their clients (discount brokers have been granted exemptions from many of these obligations). The Consultation Paper notes that one of the key investor protection issues with embedded commissions is that they do not align with services provided to investors. As stated above, one of FTI's key principles is the value of financial advice and FTI believes most retail investors are best served by having a financial adviser. However, for those investors who are do-it-yourself ("DIY") investors and do not wish to receive financial advice or the services offered by a dealer, FTI encourages regulators to consider allowing the purchase of investment funds directly from investment fund managers without the need for a dealer. Investors would then have access to fund series without any embedded commissions. Currently, investment fund managers that wish to sell direct must register as a dealer or establish a dealer affiliate with related staffing, operational and compliance costs. Allowing DIY investors to purchase directly would offer a different method of distribution and would promote greater access to mutual funds at a lower cost.

- *Increase financial literacy* – One of the CSA's concerns with embedded commissions is that they limit investors' awareness, understanding and control of dealer compensation costs. In order for investors to make well informed decisions about their investment options, they need to have a minimum level of financial education and understanding. FTI believes financial literacy for investors is critical. FTI encourages the CSA to work with provincial governments to create new and/or expanding existing financial literacy programs offered to students (both secondary and post-secondary) in teaching financial skills about saving and investing money. This would ultimately help Canadians make informed decisions about managing their money and the options/choices they have when they invest.

- *Improved disclosure* – The Consultation Paper discounts disclosure as an effective way to address conflicts of interest in the advisor-client relationship. However, disclosure is a fundamental element of securities regulation. Over the years, the CSA has added new forms of disclosure (e.g., management reports of fund performance and fund facts) to what is already an extensive disclosure regime for investment funds. If the CSA believes that current disclosure is not effective, it should be considering ways of simplifying and improving the disclosure provided to investors in order to improve investors' awareness and understanding of the investment products they are purchasing and the costs associated with such products.[15]

- *Enforcement of existing rules* – One of the key investor protection issues noted by the CSA in the Consultation Paper is conflict of interest issues raised by embedded commissions. FTI believes that, since trailing commissions are already largely standardized, there is greater potential for conflicts of interest to occur and for the interests of investment fund managers, dealers and investors to be misaligned as a result of mutual fund sales practices. National Instrument 81-105 – *Mutual Fund Sales Practices* ("NI 81-105") was introduced to restrict or prohibit many of these practices. We believe the CSA should put more focus on

[15] One of the priorities in the Ontario Securities Commission's draft statement of priorities in 2017-2018 (Ontario Securities Commission Notice 11-777 – Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018) is to identify opportunities to remove redundant and ineffective disclosure and reporting requirements for investment funds. FTI believes this is an important initiative.

enforcing existing rules such as NI 81-105 as a way to mitigate or eliminate the conflicts that exist.

Additional Research Needed

Given the significant impact that a ban on embedded compensation could have on various stakeholders in the Canadian investment fund industry, FTI believes that additional work and research is necessary. We encourage the CSA to undertake this work in order to determine the best regulatory approach to address the CSA's concerns. Examples of additional research include:

- *Investor survey* – We are not aware of any research conducted by the CSA where it surveyed investors to determine their preferences. Investors should be consulted to determine what, if any, regulatory action they feel is necessary to achieve these goals. As noted above, FTI believes investor choice is important and therefore investors should be consulted for their opinions on whether they view embedded compensation as an issue and whether they would prefer to move to direct payment arrangements.

- *Investment fund costs* – The CSA asserts that discontinuing embedded commissions will put pressure on investment fund managers to reduce their fees. The Consultation Paper states that the potential entrance of lower-cost product providers will likely increase the competitive pressure to decrease fund management costs even further over time. The Canadian investment fund industry is already highly competitive and the entrance of exchange-traded funds ("ETFs") has only increased the competition. FTI believes that market forces are already forcing industry participants to lower their management fees and other costs. There has also been a movement away from the sale of investment fund securities with a DSC.[16] In the past year, FTI announced its Simplicity Pricing initiative and it previously implemented other management fee reductions for many of its investment funds.[17] Many industry competitors have announced their own initiatives and/or management fee reductions in recent years.[18] FTI is also seeing a shift to fee-based series by investment advisors on behalf of their clients – 70% of its fund flows are now invested in series with no embedded commissions. FTI believes that investment fund costs are declining and market forces are causing a shift to fee-based series. For these reasons, regulatory intervention is not necessary. FTI encourages the CSA to conduct research to study the decline in investment fund costs and shifts in fund flows from series with embedded commissions to fee-based series.

- *Cost to investors* – According to the CSA, discontinuing embedded commissions may help to increase investors' control over dealer compensation costs. However, a potential unintended consequence is an increase in investor costs if investors are switched to alternative higher cost products/services or direct pay arrangements

[16] MFDA Report, supra note 12.
[17] The MERs of FTI's Canadian mutual funds have declined by 19%, on an asset-weighted basis, in the last five years (to December 31, 2016).
[18] Investor Economics, supra note 6.

result in higher overall costs for investors. The CSA should review the experience of other jurisdictions to determine if investor costs are actually lower when all costs (including direct fees charged by the dealer) are taken into consideration. The CSA should also study fee based platforms to understand the costs of such platforms, how they compare to the investor costs associated with embedded commissions and whether the average investor is able to negotiate better fees in a direct pay arrangement.

- *Cost-benefit analysis* – Any regulatory action to discontinue embedded commissions would have a significant cost for the investment fund industry. There are both tangible and intangible costs to industry participants and we estimate those costs to be considerable (the recent implementation of CRM2 cost the investment industry millions of dollars to implement). Furthermore, there are the costs of unintended consequences that may result from a ban. Accordingly, FTI believes that a comprehensive cost-benefit analysis should completed by an independent consultant retained by the CSA.

- *Monitoring outcomes of POS and CRM2* – In the Consultation Paper, the CSA discounts its own POS and CRM2 initiatives as means of addressing the perceived investor protection and market efficiency issues identified with respect to embedded commissions. FTI does not agree. The POS fund facts were introduced to provide investors with key information about a fund in a simple, accessible and comparable format on a timely basis. The requirement to deliver the fund facts before a fund purchase only came into effect two years ago. The CRM2 initiative introduced many new disclosure requirements for registrants, all with the aim of increasing investor awareness and understanding of mutual fund costs. The final stage of the CRM2 requirements only recently came into effect when investors started receiving performance and cost disclosure information. FTI believes that POS and CRM2 are both important initiatives that improve transparency and increase investor awareness and understanding of the funds they are purchasing, including the costs of such products. Since both initiatives have only recently been implemented, it is premature to conclude that they will not adequately address the perceived issues identified by the CSA in the Consultation Paper. These regulatory initiatives should be given time to implement and then their effectiveness properly evaluated before the CSA decides to pursue a ban on embedded compensation.[19]

- *Best interest standard* – In CSA Discussion Paper 81-407 – *Mutual Fund Fees* (the "Original Consultation Paper"), the CSA identified the imposition of a statutory best interest standard as one possible means of addressing the issues it identified. The CSA has since published the BIS Consultation Paper and recently issued a status report, indicating the direction it intends to take on various proposals. Certain CSA members continue to support a regulatory best interest standard and have committed to further work in this area. A regulatory best

[19] The CSA is currently engaged in a multi-year research project measuring the impact of these initiatives; FTI believes the results of that project will provide an important input in the study of embedded commissions as well.

interest standard is also a significant regulatory initiative. The regulatory best interest standard initiative and the initiative to consider discontinuing embedded commissions appear to be moving on parallel tracks without any coordination. FTI believes that, given their importance to the Canadian investment industry and the inter-relationship between the issues identified in both the Consultation Paper and BIS Consultation Paper, it is incumbent upon the CSA to better coordinate its work on these initiatives. The CSA should refrain from taking any regulatory action until all relevant impacts are considered.

Conclusion

The CSA's proposal to discontinue embedded commissions would have a significant impact on investment industry participants, including investment fund managers, dealers and their representatives and, most importantly, investors. FTI believes a prohibition on embedded compensation would likely have unintended consequences, including a reduction in access to financial advice and choice regarding the types of products available, lower investor savings, higher cost of advice for investors, regulatory arbitrage opportunities, a reduction in competition in the investment fund industry and increased costs for registrants. Ultimately, this would have the greatest impact on investors. For these reasons, we believe a prohibition is not the appropriate regulatory response. Instead, we urge the CSA to consider other alternatives described above that would still lead to more positive outcomes for investors while minimizing disruption for all market participants. In considering these other alternatives, we believe the CSA should undertake additional work and research before determining the appropriate regulatory response, if any.

Thank you for your consideration of this submission. We look forward to participating in further consultations on this very important topic. Please feel free to contact me at 416.957.6010 should you have any questions or wish to discuss our submission.

Yours truly,

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Re: CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Dear CSA Members,

We are writing to give you our comments on the Canadian Securities Administrators' ("CSA") *Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions* published on January 10, 2017 (the "Consultation Paper").

Introduction

Sun Life Financial Investment Services (Canada) Inc. ("SLFISI") is one of Canada's largest mutual fund dealers with assets under administration of over $22 billion. We have over 2,700 advisors operating from locations across Canada.

SLFISI has over 490,000 client accounts. SLFISI serves a broad range of Canadians including many mid-market clients with smaller accounts. Our average account size is $45,600. SLFISI offers both embedded commissions and direct pay fee-based accounts. We do not have a minimum account size for either type of account. The average size of our embedded commissions accounts is $37,500. The average account size of our fee-based nominee accounts is $157,000.

SLFISI is part of the Sun Life Financial group of companies.

Response to the CSA concerns

We agree with the CSA's comments in the Consultation Paper that embedded commissions have the potential to create conflicts of interest for advisors and dealers. However, while we agree with the need to constantly monitor and manage this risk and propose additional actions to that end, external research shows no significant evidence of client harm related to embedded commissions and conflicts of interest.

We also agree with the CSA that clients should know the costs of their investments, including the costs of embedded commissions. They should also know the services they are paying for and should get what they are paying for. However, we believe that these issues can be addressed through reforms to increase client awareness of costs and to give them a clear written agreement outlining the services they will receive.

We believe that there is a substantial risk that a ban will reduce access to advice and increase the cost of advice, especially for clients with smaller accounts.

We suggest that the best course of action is to maintain client choice and to implement the alternatives we propose that will address the CSA's concerns without the adverse consequences that a ban presents.

A ban of embedded commissions is not needed

There are several reasons why a ban is not the optimal way to address the CSA's concerns:

1. No significant evidence of conflict of interest concerns

In its recent report, PricewaterhouseCoopers concluded that:

> "There is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour. A ban on embedded commissions would likely eliminate some of these influences, but would create new instances of misalignment of interests between investors and advisors via new fee schemes."[1]

Absent such evidence, a ban is not warranted.

2. Transparency and market forces

Research shows that market forces and increased transparency have significantly reduced embedded commissions rates in recent years. In 2006, across the industry, 17.8% of equity and balanced mutual funds in Canada paid a trail commission in excess of 100 basis points. By 2015, this had dropped to 10%. Just one year later in 2016, this dropped by nearly one-half – only 6% of equity and balanced funds paid an embedded trail commission over 100 bps.[2] Market forces such as the rise of ETFs and robo-advisors, along with increased interest in index funds, have driven these changes. These forces will continue to have a powerful impact as CRM2 and Point of Sale continue to take hold. CRM3 will deepen and extend this impact.

With these reductions, the potential conflicts of interest from compensation beyond industry norms have also been reduced.

SLFISI's business has evolved with these market pressures.

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[1] PricewaterhouseCoopers, "Economic Impact Assessment of Banning Embedded Commissions in the Sales of Mutual Funds", June 2017, page iii

[2] Internal analysis by the Investment Funds Institute of Canada

As an example, SLFISI has established a robust fee-based program. We have provided advisors with detailed training and on-going guidance on how to set up and handle fee-based accounts. This includes how to determine what fees are appropriate for various types of clients, how to provide adequate disclosure and how to meet service expectations. We have also established maximum fee levels.

SLFISI manages the products on its shelf to minimize the potential for embedded commissions related conflicts of interest. As a result:

- Almost all of SLFISI's client assets under administration are in funds that pay a trail commission of 100 basis points or less.
- The trail commission rates on the funds we sell are highly aligned.
- The majority of SLFISI's assets under administration are in funds with a risk classification of "medium", "medium-low", or "low".
- SLFISI has a robust policy on DSC sales in line with MFDA guidance. DSC sales now make up less than 5% of new sales.

Transparency and other market forces have moved the industry closer to alignment of embedded commissions rates and have reduced conflicts of interest. The reforms recommended above will intensify these market forces and continue to align embedded commissions levels and further reduce the potential for conflicts of interest. In our view, this is the best way to ensure that there are checks and balances to minimize conflicts of interest.

3. All compensation systems have conflicts of interest

The Brondesbury report makes clear that fee-based compensation raises its own conflict of interest concerns.

> "Concerns about reverse churning and focus on proprietary (or related) products among fee-based advisors, suggest advisors with other forms of compensation can give biased advice too."
>
> "…every form of compensation is likely to have some form of bias associated with it."[3]

Similarly, transactional fees may incent churning. Hourly fees may encourage the advisor to maximize the time spent working with clients.[4]

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3 The Brondesbury Group, "Mutual Fund Fee Research", spring 2015 , page 57
4 PricewaterhouseCoopers, pages 46-47 and 52

The MFDA in its recent research paper notes that whatever decision is made about embedded commissions "…regulators will also need to be mindful of all conflicted compensation arrangements that raise similar or even greater regulatory concerns."[5]

PricewaterhouseCoopers identifies a number of potential conflicts of interest in the fee-based model.

> "This scheme, while fully transparent to the client, creates potential conflicts of interest.
>
> One example of such conflict is the fact that advisors may be tempted to take undue risks to grow their clients' accounts and thereby boost their own fees. This may be against the best interest of some investors who would find it optimal to have lower amounts invested in mutual funds. Moreover, fee-based platforms are characterized by financial advisors' strong disincentive to provide investment, financial planning and tax solutions that do not involve advisor management or which might reduce the amount of investor assets under management."[6]

We believe that there is no one compensation model that is suitable for all Canadians.

4. Client awareness and understanding of costs

Banning embedded commissions will make it harder for clients to determine how much they are paying because the total cost of ownership of their investments will be less transparent.

Under the embedded commissions model, clients have one number – the management expense ratio – that gives them the total cost of their investments, including the fund management costs and the cost of advice. Because MERs are publicly available, this number is readily comparable across all fund companies. [7]

Requiring clients to pay their dealer for advice separately from fund management fees may make it more difficult for clients to calculate and understand the total cost of their investments. In a fee-based model, the client must take the fund level costs reported by the fund company and add them to the cost of advice and distribution provided in a separate report from their dealer. There is no public source of these costs to facilitate comparison.[8]

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5 Mutual Fund Dealers Association of Canada, MFDA Client Research Report, May 2017, page 19
6 PricewaterhouseCoopers, page 46
7 PricewaterhouseCoopers, page 40
8 Pierre Lortie, "A major setback for retirement savings: Changing how financial advisers are compensated could hurt less-than wealthy investors most", University of Calgary, SPP Research Papers, volume 9, issue 13, April 2016, pages 26-27, 29

5. Many clients prefer embedded commissions

Many clients prefer the simplicity of the embedded commissions model.

In a recent study, Ipsos-Reid concluded that for many Canadians:

> “The preferred method for being charged for financial advice is for it to be included in the purchase price of investment products.”[9]

Thirty-five percent of clients preferred to have the cost of advice included in the cost of investment products they buy.[10] That was the most popular option among the survey respondents. In the 2016 Pollara survey, just over half (54%) would prefer to compensate their advisor through bundled commissions, while 37% would prefer to pay a direct fee.[11]

In a recent JD Power survey in the United States, “almost 60% of full-service, commission-based investors said they would ‘probably’ or ‘definitely’ take their business elsewhere if their firm’s compliance with the rule [the US Department of Labor fiduciary rule] meant switching into fee-only retirement plans… .”[12]

Clients value not only returns, but also simplicity and good service. Brondesbury identifies the following area that requires further study:

> “What do investors want in addition to money? Do they want peace of mind, time for more economically valuable pursuits, time for more pleasurable pursuits, or just the sense that someone else is looking after their needs? How well do different forms of compensation deliver on these intangibles?[13]

Many clients do not want to negotiate the cost of services they use. Elderly clients may be unable to “shop around” to gather information about the cost of advice to allow them to negotiate in a meaningful way with their advisor. They are better served by an embedded commissions account.

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9 Ipsos-Reid, “Canadians and Financial Advice, 2016”, page 13
10 Ipsos-Reid, page 13.
11 Pollara, “2016 Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry”, page 28
12 JD Power research, quoted in “Commission-based clients don’t want fee-based accounts” on FinancialPlanning.com, March 20 2017. https://www.financial-planning.com/news/fiduciary-changes-could-turn-clients-off-jd-power
13 Brondesbury, page 78

6. There is no evidence that clients will be better off after a ban

A fundamental change, such as the banning of embedded commissions, should only be made if there is compelling evidence that clients will be better off as a result. We suggest that there is no such evidence.

Research commissioned by the CSA concludes there is insufficient evidence that mandating fee-based compensation will improve long-term outcomes for clients. The Brondesbury report says:

> "In our view, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation."[14]

At SLFISI, average dealer compensation for embedded commissions accounts versus fee-based accounts are not significantly different. We believe that, in a fee-based exclusive platform, the small fee-based accounts will be charged a higher fee compared to a larger fee-based account and will not necessarily be better off than with embedded commissions.

Although, the elimination of embedded commissions would reduce mutual fund management fees because they would no longer include the cost of advice, it may not lower the total cost of investing. In some cases, especially in provinces with higher tax brackets, the total cost of investing in a fee-based account would be higher than in an embedded commission account for the same service fee percentage. Indeed, in an embedded commission series the tax charged is a blended tax rate that might be lower than the provincial tax charged to the client on the service fee in a fee-based series.

7. Cost/benefit analysis

The Consultation Paper does not provide a cost/benefit analysis. At this stage, we cannot ascertain the precise cost to the industry of implementing a ban. We expect it will be significant: both the actual implementation costs and the opportunity costs of diverting the industry's energies away from other improvements to products and services to clients. We ask the CSA to provide a cost/benefit analysis of any proposal it makes relative to the other alternatives that are available to address its concerns.

The transition effort would be large. In our view, the industry would require a transition period of at least 3 years.

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[14] Brondesbury, page 20. See also Lortie page 17

8. The value of advice is significant

Advisors play a critical role in helping clients build wealth, mitigate risk, develop savings discipline, budget, manage debt, and plan for retirement.[15] The vast majority of advisors are highly skilled professionals who put their clients' interests first and care deeply about the welfare of their clients. Most advisors want to avoid situations where compensation creates conflicts of interest.

The Consultation Paper suggests that the cost of advice paid for through embedded commissions outweighs the benefits investors receive. The research reviewed in the paper measures value to the client only in terms of fund returns.[16] The Brondesbury report does not consider the value of advice at all.[17] The Cummings report looks only at fund returns.[18] This misses critical aspects of the value that advisors add.

Most clients see the role of the advisor and the value of advice more broadly than just investment expertise. In recent research, Ipsos-Reid found that:

> "…fewer than half of clients believe investing services represent 30% or more of the value of an advisor."[19]

There is recent Canadian research that looks at the value of advice in a broader way and measures its impact on clients. The Lortie paper says that advisors add value by helping clients avoid common investing mistakes, explaining risk relative to returns and establishing and following through on long-term savings goals.[20] CIRANO's 2016 paper found that:

> "…the presence of a financial advisor proves its effect as soon as the first four years. The additional value reaches 290% for a household with an advisor for fifteen years or more: 3.9 times the value of assets of equivalent non-advised households."[21]

Advised clients accumulated substantially more wealth and had higher asset levels than non-advised clients.

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[15] Lortie, pages 8,9 and 10
[16] See the Consultation Paper at page 125ff
[17] The Brondesbury report explicitly says on page 6 that the research "will not weigh in on the topic of the value of advisors".
[18] The analysis in the Cummings report (pages 4 and 5) looks at "How does past performance affect fund flows?" and "Do fees and fund flows have any effect on future fund performance?"
[19] Ipsos-Reid, page 8
[20] Lortie, page 11
[21] Claude Montmarquette et al., "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016, page 41

Advice has significant macro-economic benefits as well. A Conference Board study in 2014 found that an increase in the number of advised households would result in a higher savings rate and better asset allocation. Over the long term, this will lead to a higher level of retirement readiness, and a positive impact on both real GDP and business investment.[22]

The unintended consequences of a ban: an advice gap

In our view, the risk of unintended consequences flowing from a ban are greater than suggested in the Consultation Paper. There are several reasons why an advice gap may develop.

Client preferences – As already noted, many clients prefer to pay for financial advice through commissions included in the cost of their investments.[23] Clients value advice but many are not prepared to pay for it upfront or directly. Many clients do not want to spend a great deal of time and effort managing their investments. Bundling the cost of advice with other product costs saves them time and simplifies the process.

What will these clients do if they are required to pay directly for financial advice? We believe there is a significant risk that many of them will simply not save and invest. This is especially likely with clients who have smaller accounts and less investment knowledge.

Affordability – Even if a client wanted a fee-based account, it may not be available to them, as dealers focus on clients with larger accounts that are more profitable:

> "In the absence of bundling, the unavoidable consequence is that a combination of lower aggregate costs per investor and higher expected fee income will motivate financial firms (and the financial advisers in their employ) to target higher-net-worth investors and shun less wealthy households."[24]

Fee-based accounts will be costly for smaller investors. Some clients will be reluctant to pay those costs. The Brondesbury report says:

> "People with less wealth and less income will find it harder to get advice for two reasons. First, it is difficult to generate sufficient income to cover costs, solely from sales of investments to this group. Second, in a fee-paying regime, there is evidence that they are less willing to pay fees to cover their cost of service."[25]

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22 Conference Board of Canada, "Boosting Retirement Readiness and the Economy Through Financial Advice" (2014), page iv
23 Ipsos-Reid, page 13. See also Pollara 2016, page 28
24 Lortie, page 21
25 Brondesbury, page 76

In its recent report, the MFDA notes concerns about the affordability of fee-based accounts for mass-market clients.[26]

Several factors influence this affordability challenge:

- For a smaller fee-based account, the dealer's account opening, maintenance and termination fees together with the dealer's advisory fee may be more than the trail commission on an embedded commissions account.
- Currently, the level of the embedded trail commission acts as a constraint on advisory fees in fee-based accounts. It is difficult for dealers and advisors to justify a fee that exceeds the trail commission rate for the same services. A ban would eliminate this constraint. "Absent this constraint, the cost of financial advice for a majority of retail clients is bound to increase."[27]

The international experience – Jurisdictions that have banned embedded commissions have experienced an advice gap as financial organizations shift their focus to high net worth investors and increase account minimums. The Brondesbury report notes that:

> "In jurisdictions that have moved to fee-based compensation people with less wealth and less income find it harder to get advisory service than others."[28]

Banks and building societies in the UK increased their account minimums shortly after the ban on embedded commissions was announced. The independent advisor channel also increased its account minimums to make its businesses financially viable in the new regulatory environment. As a result, the number of accounts in the UK industry with less than £100,000 in assets dropped by half between 2011 and 2014.[29] Many advisors turned away clients because the cost of advice was not affordable for clients with smaller accounts.[30] The advice gap was serious enough that UK regulators and government officials launched reviews to investigate the problem and identify solutions.[31] A similar reduction in the availability of advice has been seen in other jurisdictions.[32]

26 MFDA, pages 11, 15
27 Lortie, page 21
28 Brondesbury, page 7
29 GfK NOP Ltd., "Financial Research Survey" (2014). Cited in Lortie, page 23
30 Financial Advice Market Review – Final Report, page 6 – Sixty-nine percent of advisors turned away clients in the previous 12 months. The most common reason was affordability of the advice for the client.
31 Financial Advice Market Review – Final Report, March 2016
32 Lortie, page 25

Jurisdictions such as the United States, New Zealand and Singapore have not banned embedded commissions because of concerns about removing client choice and reducing access to advice for clients.

Aging advisors and an advisor gap – We are concerned about the average age of advisors in the industry. We expect this to have a significant impact on access to advice as these advisors retire and leave the industry.

Sun Life Financial is one of only a few organizations that recruits and trains significant numbers of new financial advisors from outside the industry (approximately 800 per year across Canada). The average age of our advisors is approximately 45, compared to an industry average of well over 50.

The impact of a ban on embedded commissions on the aging advisor problem should also be considered. In our view, a ban may make the problem worse. It may hasten the departure of some older advisors because it would be costly in time and investment to change their business model to adapt to a change in their compensation.

It may also make it more difficult for new advisors to attract new clients and retain existing ones because, as already noted, many clients do not want to pay directly for financial advice and prefer the embedded compensation model.

Robo advice and passive funds are not the answer for many Canadians – The Consultation Paper says that increased adoption of automated advice or robo advice with passive investment solutions will prevent an advice gap. However, recent research from Ipsos-Reid indicates that many Canadians do not see robo advice as an alternative to an advisor:

- Client interest in Canada in using robo advice is low. Only 18% of Canadians said they were likely (a rating of 6 or more on a 10-point scale) to use a robo advisor (only 5% rated their likelihood 8 or more on a 10-point scale). 82% of Canadians were unlikely to use a robo advisor.
- Only 29% of respondents under 35 and only 24 % of respondents between ages 35 and 44 rated their likelihood to use a robo advisor at 6 or higher. (Only 9% and 8%, respectively, of those groups rated their likelihood to use a robo at 8 or higher). 71% of the under-35 age group and 76% of the 35 to 44 age group were unlikely to use a robo advisor.
- Clients not interested in robo advisors valued human face-to-face contact.
- 61% of clients who were interested in trying a robo advisor would not use it to replace their existing advisor.

- Only 12% of clients who were interested in using robo advice would transfer money currently with their advisor to a robo advisor.[33]
- In a global survey by HSBC, Canadians were among the least likely people around the world to use a robo advisor.[34]

Robo advice is a relatively new concept in Canada. More time and research is needed to understand how it will evolve and which clients are suited to it. At this stage of its evolution, it is too early for millions of ordinary Canadians to rely on it as the primary channel to save for retirement.

Clients with smaller accounts should be able to choose between active and passive strategies. Passive strategies may have lower fees and tend to perform better in rising markets over shorter periods. Active strategies tend to perform better in declining or volatile markets. However, it is impossible to say which will perform best in the future. Passive investments essentially delegate the investment management function to the client. Clients with smaller accounts are less likely to be able to take on this role. Requiring them to do so is unlikely to improve their level of wealth.

Both passive and active strategies can have a place in a client's portfolio. Clients should not be limited to only one choice.

There is a significant risk that a ban on embedded commissions could leave many clients of modest means without affordable access to personalized advice. The MFDA identifies this risk in its recent research report.[35] These clients need personalized advice to build the wealth they need to provide for their retirement.

The IFIC report "Advice and the Modest Investor: A Canadian Perspective" states that:

> "If payment options for advice were to become more restricted, those with relatively few assets, comprising the mass market of Canadian investors, are at the greatest risk of becoming less financially independent over time, less prepared for retirement, less financially literate, and more prone to investment biases and self-inflicted capital losses characteristic of 'do-it-yourself' investing."[36]

33 Ipsos-Reid, page 29-32.
34 HSBC, "Trust in Technology Report – Country Report/Canada", News Release, May 24 2017
35 MFDA, page 19
36 The Investment Funds Institute of Canada, "Advice and the Modest Investor: A Canadian Perspective", page 10

Alternatives to banning embedded commissions

We believe that the CSA's concerns can be addressed without a ban. We propose a set of alternative proposals that will address the CSA's concerns and continue to give clients choice in how they pay for financial advice.

- **A service agreement and enhanced relationship disclosure –** Advisors should be required to enter into a service agreement with each client. The dealer would oversee the agreement.
  The agreement would explain the client's compensation options (embedded and fee-based) and the advisor would be required to review those options and explain the advantages and disadvantages of each.
  The agreement would also state the services the client should expect to receive.
  The client and the advisor would sign the agreement to confirm the compensation option chosen by the client and the commitment from the dealer and advisor to provide the services.
  The advisor would then have the ongoing obligation to provide the agreed upon level of service and regularly review compensation options with the client.

- **Standardized naming convention for fund types –** There should be industry standards for fund companies to identify fund series that are fee-based and fund series that have embedded commissions. This should be done in a way that clients can readily understand.

- **Deferred sales charges –** DSC units should only be offered to clients in accordance with the guidance provided by the MFDA.

- **CRM3 cost disclosure –** We support IFIC's announcement on April 25, 2017 regarding a move to CRM3 cost disclosure in client statements. This would provide clients with a dollar amount cost of management expenses at the account level, including an appropriate description of the services paid for through the management fee.

We believe these alternatives address the three key concerns identified by the CSA in the Consultation Paper.

- They support increased transparency and add to downward pressures on fees and compensation rates that are beyond industry norms. In turn, this will continue to reduce potential for commission-related conflicts of interest.
- They give clients clear choices. Clients would have clear information about how they are paying for advice and what the advice costs. Clients would have clear information about the total cost of their investments.

- They give clients a clear written commitment outlining the services they can expect to receive. They create accountability on the part of the dealer and advisor to provide those services.

Conclusion

Clients should be at the centre of any decision on this issue. Research demonstrates that many clients value the simplicity of the embedded commissions option. They should continue to have that option and the affordable access to financial advice it provides.

The alternative reforms we have proposed address the concerns raised in the Consultation Paper. Those reforms would enhance transparency and client understanding of compensation options and costs through deeper relationship discussions and an explicit service agreement. The service agreement will give clients a clear enforceable commitment that they will get the service they are paying for.

We believe that this additional transparency and client awareness, along with other market forces, will continue to reduce instances of embedded commissions rates that are beyond industry norms that give rise to conflicts of interest.

The alternative reforms will also maintain choice for clients and avoid the risks associated with a ban.

Thank you for the opportunity to participate in the consultation. I would be pleased to discuss any aspect of this letter with you.

Sincerely,

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Nick DiRenzo as President of SLFISI

Sun Life Financial

APPENDIX

CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

PART 2 – KEY INVESTOR PROTECTION AND MARKET EFFICIENCY ISSUES RAISED BY MUTUAL FUND FEES AND RELATED EVIDENCE

Question	Response
1. Do you agree with the issues described in this Part? Why or why not?	We agree with the CSA's comments in the Consultation Paper that embedded commissions have the potential to create conflicts of interest for advisors and dealers. However, while we agree with the need to constantly monitor and manage this risk and propose additional actions to that end, external research shows no significant evidence of client harm related to embedded commissions and conflicts of interest. In its recent report, PricewaterhouseCoopers concluded that: "There is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour. A ban on embedded commissions would likely eliminate some of these influences, but would create new instances of misalignment of interests between investors and advisors via new fee schemes."[37] Absent such evidence, a ban is not warranted. We also agree with the CSA that clients should know the costs of their investments, including the costs of embedded commissions. They should also know the services they are paying for and should get what they are paying for. However, we believe that these issues can be addressed through reforms to increase client awareness of costs and to give them a clear written agreement outlining the services they will receive.

[37] PricewaterhouseCoopers, "Economic Impact Assessment of Banning Embedded Commissions in the Sales of Mutual Funds", June 2017, page iii

	We believe that there is a substantial risk that a ban will reduce access to advice and increase the cost of advice, especially for clients with smaller accounts. We suggest that the best course of action is to maintain client choice and to implement the alternatives we propose that will address the CSA's concerns without the adverse consequences that a ban presents.
3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible."	In our view, there is significant benefits to embedded commissions. **Client awareness and understanding of costs -** Banning embedded commissions will make it harder for clients to determine how much they are paying because the total cost of ownership of their investments will be less transparent. Under the embedded commissions model, clients have one number – the management expense ratio – that gives them the total cost of their investments, including the fund management costs and the cost of advice. Because MERs are publicly available, this number is readily comparable across all fund companies. [38] Requiring clients to pay their dealer for advice separately from fund management fees may make it more difficult for clients to calculate and understand the total cost of their investments. In a fee-based model, the client must take the fund level costs reported by the fund company and add them to the cost of advice and distribution provided in a separate report from their dealer. There is no public source of these costs to facilitate comparison. [39] **There is no evidence that clients will be better off after a ban -** A fundamental change, such as the banning of embedded commissions, should only be made if there is compelling evidence that clients will be better off as a result. We suggest that there is no such evidence. Research commissioned by the CSA concludes there is insufficient evidence that mandating fee-based compensation will improve long-term outcomes for clients. The Brondesbury report says:

[38] PricewaterhouseCoopers, page 40

[39] Pierre Lortie, "A major setback for retirement savings: Changing how financial advisers are compensated could hurt less-than wealthy investors most", University of Calgary, SPP Research Papers, volume 9, issue 13, April 2016, pages 26-27, 29

	"In our view, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation."[40] At SLFISI, average dealer compensation for embedded commissions accounts versus fee-based accounts are not significantly different. We believe that, in a fee-based exclusive platform, the small fee-based accounts will be charged a higher fee compared to a larger fee-based account and will not necessarily be better off than with embedded commissions. Although, the elimination of embedded commissions would reduce mutual fund management fees because they would no longer include the cost of advice, it may not lower the total cost of investing. In some cases, especially in provinces with higher tax brackets, the total cost of investing in a fee-based account would be higher than in an embedded commission account for the same service fee percentage. Indeed, in an embedded commission series the tax charged is a blended tax rate that might be lower than the provincial tax charged to the client on the service fee in a fee-based series.

PART 3 – OVERVIEW OF THE PROPOSED OPTION TO DISCONTINUE EMBEDDED COMPENSATION

PART 4 – REGULATORY IMPACT

Addressing the issues

Question	Response
12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?	We agree with the CSA's comments in the Consultation Paper that embedded commissions have the potential to create conflicts of interest for advisors and dealers. However, while we agree with the need to constantly monitor and manage this risk and propose additional actions to that end, external research shows no significant evidence of client harm related to embedded commissions and conflicts of interest.

40 Brondesbury, page 20. See also Lortie page 17

	We believe that these issues can be addressed through reforms to increase client awareness of costs and to give them a clear written agreement outlining the services they will receive. We believe that there is a substantial risk that a ban will reduce access to advice and increase the cost of advice, especially for clients with smaller accounts.
13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?	**Alternatives to banning embedded commissions -** We believe that the CSA's concerns can be addressed without a ban. We propose a set of alternative proposals that will address the CSA's concerns and continue to give clients choice in how they pay for financial advice. • **A service agreement and enhanced relationship disclosure –** Advisors should be required to enter into a service agreement with each client. The dealer would oversee the agreement. The agreement would explain the client's compensation options (embedded and fee-based) and the advisor would be required to review those options and explain the advantages and disadvantages of each. The agreement would also state the services the client should expect to receive. The client and the advisor would sign the agreement to confirm the compensation option chosen by the client and the commitment from the dealer and advisor to provide the services. The advisor would then have the ongoing obligation to provide the agreed upon level of service and regularly review compensation options with the client. • **Standardized naming convention for fund types –** There should be industry standards for fund companies to identify fund series that are fee-based and fund series that have embedded commissions. This should be done in a way that clients can readily understand. • **Deferred sales charges –** DSC units should only be offered to clients in accordance with the guidance provided by the MFDA. • **CRM3 cost disclosure –** We support IFIC's announcement on April 25, 2017 regarding a move to CRM3 cost disclosure in client statements. This would provide clients with a

	dollar amount cost of management expenses at the account level, including an appropriate description of the services paid for through the management fee. We believe these alternatives address the three key concerns identified by the CSA in the Consultation Paper. • They support increased transparency and add to downward pressures on fees and compensation rates that are beyond industry norms. In turn, this will continue to reduce potential for commission-related conflicts of interest. • They give clients clear choices. Clients would have clear information about how they are paying for advice and what the advice costs. Clients would have clear information about the total cost of their investments. • They give clients a clear written commitment outlining the services they can expect to receive. They create accountability on the part of the dealer and advisor to provide those services.
14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?	**All compensation systems have conflicts of interest -** The Brondesbury report makes clear that fee-based compensation raises its own conflict of interest concerns. "Concerns about reverse churning and focus on proprietary (or related) products among fee-based advisors, suggest advisors with other forms of compensation can give biased advice too." "…every form of compensation is likely to have some form of bias associated with it."[41] Similarly, transactional fees may incent churning. Hourly fees may encourage the advisor to maximize the time spent working with clients.[42]

41 The Brondesbury Group, "Mutual Fund Fee Research", spring 2015, page 57
42 PricewaterhouseCoopers, pages 46-47 and 52

	The MFDA in its recent research paper notes that whatever decision is made about embedded commissions "…regulators will also need to be mindful of all conflicted compensation arrangements that raise similar or even greater regulatory concerns."[43] PricewaterhouseCoopers identifies a number of potential conflicts of interest in the fee-based model. "This scheme, while fully transparent to the client, creates potential conflicts of interest. One example of such conflict is the fact that advisors may be tempted to take undue risks to grow their clients' accounts and thereby boost their own fees. This may be against the best interest of some investors who would find it optimal to have lower amounts invested in mutual funds. Moreover, fee-based platforms are characterized by financial advisors' strong disincentive to provide investment, financial planning and tax solutions that do not involve advisor management or which might reduce the amount of investor assets under management."[44] We believe that there is no one compensation model that is suitable for all Canadians.

Change in investor experience and outcomes

Question	Response
15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes?	**Many clients prefer embedded commissions -** Many clients prefer the simplicity of the embedded commissions model. In a recent study, Ipsos-Reid concluded that for many Canadians:

43 Mutual Fund Dealers Association of Canada, MFDA Client Research Report, May 2017, page 19
44 PricewaterhouseCoopers, page 46

> "The preferred method for being charged for financial advice is for it to be included in the purchase price of investment products."[45]

Thirty-five percent of clients preferred to have the cost of advice included in the cost of investment products they buy.[46] That was the most popular option among the survey respondents. In the 2016 Pollara survey, just over half (54%) would prefer to compensate their advisor through bundled commissions, while 37% would prefer to pay a direct fee.[47]

In a recent JD Power survey in the United States, "almost 60% of full-service, commission-based investors said they would 'probably' or 'definitely' take their business elsewhere if their firm's compliance with the rule [the US Department of Labor fiduciary rule] meant switching into fee-only retirement plans… ."[48]

Clients value not only returns, but also simplicity and good service. Brondesbury identifies the following area that requires further study:

> "What do investors want in addition to money? Do they want peace of mind, time for more economically valuable pursuits, time for more pleasurable pursuits, or just the sense that someone else is looking after their needs? How well do different forms of compensation deliver on these intangibles?[49]

Many clients do not want to negotiate the cost of services they use. Elderly clients may be unable to "shop around" to gather information about the cost of advice to allow them to negotiate in a meaningful way with their advisor. They are better served by an embedded commissions account.

[45] Ipsos-Reid, "Canadians and Financial Advice, 2016", page 13
[46] Ipsos-Reid, page 13.
[47] Pollara, "2016 Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry", page 28
[48] JD Power research, quoted in "Commission-based clients don't want fee-based accounts" on FinancialPlanning.com, March 20 2017. https://www.financial-planning.com/news/fiduciary-changes-could-turn-clients-off-jd-power
[49] Brondesbury, page 78

The value of advice is significant - Advisors play a critical role in helping clients build wealth, mitigate risk, develop savings discipline, budget, manage debt, and plan for retirement.[50] The vast majority of advisors are highly skilled professionals who put their clients' interests first and care deeply about the welfare of their clients. Most advisors want to avoid situations where compensation creates conflicts of interest.

The Consultation Paper suggests that the cost of advice paid for through embedded commissions outweighs the benefits investors receive. The research reviewed in the paper measures value to the client only in terms of fund returns.[51] The Brondesbury report does not consider the value of advice at all.[52] The Cummings report looks only at fund returns.[53] This misses critical aspects of the value that advisors add.

Most clients see the role of the advisor and the value of advice more broadly than just investment expertise. In recent research, Ipsos-Reid found that:

> "…fewer than half of clients believe investing services represent 30% or more of the value of an advisor."[54]

There is recent Canadian research that looks at the value of advice in a broader way and measures its impact on clients. The Lortie paper says that advisors add value by helping clients avoid common investing mistakes, explaining risk relative to returns and establishing and following through on long-term savings goals.[55] CIRANO's 2016 paper found that:

> "…the presence of a financial advisor proves its effect as soon as the first four years. The additional value reaches 290% for a household with an advisor for fifteen years or more: 3.9 times the value of assets of equivalent non-advised households."[56]

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50 Lortie, pages 8, 9 and 10

51 See the Consultation Paper at page 125ff

52 The Brondesbury report explicitly says on page 6 that the research "will not weigh in on the topic of the value of advisors".

53 The analysis in the Cummings report (pages 4 and 5) looks at "How does past performance affect fund flows?" and "Do fees and fund flows have any effect on future fund performance?"

54 Ipsos-Reid, page 8

55 Lortie, page 11

56 Claude Montmarquette et al., "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016, page 41

	Advised clients accumulated substantially more wealth and had higher asset levels than non-advised clients. Advice has significant macro-economic benefits as well. A Conference Board study in 2014 found that an increase in the number of advised households would result in a higher savings rate and better asset allocation. Over the long term, this will lead to a higher level of retirement readiness, and a positive impact on both real GDP and business investment.[57] **Affordability** – Even if a client wanted a fee-based account, it may not be available to them, as dealers focus on clients with larger accounts that are more profitable: "In the absence of bundling, the unavoidable consequence is that a combination of lower aggregate costs per investor and higher expected fee income will motivate financial firms (and the financial advisers in their employ) to target higher-net-worth investors and shun less wealthy households."[58] Fee-based accounts will be costly for smaller investors. Some clients will be reluctant to pay those costs. The Brondesbury report says: "People with less wealth and less income will find it harder to get advice for two reasons. First, it is difficult to generate sufficient income to cover costs, solely from sales of investments to this group. Second, in a fee-paying regime, there is evidence that they are less willing to pay fees to cover their cost of service."[59] In its recent report, the MFDA notes concerns about the affordability of fee-based accounts for mass-market clients.[60] Several factors influence this affordability challenge: • For a smaller fee-based account, the dealer's account opening, maintenance and termination fees together with the dealer's advisory fee may be more than the trail commission on an embedded commissions account.

57 Conference Board of Canada, "Boosting Retirement Readiness and the Economy Through Financial Advice" (2014), page iv
58 Lortie, page 21
59 Brondesbury, page 76
60 MFDA, pages 11, 15

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- Currently, the level of the embedded trail commission acts as a constraint on advisory fees in fee-based accounts. It is difficult for dealers and advisors to justify a fee that exceeds the trail commission rate for the same services. A ban would eliminate this constraint. "Absent this constraint, the cost of financial advice for a majority of retail clients is bound to increase."[61]

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- What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?

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Robo advice and passive funds are not the answer for many Canadians – The Consultation Paper says that increased adoption of automated advice or robo advice with passive investment solutions will prevent an advice gap. However, recent research from Ipsos-Reid indicates that many Canadians do not see robo advice as an alternative to an advisor:

- Client interest in Canada in using robo advice is low. Only 18% of Canadians said they were likely (a rating of 6 or more on a 10-point scale) to use a robo advisor (only 5% rated their likelihood 8 or more on a 10-point scale). 82% of Canadians were unlikely to use a robo advisor.
- Only 29% of respondents under 35 and only 24 % of respondents between ages 35 and 44 rated their likelihood to use a robo advisor at 6 or higher. (Only 9% and 8%, respectively, of those groups rated their likelihood to use a robo at 8 or higher). 71% of the under-35 age group and 76% of the 35 to 44 age group were unlikely to use a robo advisor.
- Clients not interested in robo advisors valued human face-to-face contact.
- 61% of clients who were interested in trying a robo advisor would not use it to replace their existing advisor.
- Only 12% of clients who were interested in using robo advice would transfer money currently with their advisor to a robo advisor.[62]
- In a global survey by HSBC, Canadians were among the least likely people around the world to use a robo advisor.[63]

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61 Lortie, page 21
62 Ipsos-Reid, page 29-32.
63 HSBC, "Trust in Technology Report – Country Report/Canada", News Release, May 24 2017

	Robo advice is a relatively new concept in Canada. More time and research is needed to understand how it will evolve and which clients are suited to it. At this stage of its evolution, it is too early for millions of ordinary Canadians to rely on it as the primary channel to save for retirement. Clients with smaller accounts should be able to choose between active and passive strategies. Passive strategies may have lower fees and tend to perform better in rising markets over shorter periods. Active strategies tend to perform better in declining or volatile markets. However, it is impossible to say which will perform best in the future. Passive investments essentially delegate the investment management function to the client. Clients with smaller accounts are less likely to be able to take on this role. Requiring them to do so is unlikely to improve their level of wealth. Both passive and active strategies can have a place in a client's portfolio. Clients should not be limited to only one choice.
17. Do you think this proposal will lead to an advice gap? In particular • Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.	**The unintended consequences of a ban: an advice gap -** In our view, the risk of unintended consequences flowing from a ban are greater than suggested in the Consultation Paper. There are several reasons why an advice gap may develop. **Client preferences** – As already noted, many clients prefer to pay for financial advice through commissions included in the cost of their investments.[64] Clients value advice but many are not prepared to pay for it upfront or directly. Many clients do not want to spend a great deal of time and effort managing their investments. Bundling the cost of advice with other product costs saves them time and simplifies the process. What will these clients do if they are required to pay directly for financial advice? We believe there is a significant risk that many of them will simply not save and invest. This is especially likely with clients who have smaller accounts and less investment knowledge. There is a significant risk that a ban on embedded commissions could leave many clients of modest means without affordable access to personalized advice. The MFDA identifies this

[64] Ipsos-Reid, page 13. See also Pollara 2016, page 28

	risk in its recent research report.[65] These clients need personalized advice to build the wealth they need to provide for their retirement. The IFIC report "Advice and the Modest Investor: A Canadian Perspective" states that: "If payment options for advice were to become more restricted, those with relatively few assets, comprising the mass market of Canadian investors, are at the greatest risk of becoming less financially independent over time, less prepared for retirement, less financially literate, and more prone to investment biases and self-inflicted capital losses characteristic of 'do-it-yourself' investing."[66]

Industry change independent of regulatory response to discontinue embedded commissions

Question	Response
18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular: • Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	**Transparency and market forces -** Research shows that market forces and increased transparency have significantly reduced embedded commissions rates in recent years. In 2006, across the industry, 17.8% of equity and balanced mutual funds in Canada paid a trail commission in excess of 100 basis points. By 2015, this had dropped to 10%. Just one year later in 2016, this dropped by nearly one-half – only 6% of equity and balanced funds paid an embedded trail commission over 100 bps.[67] Market forces such as the rise of ETFs and robo-advisors, along with increased interest in index funds, have driven these changes. These forces will continue to have a powerful impact as CRM2 and Point of Sale continue to take hold. CRM3 will deepen and extend this impact. With these reductions, the potential conflicts of interest from compensation beyond industry norms have also been reduced.

65 MFDA, page 19
66 The Investment Funds Institute of Canada, "Advice and the Modest Investor: A Canadian Perspective", page 10
67 Internal analysis by the Investment Funds Institute of Canada

	SLFISI's business has evolved with these market pressures. As an example, SLFISI has established a robust fee-based program. We have provided advisors with detailed training and on-going guidance on how to set up and handle fee-based accounts. This includes how to determine what fees are appropriate for various types of clients, how to provide adequate disclosure and how to meet service expectations. We have also established maximum fee levels. SLFISI manages the products on its shelf to minimize the potential for embedded commissions related conflicts of interest. As a result: • Almost all of SLFISI's client assets under administration are in funds that pay a trail commission of 100 basis points or less. • The trail commission rates on the funds we sell are highly aligned. • The majority of SLFISI's assets under administration are in funds with a risk classification of "medium", "medium-low", or "low". • SLFISI has a robust policy on DSC sales in line with MFDA guidance. DSC sales now make up less than 5% of new sales. Transparency and other market forces have moved the industry closer to alignment of embedded commissions rates and have reduced conflicts of interest. The reforms recommended above will intensify these market forces and continue to align embedded commissions levels and further reduce the potential for conflicts of interest. In our view, this is the best way to ensure that there are checks and balances to minimize conflicts of interest.

Potential impact on competition and market structure

Question	Response
22. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the: • career path;	**Aging advisors and an advisor gap** – We are concerned about the average age of advisors in the industry. We expect this to have a significant impact on access to advice as these advisors retire and leave the industry.

• attractiveness of the job; • typical profile of individuals attracted to the career; • recruitment; and • relative attractiveness of careers in competing financial service business lines?	Sun Life Financial is one of only a few organizations that recruits and trains significant numbers of new financial advisors from outside the industry (approximately 800 per year across Canada). The average age of our advisors is approximately 45, compared to an industry average of well over 50. The impact of a ban on embedded commissions on the aging advisor problem should also be considered. In our view, a ban may make the problem worse. It may hasten the departure of some older advisors because it would be costly in time and investment to change their business model to adapt to a change in their compensation. It may also make it more difficult for new advisors to attract new clients and retain existing ones because, as already noted, many clients do not want to pay directly for financial advice and prefer the embedded compensation model.

PART 5 – MITIGATION MEASURES

Question	Response
29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:	**There is no evidence that clients will be better off after a ban -** A fundamental change, such as the banning of embedded commissions, should only be made if there is compelling evidence that clients will be better off as a result. We suggest that there is no such evidence. Research commissioned by the CSA concludes there is insufficient evidence that mandating fee-based compensation will improve long-term outcomes for clients. The Brondesbury report says: "In our view, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation."[68] At SLFISI, average dealer compensation for embedded commissions accounts versus fee-based accounts are not significantly different. We believe that, in a fee-based exclusive

[68] Brondesbury, page 20. See also Lortie page 17

• Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain	platform, the small fee-based accounts will be charged a higher fee compared to a larger fee-based account and will not necessarily be better off than with embedded commissions. Although, the elimination of embedded commissions would reduce mutual fund management fees because they would no longer include the cost of advice, it may not lower the total cost of investing. In some cases, especially in provinces with higher tax brackets, the total cost of investing in a fee-based account would be higher than in an embedded commission account for the same service fee percentage. Indeed, in an embedded commission series the tax charged is a blended tax rate that might be lower than the provincial tax charged to the client on the service fee in a fee-based series.
30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements, • to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;	**Affordability** – Even if a client wanted a fee-based account, it may not be available to them, as dealers focus on clients with larger accounts that are more profitable: "In the absence of bundling, the unavoidable consequence is that a combination of lower aggregate costs per investor and higher expected fee income will motivate financial firms (and the financial advisers in their employ) to target higher-net-worth investors and shun less wealthy households."[69] Fee-based accounts will be costly for smaller investors. Some clients will be reluctant to pay those costs. The Brondesbury report says: "People with less wealth and less income will find it harder to get advice for two reasons. First, it is difficult to generate sufficient income to cover costs, solely from sales of investments to this group. Second, in a fee-paying regime, there is evidence that they are less willing to pay fees to cover their cost of service."[70] In its recent report, the MFDA notes concerns about the affordability of fee-based accounts for mass-market clients.[71]

69 Lortie, page 21
70 Brondesbury, page 76
71 MFDA, pages 11, 15

	Several factors influence this affordability challenge: • For a smaller fee-based account, the dealer's account opening, maintenance and termination fees together with the dealer's advisory fee may be more than the trail commission on an embedded commissions account. • Currently, the level of the embedded trail commission acts as a constraint on advisory fees in fee-based accounts. It is difficult for dealers and advisors to justify a fee that exceeds the trail commission rate for the same services. A ban would eliminate this constraint. "Absent this constraint, the cost of financial advice for a majority of retail clients is bound to increase."[72]
32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs. • What transition **period** would be appropriate?	**Cost/benefit analysis -** The Consultation Paper does not provide a cost/benefit analysis. At this stage, we cannot ascertain the precise cost to the industry of implementing a ban. We expect it will be significant: both the actual implementation costs and the opportunity costs of diverting the industry's energies away from other improvements to products and services to clients. We ask the CSA to provide a cost/benefit analysis of any proposal it makes relative to the other alternatives that are available to address its concerns. The transition effort would be large. In our view, the industry would require a transition period of at least 3 years.

[72] Lortie, page 21

PART 6 – RELATED REGULATORY INITIATIVES AND EXISTING TOOLS

Question	Response
36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.	We believe that the CSA's concerns can be addressed without a ban. We propose a set of alternative proposals that will address the CSA's concerns and continue to give clients choice in how they pay for financial advice. **A service agreement and enhanced relationship disclosure –** Advisors should be required to enter into a service agreement with each client. The dealer would oversee the agreement. The agreement would explain the client's compensation options (embedded and fee-based) and the advisor would be required to review those options and explain the advantages and disadvantages of each. The agreement would also state the services the client should expect to receive. The client and the advisor would sign the agreement to confirm the compensation option chosen by the client and the commitment from the dealer and advisor to provide the services. The advisor would then have the ongoing obligation to provide the agreed upon level of service and regularly review compensation options with the client. **Standardized naming convention for fund types –** There should be industry standards for fund companies to identify fund series that are fee-based and fund series that have embedded commissions. This should be done in a way that clients can readily understand. **Deferred sales charges –** DSC units should only be offered to clients in accordance with the guidance provided by the MFDA. **CRM3 cost disclosure –** We support IFIC's announcement on April 25, 2017 regarding a move to CRM3 cost disclosure in client statements. This would provide clients with a dollar amount cost of management expenses at the account level, including an appropriate description of the services paid for through the management fee.

	We believe these alternatives address the three key concerns identified by the CSA in the Consultation Paper. They support increased transparency and add to downward pressures on fees and compensation rates that are beyond industry norms. In turn, this will continue to reduce potential for commission-related conflicts of interest. They give clients clear choices. Clients would have clear information about how they are paying for advice and what the advice costs. Clients would have clear information about the total cost of their investments. They give clients a clear written commitment outlining the services they can expect to receive. They create accountability on the part of the dealer and advisor to provide those services.

June 9, 2017

The Secretary
Ontario Securities Commission
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Submitted via email: comments@osc.gov.on.ca

RE: CSA Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions

Worldsource Wealth Management Inc. thanks the CSA for the opportunity to provide comments on this paper and commends the CSA for the extensive due diligence in the area of Mutual Fund costs and Dealer/Advisor compensation that they have conducted to date.

There is however more to consider in both of these areas as we feel that discontinuing embedded compensation could:

1. Disadvantage Dealers that have not integrated Asset Management capabilities into their operations;
2. Increase Investor Costs; and
3. Reduce the availability of advice to lower net worth Canadians.

Additionally we would like to comment on the CSA's statement on page 14 of Consultation Paper 81-408 where they declare that "embedded commissions paid generally do not align with the services provided to investors".

We discuss each of these concerns below:

1. Before considering discontinuing embedded commissions attention must first be given to the reasons why embedded compensation, such as trailer fees, was created. "Trailer Fees, along

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with deferred sales charges, came into being in the mid-1980s as fund companies who sold through Dealers responded to Dealers and sales people's complaints that they wanted to compete with no-load funds."[1] These no load funds were and continue to largely be sold by companies that had and have integrated their Dealer with their organization's asset management capabilities. In so doing they are able to charge investors management fees without directly compensating the Dealer. It should be noted that such relationships do not necessarily mean that cost savings are being passed down to investors, but rather similar compensation is flowed to the Dealer in the form of transfer pricing arrangements. The creation of embedded compensation increased competition, created alternate distribution channels and has helped to create a robust Canadian success story; one that according to the Conference Board of Canada estimates that the mutual fund industry in Canada directly employed 63,242 people and directly created $5.8 billion in real GDP to the Canadian economy in 2012.[2]

Any change to embedded compensation must also consider and address transfer pricing arrangements that exist within integrated financial service firms as well as ensuring the competitive landscape that exists today continues for both existing competitors as well as for new entrants. With respect to this point we feel that more work needs to be done.

2. While the introduction of embedded compensation has helped to create a level playing field amongst competitors it should be noted that it also resulted in lower investor costs. Before the introduction of embedded compensation such as trailer fees and deferred sales charges, the only compensation model available to clients was to pay an upfront commission charge which could be in excess of 9% of the amount(s) invested. In addition to this charge investors often paid a "switch fee" of 2% or more to move from one mutual fund to another. The creation of embedded compensation helped bring these costs down by providing another compensation model; one that favored investors and provided them with choice. While the CSA has outlined on page four of CSA Consultation Paper 81-408 that direct pay arrangements such as up front commissions could continue; one of the unintended consequences of discontinuing embedded commission could be increased investor costs. As a result, investors may in the future pay higher upfront commissions vs what they currently pay through embedded commissions. Research conducted by Strategic Insight in the United States supports this conclusion stating "in total, the unbundling of fees has resulted in an increase in the total shareholder costs for many mutual fund investors — with such increases amplified due to tax considerations at times. And a move

[1] Steven G Kelman 04/11/2015 Morningstar "Don't ban trailer Fees without all the facts: Regulators should make sure investors are getting their money's worth.

[2] The Conference Board of Canada briefing October 2013: Making Dollars and Sense of Canada's Mutual Fund Industry An Economic Impact Analysis

to unbundled fee-for-advice models has not resulted in a reduction of investor costs of mutual fund ownership[3]

We urge the CSA to fully investigate the impact on investor costs experienced by other countries that have moved to discontinue commissions and embedded compensation before introducing similar reforms in Canada.

3. Thus far one of the central concerns voiced by the mutual fund industry on the topic of discontinuing embedded compensation is that lower net worth Canadians would have reduced access to financial advice. To this end the OSC in their April 11, 2017 webinar indicated that they were unclear why this would be when a direct pay fee based arrangement could simply replace the trailer fee that is currently being received from the investment fund. While this comment is essentially correct (for higher net worth investors), one must also assume that the absence of embedded compensation would also increase the purchase costs borne by lower net worth Canadian investors. To this end consideration must also be given to the past and why trailer fees were created. "Trailer fees were the mutual fund industry's answer to the persistent and wealth destructing switching that occurs when investors are left entirely to their own devices or, worse still when the only source of compensation for their advisors is commission derived from making a mutual fund switch. Trailer fees created the perfect alignment of advisor incentives with investors best interests."[4] This view was also supported by Glorianne Stromberg in her 1995 report "Regulatory strategies for the mid-90's: Recommendations for Regulating Investment Funds in Canada" where she wrote, " Part of my reluctance simply to recommend that trailer or service fees be banned relates to the concern expressed by industry participants that banning these fees would just encourage sales representatives to increase the transactions within their clients' accounts or to abandon their clients after the initial sale. There is concern that even with enhancing the supervisory controls and procedures; it is unrealistic to think that the measures will be sufficient to prevent switching and churning of accounts."

The MFDA has also recently commented on this issue with respect to the use of funds that carry a DSC load charge and found that "advisors may be using the embedded DSC commission paid by the fund company upon purchase to finance the cost of offering advisory services to mass market clients (defined as those with Financial wealth of less than $100,000). If so, a ban of embedded compensation would eliminate the DSC commission and may result in advisors having to charge clients an upfront fee to cover the cost of their services. As mass market households are less likely to be able to afford direct pay arrangements and are less likely to be eligible for fee based programs, they would be the most impacted by a ban of embedded

[3] Investor Economics, "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canadian-U.S. Perspective, 2015 Update" (The Investment Funds Institute of Canada, 2015),
[4] Brendan T. N. Caldwell. 06/17/2013 The Financial Post; In praise of mutual fund trailers

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compensation."[5] This was seen "in the U.K., after the decision was made to unbundle fees, the opening of investment accounts worth less than 100,000 pounds fell by half. After Australia required fees to be unbundled, there was a similar effect."[6]

As a result additional increased upfront and continuing commission costs could also cause smaller investors to have less savings and even worse cause them to save in potentially lower returning products such as traditional deposit products. Research indicates that "Canadian households using a financial adviser to assist in saving and investment matters and plan their retirement accumulated 1.58 times as much wealth as did non-advised households after four to six years; after 15 years, that had increased to 2.73 times. [7]

The Advisor Client relationship model is complex and extends beyond the recommendation of securities and the rate of return that those securities may generate. It encompasses activities such as:

- The initial and ongoing assessment of investors risk tolerance, investment objectives and time horizon;
- An assessment of their immediate and future income requirements;
- Advice and implications on withdrawal strategies and their income tax implications;
- Advice on asset location (the use of different investment account types);
- Immediate and ongoing assessments of the progress made towards their financial goals;
- Implementing savings strategies;
- Recommending and implementing investment strategies and rebalancing on an ongoing basis; and
- Behavioral coaching and helping investors navigate difficult personal circumstances such as job loss or divorce as well as difficult investment environments.
- In addition the Dealers role in the client relationship model is also important as they provide among other things:
    - Access to online information;
    - Transaction confirmations;
    - Quarterly reporting;
    - Annual Tax reporting;
    - Performance reporting;

[5] May 2017 MFDA Client Research Report A detailed look into Members, Advisors, Clients
[6] Peirre Lortie; University of Calgary School of Public Policy: A MAJOR SETBACK FOR RETIREMENT SAVINGS: CHANGING HOW FINANCIAL ADVISERS ARE COMPENSATED COULD HURT LESS-THAN WEALTHY INVESTORS MOST April,2016
[7] Peirre Lortie; University of Calgary School of Public Policy: A MAJOR SETBACK FOR RETIREMENT SAVINGS: CHANGING HOW FINANCIAL ADVISERS ARE COMPENSATED COULD HURT LESS-THAN WEALTHY INVESTORS MOST April,2016

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- Access to Financial markets and investment products.

While studies have been conducted that suggest Advisors add approximately 3% of Alpha[8] (additional Return) to the client relationship, the best source of investor satisfaction with Advisors services needs to be gleaned from their clients. To this end, time and time again investor surveys express client satisfaction with their Advisors. However, a recent survey conducted by the Gandalf Group between April 7th and May 5th 2017 is perhaps one of the most telling as this survey was conducted after investors had a chance to review their first Dealer Compensation and Performance Reports. This report concluded that: "there is little dissatisfaction with the current system of financial advice in Canada and the way advisor compensation is calculated. While there may be some dissatisfaction about fees, generally, there is relatively higher satisfaction when it comes to advisors transparency around fees."

The acceptability about the current fee models relates partly to investor's preference for a commission-based approach to advisor compensation based on portfolio value instead of a fee-for-service approach that would see investors invoiced with a bill they would have to pay out of pocket. While investors see value to fees geared to the amount and levels of service provided, and generally agree that fees should be negotiated, investors see strengths in both approaches. In a forced choice, more opted for a system of commissions paid by fund providers and financial institutions to advisors from the capital of the investments purchased with the advisor." [9]

The value of advice provided by Advisors is not easily quantified. For instance each of the Advisor activities (and more) listed above as well as the services provided by Dealers must be included as part of the value that clients receive from Advisors throughout the engagement and relationship process.

In conclusion while the CSA is currently consulting on discontinuing embedded commissions, recognition needs to be given to how compensation models have evolved since the introduction of embedded compensation. Not long ago Advisor's relied heavily on large up front and switch fees before transitioning to back end commissions as their primary revenue stream. The last decade has seen the transition to the zero commission front end load model and the subsequent increase in recurring revenue through the higher trailer fee associated with front end load funds. Over the past two years our Mutual Fund Advisors and their clients have begun to transition to the fee for service model. As a result, today more than 13% of every new dollar that is invested with our Mutual Fund Dealership Worldsource Financial Management Inc. is through a fee based solution. Five years ago that number was just 2%. Both of these trends are also significantly higher at our Securities Dealership Worldsource Securities Inc. We believe that these trends will continue without further implementation of regulation.

[8] Vanguard March 2014: Putting a value on your value: Quantifying Vanguard Advisor's Alpha
[9] The Gandalf Group, May 30, 2017: The Canadian Investor's Survey: An Opinion Research Study in Fees & Advisory Services

One of the reasons for this belief is the continued introduction of new competitors and technology into the Canadian market. An example is Robo-Advisors some of whom now even provide advice. However, even Robo-Advisors with their sophisticated technology platforms are not without their challenges as “the average cost incurred by a U.S. Robo-Advisor to acquire a client is roughly $350 which covers such items as digital advertising and mass mail notifications. Given that the average fee in the US Robo-Advisory space is about 25 basis points, and the average account balance is $35,000, it takes them four years to just recoup their acquisition costs, and we're not even talking about additional operational overhead expenses on top of that." [10] This cost of client acquisition and account opening is also one of the main reasons that Canadian Dealers have higher account minimums on fee based advisory accounts as Dealers must marry account minimums with the expected revenue generated from their accounts. While to our knowledge the cost of client acquisition is not available in Canada it is fair to assume that it is significantly more than that experienced by US Robo-Advisors. Note that in our view the cost of client acquisition also supports the notion that lower net worth investors will not continue to have the same choice available to them as higher net worth Canadians with the discontinuance of embedded commissions.

CSA consultation paper 81-408 also:

- Expresses concern about the lack of new foreign entrants to Canada’s financial services landscape. We are of the opinion that, the cost of embedded commissions is not the reason for what has become a largely Canadian owned industry; rather the main barriers to entry of foreign financial firms are largely the result of the fact that the distribution of financial wealth in Canada is concentrated (approximately 60%) in the hands of a handful of organizations. Additionally “Compared to the U.S., Canada is a relatively more complex market with two official languages, two legal systems, 13 securities regulators and fragmented regulatory bodies which are currently different for each province. As interviewees’ expressed, these complexities become daunting to foreigners, especially U.S. - based ones and the cost of entry becomes significant relative to the opportunity to build significant share.” [11]

- Suggests that embedded commissions incent investment fund managers to rely more on payments to Dealers than on the generation of performance to gather and preserve assets under management. While mutual fund sales activities are regulated under “NI 81-105 Mutual Fund Sales Practices” our research indicates that in most cases, the portfolio managers that are employed by investment managers are paid a base salary and receive a bonus based on their performance, either relative to their Funds benchmark or to their peer group. In many cases, this bonus is paid on their Funds rolling one, three, and five-year periods, providing incentive to deliver strong long-term returns for investors. In other cases, portfolio managers are required to invest a substantial portion of their investible assets in the Funds they manage, to ensure they

[10] Tracey Lemay November 2015 Investment Executive DAC2015 Robo-advisors face challenges
[11] Strategic Insight Fee-based Report –Canada Winter 2017

are “on the same side” as their investors. Note that we have also seen several instances where any bonuses received by the portfolio managers are required to be invested in the funds they manage, and will not be accessible for a period of time, in some cases, as long as five-years out.

Evaluating the cost associated with investing is an important one. However, ultimately it must be investors who decide the distribution channel they deal with, the price that they are willing to pay for advice and the best method for them to pay for that advice. We believe that the CSA proposal will have a serious impact on wealth generation for Canadians. Embedded fees support a broad range of products and services for investors. Evidence from similar regulations in the UK and Australia suggests unbundling these fees led to increased financial advisor attrition and fewer financial services available to the average, mass-market investor (who didn’t meet asset thresholds). Both these outcomes represent the loss of sound, professional advice to the very people who needed it most.

We feel that regulation should encourage choice and apply equally to all Dealer and Investment Fund Management platforms.

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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 81-408
Consultation on the Option of Discontinuing Embedded Commissions

On behalf of Advocis, The Financial Advisors Association of Canada, we are pleased to provide our comments in regards to the Canadian Securities Administrators' ("CSA") Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the "Consultation Paper").

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1. INTRODUCTION AND EXECUTIVE SUMMARY

The CSA is contemplating bringing about nothing short of devastating change to the investment funds industry. Let us be clear in our position: we are opposed to the CSA's proposal to ban the embedded compensation option for retail investment funds. This is fundamentally an issue of consumer choice and fairness. We believe that the elimination of commissions by regulatory fiat would cripple the ability of low- and middle-income consumers to access financial advice.

Financial advice is of tremendous value to clients. Multiple studies have proven this fact conclusively. But to understand its value, the CSA must look not to traditional metrics such as *alpha*, the chasing of excess returns, or *beta*, portfolio construction and asset allocation. The value of advice is about *gamma*, the ability of an advisor to transform clients' ingrained savings apathy towards a forward-looking mindset of long-term investments. Despite the CSA's apparent dismissal of this skill based on the tone of its commentary on behaviour modification in the Consultation Paper, changing clients' predilections is an extraordinarily difficult task that the vast majority of investors cannot achieve alone.

Because of embedded commissions, financial advice is currently available to all investors, large and small. This is evidenced by data that shows the modest size of new advised investment accounts. It is true that not enough small investors are seeking advice, even when they feel they should; so the CSA should enact policies that would expand access, rather than restrict it. Advisors are currently willing to serve these small investors because of the cross-subsidization that embedded compensation allows, as well as the promise of growing future income streams that is only realized if the investor is successful as well.

The fact is that most low- and middle-income consumers are not willing to pay for advice directly. Without the benefit of the cross-subsidy, investors will be facing charges that effectively equate to hundreds of dollars per hour. Even if small investors are able to pay these fees, they would have to understand the value of financial advice to be willing to do so. But financial advice is a credence good by nature, so its value is not easily discernible to an individual investor – particularly as its benefits cannot be nailed down at any particular moment in time and only become apparent, in hindsight, after years or decades of committed use. So eliminating commission compensation means that these investors will not have access to advice, and will miss out on the benefits of the gamma factor.

So the elimination of commissions will orphan millions of small consumers. The CSA should not count on banks or fintech filling in the gap. And the CSA's fixation on passive investment strategies based on low costs alone evinces its outdated emphasis on alpha as the value of advice; its desire to see a wholesale shift to passive products could create serious implications for the capital markets, including in regards to market efficiency and price discovery.

The CSA should also be cognizant that direct-pay arrangements are no panacea. No compensation scheme is behaviourally-neutral: they each carry their own set of challenges. We have recently seen an outcry in popular media against the questionable sales techniques of employees at large, vertically-integrated firms incented by proprietary product sales targets and the constant threat of dismissal for failure to hit revenue targets. Yet the elimination of commissions would suffocate the independent channel that competes with, and counter-balances the influence of, vertical firms and it would give even more leverage to the latter.

Ultimately, we understand that the CSA is motivated by its honest and forthright goal of improving investor protection. But the CSA's focus on commission compensation, and the deleterious effects it can have, is too narrow and its proposed solutions would cause more harm than good. At the same time, we recognize that the gamma factor is grounded in the trust clients place in their advisor – so advisors must be worthy of that trust, and it is our collective responsibility to ensure that is the case.

We believe the better way forward is to professionalize advice so that consumers can be assured that their trust is well-placed. Financial advisors are most consumers' sole interface with the entire financial services sector. So they are also the key consumer safeguard. It is time to elevate financial advice to a profession – by raising proficiency standards across the board and re-aligning the regulation of advice so that it accords with the modern consumer's perspective, we could solve more consumer protection issues, more dynamically and effectively than prescriptive regulation ever could.

Professional advisors must be involved in their own regulation and, as professionals, must be subject to the highest of standards – including a duty to act in their clients' best interests. In doing so, we can preserve choice and access to advice for all investors, regardless of their wealth, while increasing the quality of the advisory relationship that is so critical to achieving financial independence.

2. ABOUT ADVOCIS

Advocis is the association of choice for financial advisors and planners. With more than 12,000 members across the country, Advocis is the definitive voice of the profession, advocating for professionalism and consumer protection. Our members are provincially licensed to sell life, health and accident and sickness insurance, as well as by provincial securities commissions as registrants for the sale of mutual funds or other securities. Members of Advocis are primarily owners and operators of their own small businesses and create thousands of jobs across Canada. Advocis members provide advice in a number of key areas, including estate and retirement planning, wealth management, risk management, tax planning, employee benefits, critical illness and disability insurance.

Professional financial advisors and planners are critical to the ongoing success of the economy, helping consumers to make sound financial decisions that ultimately lead to greater financial stability and independence both for the consumer and the country. No one spends more time with consumers than financial advisors, educating them about financial matters and helping them to reach their financial goals. Advocis works with decision-makers and the public, stressing the value of financial advice and striving for an environment in which all Canadians have access to the advice they need.

3. A Looming Retirement Crisis

Canadians are living longer, but they are not saving sufficiently

As the CSA is aware, Canada faces a looming retirement crisis. By 2031, life expectancy is expected to be about 82 years for men and 86 years for women,[1] up sharply from 69 and 76 years, respectively, in 1970.[2] But only about 70 to 80 of those years are expected to be in "good health",[3] meaning that private spending on medical and home care services are poised to skyrocket. At the same time, there has been a major drop off in the proportion of the public that is covered by a workplace pension: now, only about 25% of private sector employees have a workplace pension,[4] with defined contribution plans being the dominant option for new entrants.

These demographic and structural changes mean that consumers will need to rely on the accumulation of voluntary savings, in greater amounts and for a longer duration than ever before. Consumers now bear the challenge of market, inflation and longevity risks. But consumers are ill-equipped to deal with these challenges alone, as financial literacy is poor amongst the general public – which is a problem that is not unique to Canada.[5] Public financial education is helpful, but it is clear that educational campaigns alone will not suffice.

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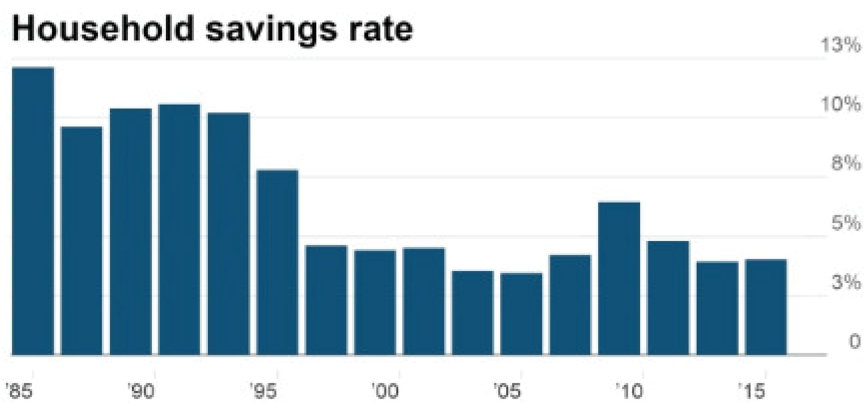
[1] Statistics Canada, Canadian Demographics at a Glance. Catalogue 91-003 Ottawa: 2008.
[2] Statistics Canada, CANSIM Table 102-0512 and Catalogue no. 84-537-XIE.
[3] Statistics Canada, CANSIM Health-adjusted life expectancy, at birth and at age 65, by sex and income group, Canada and provinces.
[4] Statistics Canada, Pension plans in Canada. Available at: http://www.statcan.gc.ca/daily-quotidien/110509/dq110509a-eng.htm.
[5] Surveys conducted in OECD countries and some non-OECD economies show that not only do consumers have low levels of financial literacy preventing them from making good and informed financial decisions, but they also often overestimate their

On the whole, Canadians have demonstrated poor financial discipline: according to Statistics Canada, the national saving rate is just 4.5%, which is near 30-year lows. At the same time, debt levels have reached record levels, exceeding $2 trillion nationally, mostly consisting of mortgage loans and consumer credit.



Source: Statistics Canada

As a result, most Canadians are alarmingly ill-prepared for retirement. A recent Broadbent Institute study found that nearly half of Canadians aged 55 to 64 who are without an employer pension plan have accumulated a "wholly inadequate" amount of retirement assets.[6] Specifically, retirement assets amounted to only $250 on average for those earning between $25,000 and $50,000, and $21,000 for those with incomes in the $50,000 and $100,000 range. Across the whole group, the median level of savings was only $3,000. Fewer than one in five people who do not have an employer pension have enough to live in retirement for five years or more.

It is plainly obvious that regulators and policy makers must contemplate action that can reverse this disturbing trend and set Canadians on a path towards greater wealth accumulation.

Retirement wealth is built on investments, not savings alone

The traditional line of thinking is that saving for retirement means just that – starting early and putting little by little into "safe" deposit accounts or GICs. Retirement funds are thought to be a nest egg that should largely be shielded from market risk. But this cannot be the case in a sustained

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financial skills, knowledge and awareness. See: *Financial Literacy and Consumer Protection - Overlooked Aspects of the Crisis*, OECD 2009.

[6] Richard Shillington, *An Analysis of the Economic Circumstances of Canadian Seniors*, Broadbent Institute, February 2016.

low interest rate environment. Instead, to achieve retirement savings targets, consumers must have an appetite for bearing some risk. After all, the real risk facing most Canadians is not losing money from investments over a long time horizon, but running out of money in retirement.

Average Real Return from 2005-2014			
	Nominal Return	**CPI (Inflation)**	**Real Return**
1-Year GIC	1.40%	1.81%	-0.41%
3-Year GIC	1.85%	1.81%	0.04%
5-Year GIC	2.28%	1.81%	0.47%

Source: Ratehub.com

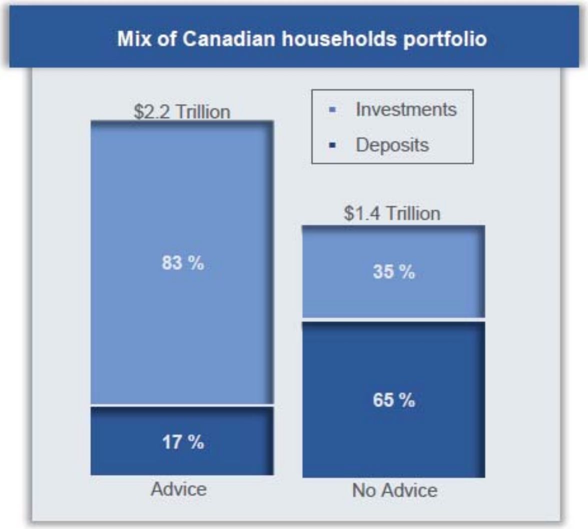
Recent studies have established that the causal factor for rising wealth is the rising value of investments, not income from labour.[7] When it comes to the success of those investments, the key driver is the allocation of savings between "riskless" assets (such as treasury bills, government bonds or GICs) and "risk bearing" assets (such as mutual funds): it is the choice of risk bearing assets that is responsible for higher returns in investor portfolios.[8]

Consumers are risk averse

The problem is that, generally, people are naturally risk averse and are prone to weigh potential losses more than gains.[9] They are reticent to wade into the capital markets alone: without professional assistance (particularly as financial literacy levels are so low), uncertainty and potential losses are magnified. Downside risk looms large over the benefits of investing in the market, the latter of which are only realized years and decades later, which leads to the further discounting of its potential benefits when investing decisions are made today.

This is evidenced in a recent Pollara report that indicates investors would have very limited confidence choosing mutual funds without the help of an advisor. The majority (56%) say they would feel "not very confident" or "not confident at all" without professional assistance.[10] Consequently, it is no surprise that non-advised consumers hold a disproportionate share of their assets in deposit instruments rather than investments, relative to consumers receiving financial advice.

[7] Thomas Piketty, Emmanuel Sary, Gabriel Zucman, *Distributional National Accounts: Methods and Estimates for the United States*, NBER Working Paper no. 22945, January 2017.
[8] Thomas Piketty, *Capital in the Twenty-First Century*, Harvard University Press, 2014.
[9] Ito, T. A., Larsen, J. T., Smith, N. K., & Cacioppo, J. T. (1988). *Negative information weighs more heavily on the brain: The negativity bias in evaluative categorizations*, Journal of Personality and Social Psychology.
[10] *Infra*, note 15.



Source: Investor Economics, 2015 Household Balance Sheet Report

This is disastrous to wealth accumulation in the long run. By keeping such a large proportion of their assets in low-return deposit instruments, non-advised consumers are poised to see the value of their savings eroded by inflation and they will miss out on the critical investment growth that is needed to sustain their lifestyles in retirement.

<u>Only professional financial advice can stem the crisis</u>

Given the facts above, we believe it is unreasonable to expect most consumers to manage their retirement needs by themselves. In fact, research estimates that only 6% of Canadian investors meet the criteria required to be successful at being their own financial advisor.[11] At the same time, there is clear proof – detailed in Section 5 below – that accessing professional financial advice materially improves investor outcomes, which includes providing investors with the confidence that is necessary to invest in the risk-bearing assets that are crucial to wealth accumulation. **Therefore, to enact a regulatory regime that deprives consumers of professional assistance in managing their financial affairs is nothing short of putting the public's retirement security at risk.**

High net worth investors have the means to access professional financial advice, regardless of what compensation structure is mandated by regulators. Those consumers at the very lowest levels of

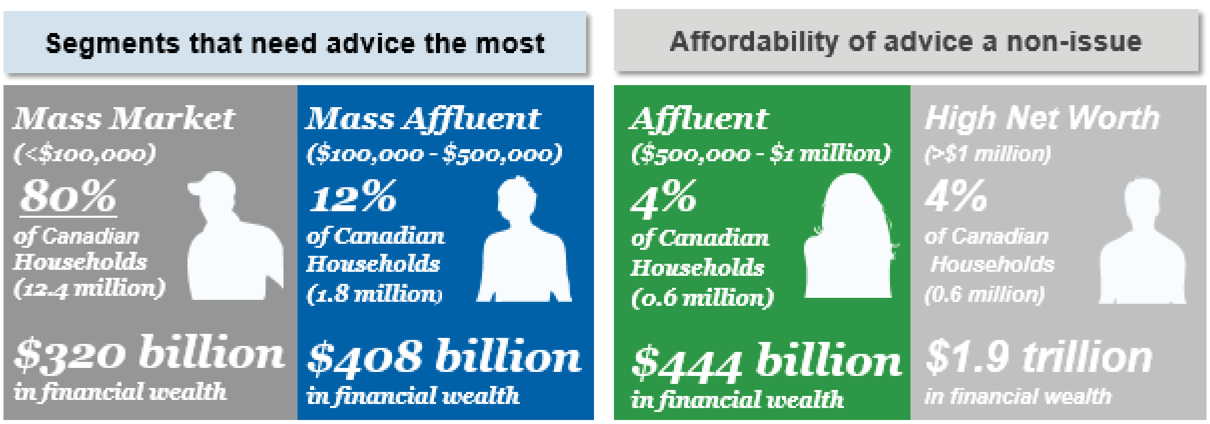
[11] Claude Montmarquette and N. Viennot-Briot, *Econometric Models on the Value of Advice of a Financial Advisor*, Le Centre interuniversitaire de recherche en analyse des organisations, July 2012 (hereafter, "2012 CIRANO Report"). In the 2012 CIRANO Report, investors meeting this criteria are described as those who identify themselves as their own main source of investment information and capable of self-managing their investments by exhibiting greater levels of education, income and financial literacy.

income and wealth are reasonably covered by social programs, such as CPP/QPP, OAS and GIS,[12] which largely replace their levels of pre-retirement income – although they too would benefit from professional advice. But the cohort most at risk of poor post-retirement financial outcomes are those with middle- and upper-middle levels of earnings and wealth.[13]

In the face of this looming crisis, it is clear that Canadians need more and better access to professional financial advice, not less. Regulatory policy must reflect this.

4. A SNAPSHOT OF THE MARKET TODAY

Let us provide a snapshot of what the market for financial advice looks like today. Of about 15 million Canadian households, about 80% have less than $100,000 in investible assets – this segment is commonly referred to as the "mass market". Despite representing the vast majority of households by number, they represent only about 10% of Canadian household financial wealth.



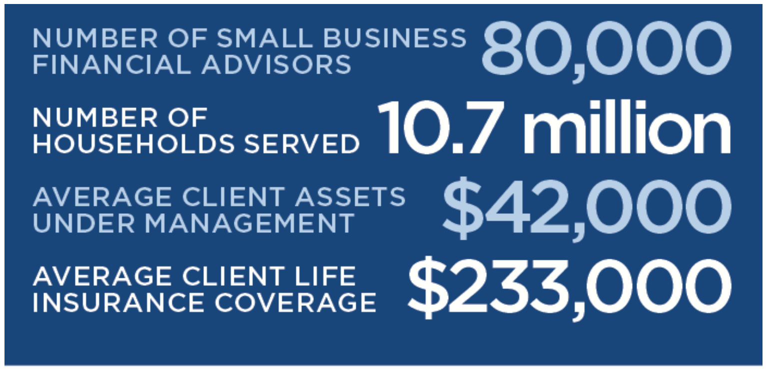
Source: Strategic Insight

Advice is accessible to small investors today

Today, mass market households that seek financial advice are able to obtain it. In fact, according to The Investment Funds Institute of Canada ("IFIC"), half of all mutual fund investors have less than $25,000 when they first engage an advisor.[14] And one third of all clients with advisors start with less than $10,000 to invest.[15] According to Strategic Insight, small-business financial advisors have

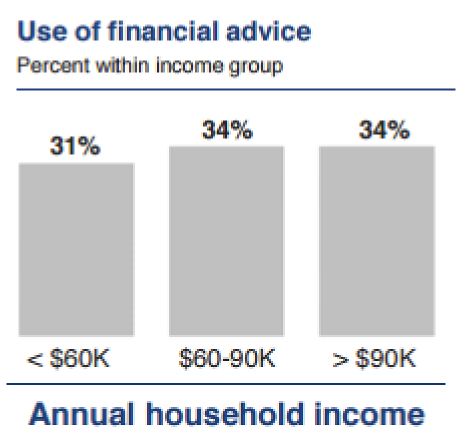
[12] Stephen Gordon, *If it isn't broken…*, National Post, June 21, 2016.
[13] Bob Baldwin, *Assessing the Retirement Income Prospects of Canada's Future Elderly: A review of Five Studies*, C.D. Howe Institute, September 2016.
[14] The Investment Funds Institute of Canada, *Industry Statistics*, available at: https://www.ific.ca/en/stats/.
[15] Pollara Research, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry 2016*.

tremendous reach: they serve nearly 11 million households and the average client asset balance is only $42,000. This is in large part due to the ability of consumers to choose the advisory business model that works for them, which often includes the embedded compensation structure.



Source: Strategic Insight

From the advisor's perspective, the embedded compensation structure promises a continuing income stream which will grow as clients accumulate assets over time. Although smaller investors are not usually profitable to advisors at the initial stages of the relationship, the cross-subsidization allowed by embedded compensation (discussed further in Section 6 below) makes it viable for the advisor to invest resources in taking on the client and fostering a relationship. This arrangement allows for a salutary alignment of interests, as both the client and the advisor benefit from the growth of the portfolio and both have an interest in a stable, long-term successful relationship.



Source: Ipsos-Reid survey, 2014

There is tremendous value in financial advice. We will discuss this value in detail in Section 5. But as we do so, we ask the CSA to consider that, given the tremendous value of advice, isn't the 1% trailer commission of a typical equity mutual fund[16] (or about $420 a year for the average client, based on the $42,000 average account size) that covers *both* dealer and advisor compensation a tremendous bargain for professional advice?

Despite its accessibility, not enough consumers access advice today

In a survey by the Financial Consumer Agency of Canada,[17] 27% of consumers did not seek financial advice even though they felt that they should have. Only 8% reported always seeking financial advice when they felt it was needed. This is an alarming result which suggests that policymakers should foster an expanded role for professional advice, not less.

In the Consultation Paper, the CSA acknowledges that those with less than $100,000 to invest are already underserved in the market, and concedes that "independent fund dealers may choose not to continue to service these households" if commissions are eliminated.[18] Given the tremendous value of advice that is detailed in the next section, we urge the CSA to be very careful in considering whether the elimination of commissions is in the best interests of mass-market consumers.

5. THE VALUE OF FINANCIAL ADVICE

What modern financial advisors do (and don't do)

In participating in many consultations with regulators, politicians and consumer groups, what we have come to realize is that there is a misunderstanding of what exactly it is that modern financial advisors actually do.

Traditionally, financial advisors were seen as providing two key services for their clients:[19]

Seeking *alpha*, excess returns relative to a benchmark. Described in a layperson's terms, this is stock picking. Outdated depictions portray individual stockbrokers as the go-to person for insights on the next "sure thing", but this just doesn't happen today. The search for superior returns

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[16] Investor Economics, *Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives*, September 2012.
[17] Financial Consumer Agency of Canada, *Payday Loans: Market Trends*, October 25, 2016. Available at: https://www.canada.ca/content/dam/fcac-acfc/documents/programs/research-surveys-studies-reports/payday-loans-market-trends.pdf.
[18] Consultation Paper at p.62.
[19] Henri-Paul Rousseau, *Why Banning Embedded Sales Commissions Is a Public Policy Issue*, The New Paradigm of Financial Advice Conference: Toronto, March 31, 2017.

through active means is now an incredibly complex matter, built on research reports, quantitative analysis and sophisticated algorithms, with the data parsed by entire teams of analysts.

Asset allocation and portfolio construction. This is a technical task to ensure that an investor's portfolio is adequately diversified in line with the investor's risk tolerance, liquidity needs and long-term financial goals. Portfolio optimization work is also largely the domain of computer automation today.

So neither of these traditional services are particularly dependent on the advisor any longer. Instead, the key value that advisors create has to do with **behaviour modification**: advisors can create a real and measurable shift in client behaviour towards prudent long-run financial planning, saving and (critically) investing that sets clients on the right path towards retirement readiness. This view is borne out by a 2015 survey of investors working with a financial advisor, which found 88 per cent of respondents see their advisors more as advice and guidance providers than as salespeople.[20]

This behavioural change has been called the *gamma factor*[21] by commentators. It is not one single action, but the culmination of day-to-day behaviours driven by a holistic and mutually accountable relationship between the client and advisor over the course of many years. The gamma factor is not an effect that is observable instantly, but one that strengthens over course of time, and it is difficult to capture the impact of any one particular action at the time it is undertaken. But the sum of these shifts brought about by the advisor's work creates **real and significant** benefits to client welfare.

The CSA seems reticent to acknowledge the value of behaviour modification in the Consultation Paper; in casually dismissing the CIRANO Studies,[22] the CSA states that the superior outcomes enjoyed by advised clients are "not [brought about] by better returns due to advisor skill".[23] This is a very unfortunate and narrow view, exposing the regulators' improper focus on alpha as its chosen, yet flawed, metric to judge value.

We firmly argue that behaviour modification is a skill, and a very difficult one to achieve at that. Changing the public's natural disposition from apathy and present consumption and convincing them to delay gratification, save and invest for the future is a daunting task – particularly when the benefits of doing so are decades down the road and are not guaranteed. We note the OSC itself has recently published Staff Notice 11-778 *Behavioural Insights: Key Concepts, Applications and*

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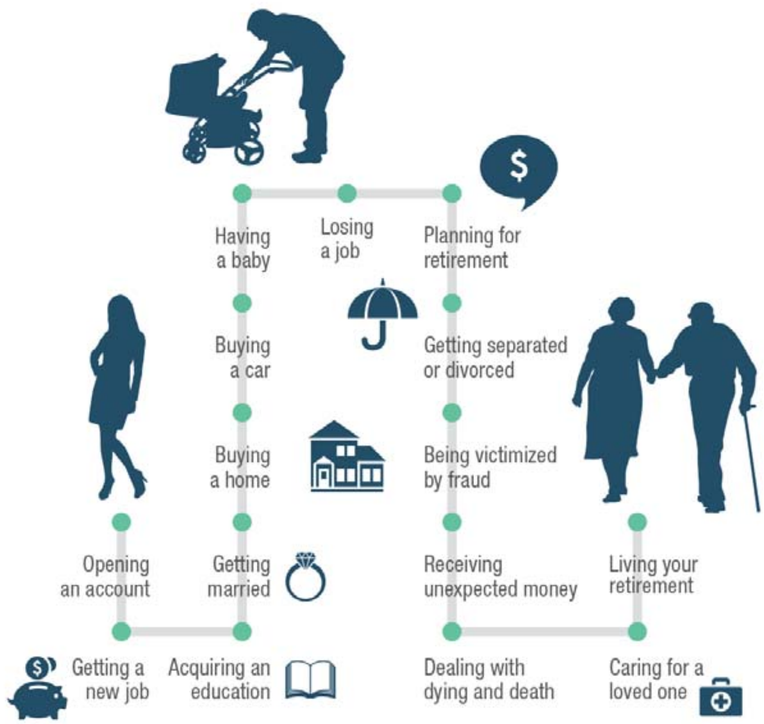
[20] Advocis, *Investor Insights on the Financial Advice Industry*, November 2015. Available at: http://www.advocis.ca/pdf/Consumer-Voice-2015.pdf.
[21] See, for example, Morningstar Investment Management, *Alpha, Beta and now…Gamma*, 2013.
[22] *Infra*, note 39.
[23] Consultation Paper at p. 126.

Regulatory Considerations,[24] a report detailing how leading practitioners and regulators around the world are using behavioural insights to address capital markets issues and improve outcomes for investors. The report highlights how investors are prone to make irrational decisions based on emotions and other psychological factors.

This includes the common problem of recency bias, the assumption that what has occurred recently will continue to do so indefinitely; this bias causes ill-advised investors to liquidate their portfolios at the bottom of a financial crisis, buy individual stocks at a market peak after they've become popularized 'media darlings', or assume that certain asset prices (such as housing) will rise forever. We know how disastrous irrational emotion-driven investing decisions can be, and how many investors will never recover from them.



Financial advisors help clients ensure they are financially prepared for life's events.

The authors of *Nudge*, a leading book on behavioural economics, opine that standard theories about retirement savings are based on two incorrect assumptions: that investors are able to calculate how much they need to save for retirement, and that they have the willpower to stick to

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24 OSC Staff Notice 11-778, *Behavioural Insights: Key Concepts, Applications and Regulatory Considerations*. Available at: https://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20170329_11-778_behavioural-insights.pdf

their plan – day to day, and even in the face of crisis. They argue that neither is generally true.[25] An advisor's ability to overcome these real, and major, behavioural deficiencies and set investors on a steady path towards retirement security is the key component of the gamma factor.

Trust drives the gamma factor

What drives advised consumers to overcome their natural predisposition against long-term thinking and complex-sounding risk-bearing assets? It is the trust forged between client and advisor. In fact, consumers cite 'trust' as the most important factor in seeking a financial advisor,[26] with evidence showing that households with lower financial capability need to trust their financial advisor in order to invest in risky assets.[27] Further, the level of trust consumers express about advisors increases after actually working with an advisor by about 30%,[28] demonstrating the positive outcomes that consumers enjoy from the experience.

Trust can only be forged between an advisor and client through a holistic relationship – not a transactional one. Perhaps once, advisors were primarily seen as a gateway to product. But today, if access to product is all that consumers are looking for, it is far easier to simply transact directly with a manufacturer on the internet.

Indeed, the primary role of the *modern* advisor is to offer holistic financial guidance to clients through relationships that last years or even decades. These relationships ensure clients' financial preparedness for life's major events – such as marriage, home ownership, the raising of children, and even death, through trust and estate matters, and it is through these experiences, shared over many years, that trust is created. Without trust, the gamma factor cannot be realized.

The CSA's focus on alpha is wrong

Part of the CSA's reasoning behind its proposal is based on the impact of embedded commissions on alpha as suggested by the Cumming Report.[29] We have attempted to make clear throughout this submission that regulators' focus must not be on seeking alpha, which is not the value of the

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[25] Richard H. Thaler and Cass R. *Nudge: Improving Decisions about Health, Wealth, and Happiness*, Sunstein, Penguin Books, 2009.
[26] Jeremy Burke and Angela A. Hung, *Trust and Financial Advice*, RAND Corporation, January 2015.
[27] Dimitris Georgarakos and Roman Inderst, *Financial Advice and Stock Market Participation*, Goethe University, 2014.
[28] 2012 CIRANO Report at p.36.
[29] Douglas Cumming, Sofia Johan and Yelin Zhang, *A Dissection of Mutual Fund Fees and Performance*, February 8, 2016. Available at: https://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_dissection-mutual-fund-fees.pdf (hereafter, the "Cumming Report").

modern advisor, but on gamma. To focus on the former is to miscast the role of the advisor as a transactional processor, rather than as a trusted guide in a longstanding relationship.

This improper focus on alpha explains why it is inappropriate to use flow of funds studies, like the Cumming Report, to judge whether an advisory relationship delivers value. Flow of funds studies focus on actions in the *aggregate*, so they will haphazardly suggest that advisors are initiating the 'wrong' flows when they are doing precisely the things they are supposed to be doing at the *individual* client level, such as rebalancing portfolios by selling assets which have gained in value and now represent an overweight position for a client.

What the Cumming Report tells us is that sales under fee-based models are more sensitive to past performance than under the embedded commission model. But we cannot discern the reasons why this is so. Only by studying actions at the account level can we know whether this is because fee-based advisors are chasing past performance or whether, perhaps, the commission-based account is pursuing an accumulation strategy, such as is often seen with pre-authorized contribution plans.

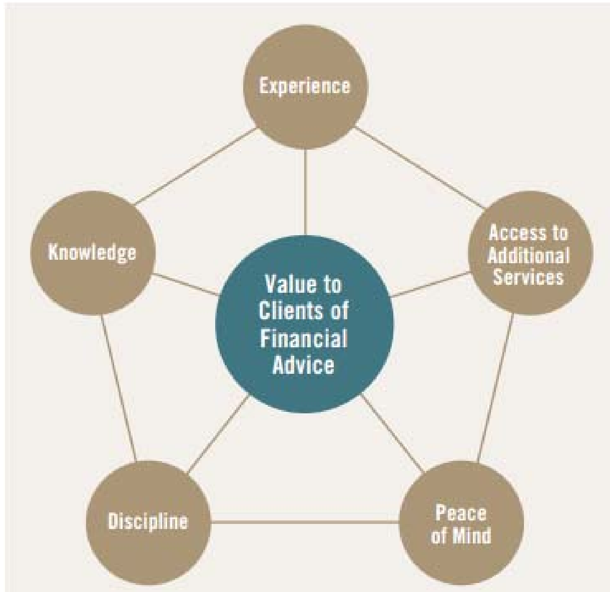
Because of the limitation of aggregate data, no study of fund flows can capture the investor experience and explain how compensation structures impact, at the client level, the ability to achieve financial objectives related to wealth accumulation, diversification, risk tolerance, tax strategies and so on. Critically, no flow of funds study can analyze long-run investor outcomes.

The qualitative components of the gamma factor

In developing the relationship of trust, advisors provide their clients with (*inter alia*):

- Knowledge – including an understanding of financial instruments, investment strategies, and insurance products;
- Experience – on market trends and behaviours, including on the nature of economic cycles;
- Discipline – through savings and investment behaviour, helping clients stay on plan during volatile markets;
- Peace of mind – evidenced by consumers' high levels of trust, satisfaction and confidence in their financial advisors; and
- Access to additional services – with tax strategies warranting particular mention given the huge importance of taxation in financial planning.[30]

[30] PricewaterhouseCoopers LLP, *Sound Advice: Insights into Canada's Financial Advice Industry*, July 2014. Available at: http://www.advocis.ca/sareport.pdf.



Source: Sound Advice

These salutary benefits manifest themselves in many ways.

Advised households are more likely to have, and stick to, a financial plan. According to IFIC's 2012 *The Value of Advice Report*,[31] investors with financial advice are more than 1.5x more likely to maintain a long-term investment strategy relative to those without financial advice. And investors with a written financial plan are almost twice as likely to rebalance appropriately during a bear market than investors without a written plan. Having a financial plan creates a critical accountability mechanism that makes achieving long-run financial goals more realistic.

Advisors help consumers invest confidently. In the 2016 IFIC/Pollara Investor Survey,[32] respondents said that they would have limited confidence choosing mutual funds without the help of an advisor. The majority (56%) say they would feel 'not very confident' or 'not confident at all', while only 3% would feel completely confident. A separate report prepared for the Financial Consumer Agency of Canada found that "financial confidence has important effects on retirement preparedness among seniors and near-seniors" but that "high knowledge alone is not enough to lead to financially desirable behaviours."[33] Given the importance of investing in risk-bearing assets

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[31] https://www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650/.
[32] https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/.
[33] The Social Research and Demonstration Corporation, *The role of financial literacy in financial decisions and retirement preparedness among seniors and near-seniors*, May 2016.

to retirement readiness, advisors are a crucial link in enabling access for mass market consumers to the growth potential of investments.

Advisors help reduce consumer anxiety about money. A 2014 survey of Canadians by Leger Marketing found that financial anxiety is the number one source of stress.[34] In the study, 42% ranked money as their greatest stress, far more than work (23%), personal health (19%) or relationships (17%). 87% of respondents wished they had made better financial decisions earlier in life, including saving and investing more. A separate study found that those who engage with a financial advisor have a significantly higher overall sense of financial well-being[35] and are more likely to experience positive emotions about their finances.

The result is retirement readiness. Research reveals that having a financial advisor makes a major impact on retirement readiness. A study by McKinsey and Company shows that households that do not have an employer pension plan, but are nevertheless on track to maintain their standard of living in retirement, are twice as likely to use financial advice (49% use rate) compared to those households that are not on track (27% use rate).[36]

And according to the Financial Consumer Agency of Canada's *Canadian Financial Capability Survey*,[37] retirees who frequently sought financial advice reported a standard of living that met or exceeded their expectations at a higher rate than those retirees who did not seek advice; and near-retirees (defined as working Canadians aged 55 or greater) who frequently sought advice on financial matters reported higher levels of assets in their RRSPs, TFSAs, and other account balances. Consumers overwhelmingly credit their advisors for these positive outcomes, with 82% saying that advisors are responsible for helping them achieve their savings and investment habits.[38]

The value of advice, quantified

These qualitative benefits translate into quantifiable impacts on client wealth accumulation. According to the updated 2016 CIRANO Report,[39] advice has a positive and significant impact on wealth accumulation, relative to non-advised persons. Households with four-to-six year long

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[34] http://www.fpsc.ca/news/publications-research/how-is-financial-stress-affecting-canadians.

[35] John Ameriks, Andrew Caplin and John Leahy*, Wealth Accumulation and the Propensity to Plan*, Quarterly Journal of Economics (2003); and Annamaria Lusardi, *Explaining why so many households do not save*, University of Chicago (2000).

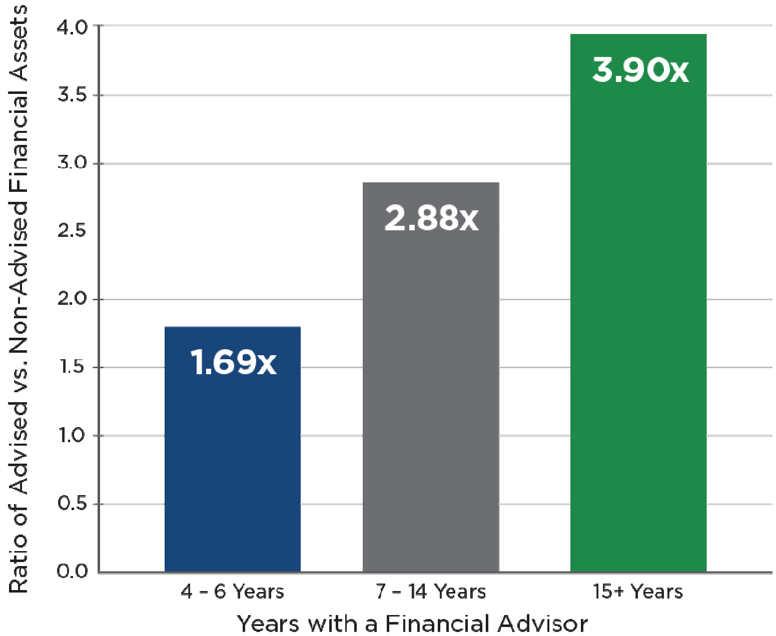
[36] McKinsey & Company, *Building on Canada's strong retirement readiness*, 2015.

[37] Simhon, Y, *Financial Literacy and Retirement Well-Being in Canada: An Analysis of the 2014 Canadian Financial Capability Survey*. Paper presented at the 50th Annual Conference of the Canadian Economics Association, Ottawa, Canada (June 2016).

[38] Pollara, *Mutual Fund Investors Perceptions of Mutual Funds and the Mutual Fund Industry*, 2016.

[39] Claude Montmarquette and Nathalie Viennot-Briot, *The Gamma Factor and the Value of Financial Advice*, CIRANO, August 2016 (the "2016 CIRANO Report", and together with the 2012 CIRANO Report, the "CIRANO Studies").

advisory relationships accumulated 69% greater assets, and households with 15+ year advisory relationships accumulated 290% more assets, relative to non-advised peer households.



Source: The Gamma Factor and the Value of Financial Advice, CIRANO, August 2016

Vanguard, the major fund manufacturer that is known for championing a low-fee message, conducted its own study which found that financial advice creates real value.[40] It found that, over time, advisors add about 3 percentage points of value in net portfolio returns per year. More importantly, Vanguard sees meaningful value in the behavioural coaching (or gamma) element of an advisor's work – so even after accounting for the fees that necessarily must be paid to an advisor (as no professional works for free), there is additional value for investors when they obtain professional advice.

The 2016 CIRANO Study considered an additional intriguing variable: what happens when households with financial advice discontinue their use of that advice, and branch out on their own? Does the behavioural coaching learned from their time with an advisor persist beyond that relationship? That is, once the behaviour is learned, can it be retained by investors acting alone?

[40] Vanguard Canada, *The added value of financial advisors*, May 2015. Available at: https://www.vanguardcanada.ca/documents/added-value-of-advisors.pdf

Simply, no. Between 2010 and 2014, households that discontinued the relationship with their advisor accumulated 45% less additional assets than households who continued their relationship.[41]

From this, it is clear that the gamma factor is not a one-time event that, once experienced, forever alters the client's behaviour for the better. Instead, the advisor's work must be ongoing, continuously pushing back against human inclinations (of excessive present consumption, poor savings discipline, costly emotional investing decisions and so on) that would undo the good work achieved during the advised period – the advisor is providing value in every year of the relationship. This finding also explains why the positive impact of financial advice, as quantified in the CIRANO Studies, grows in magnitude with the duration of advice.

6. WHY EMBEDDED COMPENSATION MUST BE PRESERVED AS AN OPTION

If the CSA were to discontinue embedded commissions, we argue that a sub-optimal number of consumers would be willing to pay for financial advice because they are unable to properly value that advice. This will result in materially worse outcomes for consumers.

The nature of financial advice

The oft-cited and common sense argument against embedded commissions is that if it has value, consumers should be willing to pay for it. The idea is that financial advice should not have to be embedded in the 'actual' product that consumers are purportedly seeking (the underlying financial product) – it should be able to stand on its own as a valued service, garner its own consumer demand, and carry its own price. To embed it within a financial product is perceived as a deceptive sales practice, with the idea that consumers are forced to purchase it because it is intertwined with the product they are actually seeking.

This argument does not hold with financial advice. Consumers will not pay directly for financial advice because it is a *credence* good. Pierre Lortie explains the fundamental difference between credence goods and other goods as follows:

> In economic terms, "credence goods" differ from "experience goods" and "search goods." A search good is a product or service with features and characteristics that can be easily evaluated before purchase. An experience good is a product or service where the characteristics and features are assessable, but only after consumption or use. In the case of a credence

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[41] *Supra*, note 39.

> good, its "utility" is difficult if not impossible to ascertain even after consumption. [42]

What makes financial advice a credence good is that the value of advice is realized over a very long timeframe – for many consumers of advice, all the way through retirement and the de-accumulation phase – and this long horizon means that its consumers receive feedback about its impact at low frequencies.

It is very difficult for consumers, making decisions today, to value something whose benefits are abstract, delayed in time, and not even necessarily understandable (at the individual level) in hindsight; after all, how do consumers assess what their comparative financial situation would have been had they *not* engaged an advisor? While large, econometric studies such as the CIRANO Studies tell us definitively that accessing advice drives wealth at the aggregate level, there is no way for any single consumer to know exactly how advice may or may not have impacted their individual situation and outcome.

Confronted with this uncertainty, studies have demonstrated that a large proportion of individuals will shun financial advice if they are required to pay directly for it.[43] Consumers are reluctant to pay up-front for advice because they do not want to lock in a guaranteed loss (*i.e.* the payment of direct fees for advice) when they cannot adequately judge the value they are receiving in exchange. This skepticism is the rational consumer response to a credence good, but it is not the optimal response for consumers as a whole, over the long run.

Embedded compensation is an effective mechanism for fostering greater access to credence goods that consumers would otherwise under-subscribe to in a direct pay model. By eliminating the large psychological barrier of a direct-pay requirement, and financing the benefit of the gamma factor (the ongoing nature of which is proven by the outcomes of households who discontinued use of their advisor in the 2016 CIRANO Study) though trailers, this model allows skeptical consumers to get at least partial feedback on their own value of advice as they pay for it on an incremental basis. In doing so, this model aligns payments with the periods where the benefit is received and promotes the accessibility of advice to the lower- and middle-income price-sensitive consumers that need it most.

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[42] Pierre Lortie, *A Major Setback for Retirement Savings: Changing How Financial Advisers are Compensated Could Hurt Less-than-Wealthy Investors Most* (April 1, 2016). SPP Research Paper Vol 9, Issue 13, 2016. Available at: https://ssrn.com/abstract=2804696.

[43] N. Chater, R. Inderst and S. Huck, *Consumer decision-making in retail investment services*, Report to the European Commission (SANCO), 2010.

Embedded commissions also encourage the development of a diverse and vibrant horizontal industry structure, where manufacturers distribute their financial products through unrelated financial intermediaries. This promotes market transparency and competition at both the product and distribution levels.

<u>This is ultimately about freedom of choice</u>

We do not believe that the embedded commission model is right for everyone. Depending on an individual investor's needs and size of portfolio, a direct-pay model may be more appropriate. Generally speaking, once an investor achieves a sizeable portfolio (typically $250,000 or more), an investor should consider whether moving to a different service model makes sense for them.

But we absolutely disagree with a notion that the embedded commission option should be eliminated by regulatory decree so that all investors are forced into a direct pay model. The significant and proven benefits of the gamma factor should not be restricted to the wealthy who can afford a direct-pay model. Let *all* investors benefit from advice, and when their assets have grown to a size that can support other payment models, let consumers decide what is best for them.

Eliminating embedded compensation would also run counter to public opinion. A 2015 survey by PMG Intelligence found that 88% of consumers want to preserve choice in how they pay for advice, 88% feel that losing choice would negatively affect them personally and 85% feel that governments should not implement changes in how they do business with their advisor.[44]

A separate survey found that a majority of investors with advisors (54%) prefer to pay their advisor through embedded fees, with 37% choosing to pay directly in some form.[45] The point is that regulators should preserve consumer choice: not only is it beneficial for consumers' financial outcomes, it is also what consumers themselves want.

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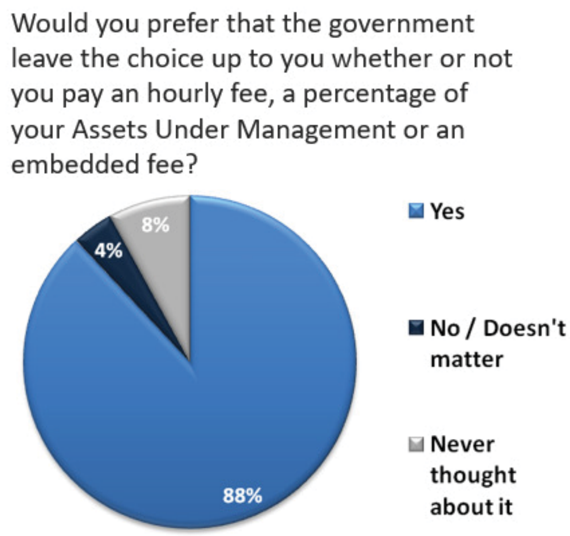
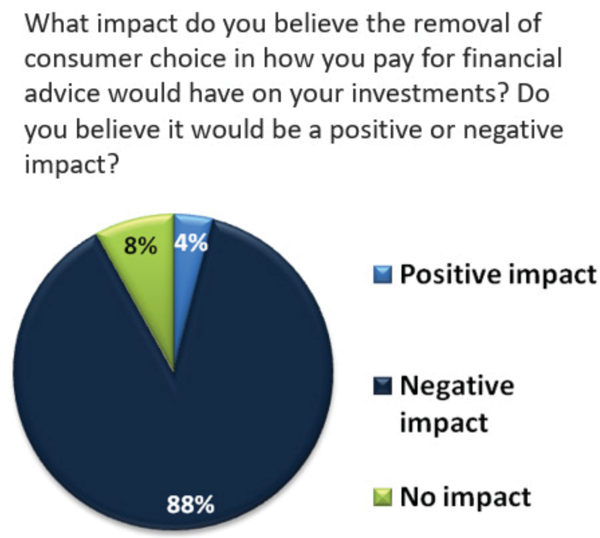
[44] PMG Intelligence surveyed 1,739 Canadian investors with a financial advisor between January and March 2015. The study has a margin of error of +/- 2.35% at a 95% confidence interval.
[45] *Supra*, note 15.





Source: PMG Intelligence

Source: PMG Intelligence

7. <u>Problems Arising From A Commissions Ban</u>

Implementing a ban on embedded commissions would create several serious problems – impacting small investors, the competitive vitality of stakeholders, and the stability of the market as a whole.

Recently, The Honorable Joe Oliver, former federal Minister of Finance, stated that "the decision raises a broader issue: the overarching need for balance in regulating our capital markets."[46]

In his view, a commissions ban would "undermin[e] the competitive structure of the securities industry, shrinking the weakening independent brokerage sector even further." He adds that "[h]owever well intentioned, excessive regulation inflates costs, undermines efficiency, impairs competitiveness and can have uneven, unintended and perverse results."[47]

Below we detail several of these perverse results.

<u>The loss of the cross-subsidy means a focus on high net worth clients</u>

The CSA has repeatedly asked why the elimination of embedded compensation would restrict access to lower-income consumers. During the April 11, 2017 session on the Consultation Paper hosted by the OSC, OSC staff questioned why servicing small investors would not be economically viable in a post-commission world. The reason is that, under the embedded compensation mechanism, wealthier investors with larger portfolios subsidize access to advice for investors with smaller portfolios.

While the time and effort required to service larger, more sophisticated portfolios is greater than that required to service smaller portfolios, the increase is not necessarily linear. Instead, servicing every client requires a certain 'core' level of service (such as fulfilling know-your-client and anti-money laundering requirements) and the attention required to address specialized needs stemming from larger portfolios may not be as demanding on a proportionate basis.

By receiving a relatively large amount of compensation from clients with larger portfolios, advisors are able to provide service to clients with smaller portfolios – with the shared goal of helping that smaller investor become a larger investor as well, over time. Policy-wise, there is nothing inherently wrong with cross-subsidization. For example, Canada boasts a progressive income tax system, where large taxpayers allow small earners to pay lower amounts of, or even no, income tax; and public schools are funded by the taxes of those with or without children, not only by parents utilizing the infrastructure.

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[46] Joe Oliver, *Banning embedded mutual fund fees will only hurt the investors we should be helping*, Financial Post, April 17, 2017. Available at: http://business.financialpost.com/fp-comment/joe-oliver-banning-embedded-mutual-fund-fees-will-only-hurt-the-investors-we-should-be-helping.
[47] *Ibid*.

PriceMetrix analysis demonstrates that smaller clients (defined as those with less than $250,000 in assets) have a negative effect on advisor revenues – they cost more to serve than the revenue they bring about.[48] Without the cross-subsidy of embedded commissions, and the promise of the smaller investor's commission revenue growing over time (in absolute terms rather than percentage, by virtue of the portfolio growing larger), it will become uneconomical to provide service to smaller investors. Consequently, advice will become out of reach for many consumers, including the lower-income consumers who need it most.[49] As discussed above, there is already evidence of consumers failing to seek advice even when they feel they should do so; if the cross-subsidy is eliminated, the problem will only worsen.

As a natural consequence of all of this, those advisors remaining in the industry will naturally gravitate towards high net worth clients. We saw this occur in the U.K. after the Retail Distribution Review ("RDR"), where research found that smaller investors were "abandoned by advisers in the fall out."[50] We see this already with the fee-based business in Canada, where the average account size is approximately $300,000[51] – far larger than the average $42,000 account size served by small- and medium-business sized advisors.

Banks will not fill in the gap

The CSA should be wary about assuming that Canadian banks will step in and serve low income consumers in a post-commission world. In the U.K.'s post-RDR environment, there was an exodus of banks from the mass advice market – which included major players such as Barclays, Lloyds and Santander that had a large retail presence.[52] Consequently, millions of consumers became orphaned, without access to the advice they had once relied upon.[53] The U.K. regulator, the

[48] PriceMetrix, *Moneyball for Advisors*, Pricemetrix Insights, Volume 7, October 2012.
[49] Patrick Ring, *The Retail Distribution Review*, Journal of Financial Regulation and Compliance, Vol. 24, Issue 2.
[50] CoreData Research, *High-end clients are RDR's big winners*, available at: http://www.coredataresearch.co.uk/?inmedia=high-end-clients-are-rdrs-big-winners-coredata.
[51] *Infra*, note 65.
[52] MoneyMarketing, *The death of bank advice: more than just the RDR to blame?*, May 23, 2013. Available at: https://www.moneymarketing.co.uk/the-death-of-bank-advice-more-than-just-the-rdr-to-blame/. While certain banks that left the mass market have recently begun re-entering it, they have been doing so very cautiously, with demands for high account minimums to compensation them for the risk. For example, in restarting its 'retail' advice service, HSBC required customers to have £50,000 as a minimum balance.
[53] Fundscape, *Navigating the Post-RDR Landscape in the UK*, 2014. Available at: http://www.alfi.lu/sites/alfi.lu/files/Navigating-the-post-RDR-lanscape-final-web.pdf.

Financial Conduct Authority, now admits the major role of the RDR in creating this disastrous unintended consequence.[54]

Commentators have opined that the exit of banks and the creation of the advice gap clearly shows where regulators have "failed to meet its objectives of bringing better quality advice and better investment outcomes to retail investors."[55] Banks were simply not able to balance the cost of providing advice in a direct-pay world at a level that is palatable to mass market consumers.

Fintech does not replace the human element

The CSA should also be wary about assuming that fintech can replace the traditional advisor, particularly for lower- and middle-income investors. There is an important and growing role for fintech in the retail financial services sector – it can provide amazing tools to streamline a human advisor's practice (for example, to assist in taking care of certain regulatory requirements, tracking progress or rebalancing a client's portfolio), or for do-it-yourself investors that have the knowledge and the discipline to manage their own financial affairs (although, as stated above, this is an exceedingly small subset of investors[56]).

But the CSA should see fintech for what it is today: it is a tool that makes discrete transactions easier to execute. It is not a substitute for advice and guidance. Remember that the gamma factor is driven by client trust in their advisor, and the consequent willingness to invest in the risk-bearing assets that are necessary for retirement security. An algorithm simply cannot forge the same connection of mutual accountability that is necessary to overcome basic human fallibilities and emotions that manifest themselves during the course of long-run investing, such as the tendency to panic-sell during a downturn – which leads to disastrous outcomes for clients.[57]

The numbers bear out the fact that consumers are ready to use fintech to help their everyday lives, but are not prepared to *trust* them for true financial advice. According to a Pollara study, 37% of respondents expressed that they would be comfortable with making a discrete purchase of mutual funds on-line, but only 17% said they would be comfortable with using a robo-advisor for holistic advice. Only 3% of respondents had ever tried robo-advice, and only 12% were interested in doing

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[54] FTAdviser, "FCA admits RDR contributed to advice gap", July 19, 2016. Available at: https://www.ftadviser.com/2016/07/19/regulation/rdr/fca-admits-rdr-contributed-to-advice-gap-chujPxa8fmBkivLaaAxxfN/article.html.
[55] *Supra*, note 50.
[56] *Supra*, note 11, in regards to how just 6% of the population are qualified to be true self-directed investors.
[57] See, for example, DALBAR's 2016 Quantitative Analysis of Investor Behaviour that found that over a 30-year period, the average self-directed equity mutual fund investor earned only 3.7% per year, compared with 10.4% per year for the S&P500 over the same period. Much of this shortfall is due to panic selling during market downturns, or attempts to "time the market."

so.[58] And according to an international comparative report by U.K.-based HSBC Holdings PLC, Canadians are particularly reticent to 'go it alone' using fintech, relative to residents of other nations: only 7% of Canadian respondents said they are likely to trust recommendations delivered by a robo-advisor, compared to 44% in China and 38% in India. Only 18% of Canadians surveyed feel that robo-advisors are able to offer more accurate advice than their human counterparts.[59]

So fintech facilitates transactions – it does not engender trust or create long-run changes in investor behaviour. It can be a boon for advisors, freeing up time for advisors to focus on their clients, with "more robust conversations that lead to greater understanding and, ultimately, a superior investment experience."[60] But it is certainly not a replacement for human advisors, and the CSA should not believe fintech can address the fallout from a commissions ban.

Favours vertically-integrated firms and concentration in the financial services sector

Embedded commissions are crucial to the health of a horizontal market structure. They allow independent fund manufacturers to secure distribution through independent advisors. A ban on embedded commissions would give a decided advantage to vertically-integrated firms, furthering the concentration of wealth in Canada's large financial institutions and decimating independent dealers and advisors.

As the CSA is aware, many of the large vertical firms do not charge the sales and trailing commissions that are targeted by this consultation, but as explained in Section 8 below, they use sales practices that carry their own conflicts of interest that are arguably more problematic than the commissions at issue here.

Further favouring the vertical channel would limit the breadth, variety and independence of advice because advisors in vertical channels tend to recommend proprietary products, as they are strongly incentivized to do so by their payout structure. The Cumming Report oft cited by the CSA demonstrates that funds sold by dealers affiliated with the manufacturer tend to perform worse relative to independent structures.

The vertical structure also encourages bank-based advisors to put clients' funds in low-yielding savings accounts or GICs, as banks are under pressure to satisfy the increasing capital requirements

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[58] *Supra*, note 15.
[59] Beatrice Paez, *Canadians prefer financial advisors to robo-advisors*, May 24, 2017. Available at: http://www.investmentexecutive.com/-/canadians-prefer-financial-advisors-to-robo-advisors.
[60] Peter Intraligi, *Embracing the fintech revolution*, July 7, 2016. Available at: http://blog.invesco.ca/embracing-fintech-revolution/.

of Basel III. While good for the welfare of the banks, putting money in these instruments is harmful to the needs of their clients – clients should be investing in risk-bearing assets to generate the returns needed for retirement. With 35% of Canadians' financial wealth already in deposit instruments,[61] the CSA should ensure that it does not incentivize a greater migration of funds earmarked for retirement into low-performing asset classes.

The CSA notes in Table 5 of the Consultation Paper that deposit-taker and insurer owned dealers already dominate in Canada, with about an 80% market share. It further states that "[h]ouseholds with lower levels of accumulated wealth are less likely to purchase their funds through an independent dealer." Unless the CSA wishes this situation to deteriorate further, the CSA should be wary about inadvertently giving large financial institutions such a major advantage and harming the vitality of the independent channel through a ban on commissions.

New and costly administrative burden

The Consultation Paper states that fund companies may not collect and pay commissions or fees to dealers. In other words, in a post-commission world, assets held by fund companies must be moved to dealer-held assets. As MFDA firms hold the majority of their assets in client name accounts at fund companies, there will be significant migration costs borne by dealers. This will create new and unintended costs for clients in the form of dealers' annual self-directed fees (with most dealers charging from $135 to $150 per account), as well as numerous additional service fees that fund company-held clients do not currently pay.

Advisors will be tasked with the unenviable responsibility of explaining to clients that they will be paying hundreds of dollars more in fees for the same services that they had before. For example, if a husband and wife each have $50,000 in assets, instead of paying a 1% trailer, they now accept a professional fee of 0.75% and thus save 0.25% each on their accounts – equating to a total family savings of $250. But they must now pay a new trustee fee of $300 charged by the dealer trustee, resulting from moving to dealer-held administration, when they previously did not have to pay trustee fees – resulting in a net loss for the family. The only ones making money after the business costs associated of transferring the accounts are the trustees, which are generally bank-owned.

The elimination of embedded commissions will create significant new administrative burdens by disrupting well-established business models. As all costs are ultimately borne by consumers, these new costs will end up harming consumers' outcomes.

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[61] Investor Economics, *2015 Household Balance Sheet Report*, June 18, 2015. Available at: http://investoreconomics.com/issue/2015-household-balance-sheet-report-statistical-tables-pre-release.

Reduced cost transparency and increased total cost of ownership

In the Consultation Paper, the CSA suggests that the elimination of commissions could put competitive pressure on fees, which could improve consumer outcomes by lowering their total cost of ownership. Empirical evidence tells us that eliminating commissions creates a host of new problems that put upward pressure on fees, actually increasing total costs for retail investors and reducing consumer welfare.

The U.K. experience is illustrative. Under the RDR, although the cost of products themselves fell with commissions parsed out (which is simply a matter of subtracting the advisory charge from the management expense), the total cost of ownership for consumers is similar or greater than what it was before RDR. And many consumers were pushed out of the market for financial advice entirely – it is estimated that clients now require somewhere between £61,000 (~$105,000 CAD) and £100,000 (~$170,000 CAD) in investible assets to gain the attention of an advisor – although 75% of the population does not have even £60,000 in assets.[62]

Under an unbundled service model, a major challenge arises for small investors as they are required to individually negotiate the fee structure with their advisor, whether operating under a fee-based or an assets-under-management model of direct payment. Investors have far less negotiating power on their own, and small, novice clients are particularly disadvantaged as negotiators in this scenario.

Compare this to the embedded fee model, where it is very easy for consumers to see the total cost of ownership on one single line – the mutual fund's management expense ratio. This allows investors to compare prospective funds easily. This transparency also promotes fee competition amongst fund manufacturers, with individual investors able to take advantage of market-wide competition. Mandating a direct-pay model will obscure the transparency of pricing for clients and lead to price disparity amongst retail consumers that is contingent on their individual bargaining abilities.

Below are some of the particular issues arising with both the fee-based and asset-based models of direct pay arrangements.

[62] *Supra*, note 49.

Fee-based service. According to the U.K.'s Money Advice Service, under the RDR, the average hourly rate for financial advice ranges from £75 to £350, with the average being around £150,[63] or over $250 CAD. Unsurprisingly, many retail consumers are unwilling to pay this amount, with the average *total* willing commitment per consumer being a paltry £250, or 1.67 hours worth of advice.[64] On its face, this is clearly not enough time to instill the life-long behavioural change that is critical to wealth accumulation. This is a clear example of the mismatch that occurs when forced to price credence goods in this manner.

Asset-based service. The disadvantages faced by individual small investors negotiating fees on their own becomes starkly evident when looking at asset-based direct fees. According to consultancy firm PriceMetrix, clients with lower levels of investible assets (<$250,000 in assets according to PriceMetrix's brackets, which would include more than of 80% of households) pay about 1.43% of their assets for advice alone in an asset-based direct pay model.[65] Other fund expenses are still automatically deducted through the MER, boosting the total cost of ownership much higher.

Compare this to Investor Economics' finding that under the embedded compensation model, on average, the annual trailer is only 0.78%, with advisors receiving about two-thirds of that.[66] Also note that PriceMetrix's data show that wealthier clients do much better under this compensation model, with those with $2 million or more in assets paying just 0.79% for advice – which shows how disadvantaged smaller investors are in negotiating asset-based fees.

Troubling statistics are also coming out of the U.K. According to the Financial Conduct Authority's *Post-implementation review of the retail distribution review – Phase 1,*[67] there is clear evidence that the cost of advice has increased. Thisismoney.co.uk reported that when advisers started charging fees "most started charging clients 0.5 per cent of their total investment as an annual advice fee… However, research from Schroders Adviser Survey has found [that] more than four in 10 advisers now charge clients 0.75 per cent of their assets – a hike of 50 per cent in just four years."[68] Similarly, FTAdviser reported that according to recent research, "adviser charges have steadily increased in recent years with a 1 per cent charge now being the norm."[69]

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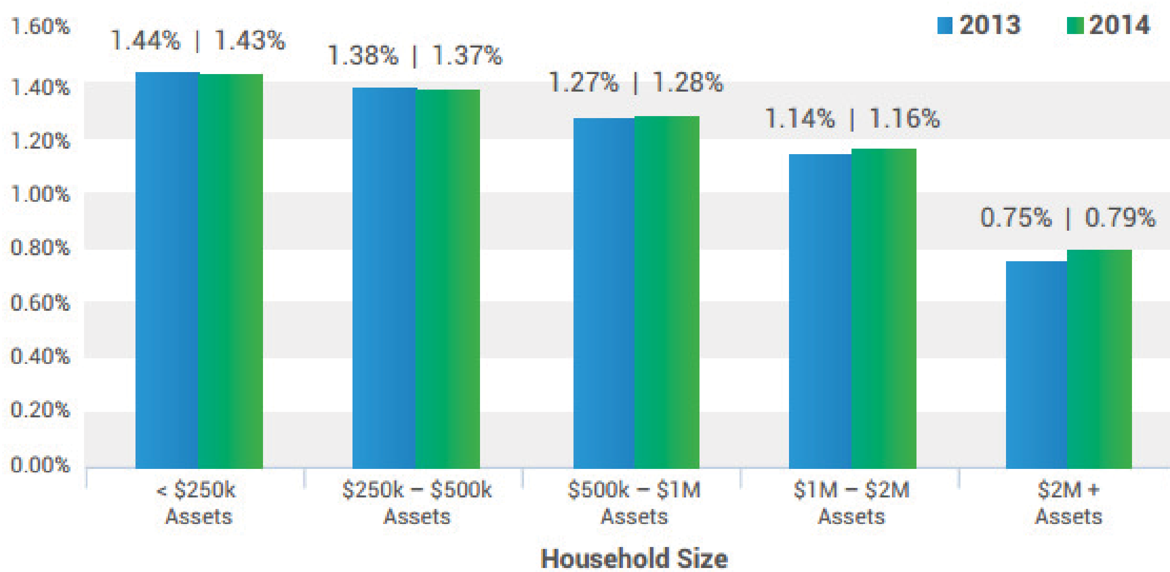
[63] https://www.moneyadviceservice.org.uk/en/articles/Guide-to-financial-adviser-fees.
[64] *Supra*, note 49.
[65] PriceMetrix, *The State of Retail Wealth Management – 5th Annual Report*. Available at: http://www.pricemetrix.com/cms/wp-content/uploads/State-of-Retail-2015-05.pdf.
[66] *Supra*, note 16.
[67] Available at: https://www.fca.org.uk/publication/research/post-implementation-review-rdr-phase-1.pdf.
[68] Lawrie, Eleanor, *Financial advisers hike investment fees 50% in four years and even admit dumping clients with less cash*. Available at: http://www.thisismoney.co.uk/money/investing/article-4024484/Financial-advisers-hike-investment-fees-50.html.
[69] Fantato, Damian. Financial advisers charge 1% in 2016. FTAdviser. December 15, 2016. Available at: https://www.ftadviser.com/your-industry/2016/12/15/financial-advisers-charge-1-in-2016/.

It is doubtful whether forcing smaller investors into direct pay arrangements is truly serving their interests.

Revenue on Assets, Fee-based Business



Source: PriceMetrix

Over-reliance on passive strategies is harmful to capital markets

In the Consultation Paper, the CSA predicts that upon the discontinuation of commissions, mass market investors would be serviced by new entrants such as online advice providers that offer passive products because of their low costs. The CSA seems to believe this would be a net positive outcome for consumers, which, in our view, demonstrates the CSA's continued but incorrect focus on alpha as the value of advice. And having a large proportion of investors shift into passive products could create distortions in the capital markets and increase systemic risk.

Passive products do not help the growth of the capital markets: they generally do not participate in IPOs and other capital-forming activities, they do not exert market pressure and discipline on any particular company to continuously improve and innovate, and they are not involved in shareholder democracy or hold boards to account. They abscond from the responsibility of being contributors to efficient markets and instead 'free ride' on the efforts of others who undertake the effort of research and analysis in the capital markets.

Compare this to active management, which distributes capital efficiently by rewarding productivity and innovation and reprimanding poor business management. Active management allows small but innovative companies to grow. It has a fundamental role in the capital markets, in that by analyzing the state of individual companies, active managers determine prices – and without price discovery, there is a major risk of the formation of asset bubbles.

A recent Bloomberg article quotes a major fund manager as stating that passive products such as most exchange-traded funds are "weapons of mass destruction" that distort prices and create the potential for a market selloff.[70] The flood of money into passive products makes prices move in lockstep as prices of any one particular security becomes increasingly divorced from that company's underlying fundamentals. So as more investors opt for passive investing over active management, "the more inefficient the market is likely to become."

Also note that for individual investors, the market capitalization weighting of passive funds means that unitholders are peak weighted at exactly the worst time. So while there is a role for passive products, regulators should not be emphatically endorsing policies that favour passive investing without fully appreciating the consequences.

8. THE CONFLICTS OF INTEREST PROBLEM

The CSA states that one of its key motivations driving its proposal is its concern that embedded commissions create conflicts of interest that cannot be adequately controlled by disclosure and materially impact the quality of service that consumers receive.

We agree in principle that conflicts of interest can harm investor outcomes. All professional principal-agent relationships, where one party's skill and knowledge is exchanged for financial consideration, will raise certain conflicts of interest related to adverse selection and moral hazard. The question for policymakers is how best to address these conflicts without reducing access to the service rendered so that clients can continue to enjoy its benefits.

[70] Charles Stein, *ETFs Are 'Weapons of Mass Destruction,' FPA Capital Managers Say*, Bloomberg, April 27, 2017. Available at: https://www.bloomberg.com/news/articles/2017-04-27/etfs-are-weapons-of-mass-destruction-fpa-capital-managers-say.

Bias in financial advice

The CSA's stated concern with commission compensation is that financial advisors may be biasing their product recommendations to their clients, who often accept these recommendations, based not on the quality of the product as it relates to the needs of that particular client but based on the expected value of the commission compensation that would be payable from the investment fund to the advisor. That is, investment fund companies are competing for advisors' loyalty by offering higher trailing commissions.

This is largely not the case – investment funds do not compete for flows sent their way by advisors because the trailers they pay are *de facto* uniform across the industry. Almost all large-cap equity funds pay around a 1% trailer, and almost all large-cap fixed income funds pay around a 0.5% trailer.[71] And there is no bias that emerges with scale: a fund manufacturer offers the advisor who sells $1 of its fund the same percentage commission as it does to the advisor who sells $1 million in that same fund.

This does not mean that there is no bias in the advice given by advisors – multiple studies have confirmed that there is a definite bias in the recommendations that advisors make. But the largest factor creating bias is not the level of commission compensation from investment funds. Instead, advisors tend to bias client portfolios to mimic what advisors themselves hold, putting clients in line with their own beliefs about investment strategies.[72] Another rigorous examination of Canadian investment portfolios found that the composition of the advisor's own portfolio "is far and away the strongest predictor of the risk taken in their client's portfolios even after controlling for advisor and client characteristics."[73]

This suggests that advisors' recommendations are not biased due to the presence of commissions, but because they personally and genuinely believe their own portfolio is best positioned to achieve success in the long run, and they wish to share that success with their clients.

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[71] Peter Intraligi, *A simpler approach to the future of fees*, March 8, 2017. Available at: http://blog.invesco.ca/simpler-approach-future-fees/.

[72] Juhani T. Linnainmaa, Brian T. Melzer, Alessandro Previtero, *Costly Financial Advice: Conflicts of Interest or Misguided Beliefs?*, December 2015.

[73] Stephen Foerster, Juhani Linnainmaa, Brian Melzer and Alessandro Previtero, *Retail Financial Advice: Does One Size Fit All?*, NBER Working Paper 20712, (2014). Available at: http://www.nber.org/papers/w20712.

Trailing commissions do align the interests of client and advisor

When an advisor is paid an ongoing commission based on a percentage of the assets held in a client's account, there is a long-term alignment of interests between the advisor and the client in growing the account. Advisors are interested in seeing their clients do well as it will result in a growing income stream, which encourages the advisor to provide the utmost in ongoing service – with the end result being retirement readiness for the client. In contrast, in a fee-for-service direct-pay relationship, there is less of an incentive for the advisor to achieve long-run asset growth for the client.

Commissions also help level the playing field between large and small investors, as investment fund trailers apply at the same percentage rate to large and small investors alike. This is not the case in direct-pay arrangements, with larger investors invariably paying a lower rate – as expressed as a percentage of their assets – than smaller investors. (See the chart on page 31 above.)

A commission structure also encourages investors to take a 'buy and hold' stance. A major investor behavioural problem is the tendency to chase after past winners or panic sell at the first sign of setback. Timing the market is generally not a good strategy – particularly for investors with long time horizons. For the vast majority of investors, the vast majority of the time, the best investment decision is to continue to hold their existing mutual fund positions. It is excessive trading that gets long-term investors into trouble.

Conflicts of interest still exist in direct pay arrangements

As mentioned, all compensation structures – including direct-pay arrangements – inherently create certain conflicts of interest. It is arguable that the market distortion caused by forcing all investors into direct-pay schemes would result in inferior outcomes for investors, and especially for small investors who are particularly vulnerable to the conflicts that would take prominence in a post-commission world.

Increased influence of vertically-integrated firms and push of proprietary/related party products. With the loss of independent firms and advisors, large, vertically-integrated firms (mostly being bank- and insurer-owned entities) will have an even greater influence in the market. If these firms do serve smaller investors, they will only do so by exacting pressure to extract maximum revenue from these "low margin" clients – with these institutions likely establishing structures that strongly incent their employees to push clients towards proprietary or related party products by rewarding sales thereof with commission-like internal transfer payments and requiring high minimum revenue targets in order to remain employed.

This conflict arguably does far more harm to clients than the conflict from a trailing commission. It virtually assures that clients will be shuffled directly to the in-house portfolio and other competitive investment platforms that could better serve clients will be ignored. A recent IIROC review found cases where the compensation grid payout was greater for non-arm's-length products than for comparable third-party products.[74] IIROC also found more subtle forms of bias that could indirectly motivate representatives to inappropriately favour related-party products, such as bonuses based on the overall percentage of fee-based revenue, and equity ownership programs in related-party issuers.

We have recently seen a great deal of public concern over this very situation. There has been a barrage of stories in the mainstream media about bank-based employees being unleashed on the public, with very little training and qualifications, yet pressured by 'higher ups' to hit revenue targets or fear losing their jobs.[75] Some staff report of pressures to hit targets that are monitored weekly, daily and in some cases hourly.[76]

Remember that this is all occurring in an environment that is separate from the sales and trailing commissions at issue in the Consultation Paper. In our view, the conflicts caused by poorly trained and unprofessional staff pushing non-arm's length products under the extreme pressure of hitting revenue targets – under threat of being dismissed – is a far greater public interest concern than commission compensation, and banning of commissions will only further accentuate the power of these vertical entities.

'Active' advisors. A fee-for-service structure will incentivize advisors to be more "active", initiating a larger number of trades, even if those trades are unnecessary or harmful to the client. According to the president of an independent investment management firm, trailer fees were the mutual fund industry's answer to the persistent and wealth-destructive switching that occurs when investors are left entirely to their own devices or, worse still, when the only source of compensation for advisors is commission derived from making a mutual fund switch.[77] Consider what actually happened in the U.K.: following RDR, advisors have been accused of charging higher fees that do not fairly reflect the actual work that was needed to be carried out – by a factor of two-and-a-half times more, compared to before commissions were eliminated.[78]

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[74] *Infra*, note 79.
[75] CBC News, *'I feel duped': Why bank employees with impressive but misleading titles could cost you big time*, March 29, 2017. Available at: http://www.cbc.ca/news/business/bank-s-deceptive-titles-put-investments-at-risk-1.4044702.
[76] CBC News, *'We are all doing it': Employees at Canada's 5 big banks speak out about pressure to dupe customers*, March 15, 2017. Available at: http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575.
[77] Brendan T. N. Caldwell, *In praise of mutual fund trailer fees*, Financial Post, June 17, 2013. Available at: http://business.financialpost.com/fp-comment/in-praise-of-mutual-fund-trailer-fees.
[78] Julia Faurschou, *Advisers accused of overcharging post RDR*, FT Adviser, March 16, 2017.

Regulator-mandated reverse churning. Recently, IIROC issued Notice 16-0297, *Managing Conflicts in the Best Interest of the Client – Status Update* on December 15, 2016.[79] One of the three major concerns identified was the potential that higher advisor compensation for fee-based accounts could incent representatives to move clients from commission-based accounts to fee-based even when that might not be in the clients' best interest. The effect of reverse churning is particularly harmful for smaller accounts, but amazingly, this is what would be *mandated* by regulators should they proceed with a ban on embedded commissions.

<u>Our view of the issue</u>

Conflicts of interest arise in all principal-agent situations. But the conflict created by embedded commissions may not be as serious as regulators purport it to be, as commissions also align the long-run interests of both clients and advisors. The largest biasing factor in an advisor's practice is the tendency to have clients' portfolios match their own, demonstrating their true belief in the quality of their recommendations. And the direct-pay structures that regulators are so eager to push all clients into create serious concerns for consumer welfare, especially for smaller investors vis-à-vis large, vertically-integrated firms.

All of this is not to say that conflicts of interest are not a problem or to dismiss the seriousness of the CSA's concerns. In relationships of trust such as that between an advisor and a client, we should do everything we reasonably can to minimize conflicts of interest, including making available, as an option, compensation structures that minimize conflicts for the most vulnerable investors and coupling accessibility with plain-language disclosure that makes clear to the client the nature of the conflict. We must also take a serious look at the proficiency and qualifications of those who provide advice, which is the subject of the remainder of this submission.

But we must take great care not to promulgate policies that effectively eliminate access to advice, particularly for those with modest means. It is not the role of regulation to restrict the tremendous benefits of a service such as financial advice to those who can afford a regulation-burdened, high-cost version of it. We believe the CSA should focus on addressing the larger underlying issues of professional qualifications and standing. In attempting to insulate smaller investors from potential harm by eliminating choice in compensation models, the CSA may end up suffocating their retirement prospects.

[79] IIROC Notice 16-0297, *Managing Conflicts in the Best Interest of the Client – Status Update*, December 15, 2016. Available at: http://www.iiroc.ca/Documents/2016/4dd98e70-f053-4980-bc75-10ceb6f3940d_en.pdf.

To that end, we urge the CSA to carefully study the line of thinking from Sweden, which considered, but ultimately decided against banning embedded commissions. The government's position was summarized by Per Bolund, Sweden's Minister of Financial Markets and Consumer Affairs:

> The government is not going to introduce a general ban against third party remuneration nor ban commission-led sales of financial advice and products. The ambition is to reach a balanced solution, which supports good advice to customers at the same time that household needs to access financial services are met in a good way.[80]

9. A Better Way Forward

The bottom line is that all Canadians, regardless of their income, deserve access to sound and trustworthy financial advice delivered by qualified professionals. Financial advice creates tremendous value for consumers – not from alpha or beta, but from gamma, the advisor-driven behavioural change that pivots consumers' inherently poor savings and investing habits towards a more forward-looking vision. But because gamma is built on trust, we must ensure that advisors are worthy of this trust.

The CSA has focused prescriptively on commission compensation in its Consultation Paper as a vulnerability through which consumer trust can be exploited by unscrupulous advisors. But banning embedded commissions in an attempt to address conflicts of interest would only serve to restrict (or eliminate) access to advice for lower-income consumers and give greater weight to business models that carry their own, arguably more serious, conflicts of interest. And such a ban would do nothing to enhance the quality of advice that consumers receive.

We believe the CSA's narrow focus on commissions is misdirected. There are legitimate concerns about the quality of financial advice and the proficiency and conduct of those who purport to provide this advice to consumers. It is these concerns that should be the primary focus of regulators. After all, the financial advisor is at the front line of the entire financial services industry – their standing is the culmination of the work and effort of all stakeholders, from regulators, product manufacturers, dealers, industry associations and advisors themselves. For the majority of investors, it is the financial advisor that is their only point of contact with the industry. And as such, advisors serve as the key consumer safeguard.

[80] Investment Europe, *Swedish government proposes not to ban commission-led sales*, May 24, 2016. Available at: http://www.investmenteurope.net/regions/swedendenmarkfinlandnorway/swedish-government-proposes-not-ban-commission-led-sales/.

The existing framework puts consumers at risk

Given this critical role, consumers should be able to trust that their financial advisors are proficient, up-to-date in their knowledge, and compliant with the highest standards of conduct and ethics. While many advisors meet these expectations, there are inevitably some who do not – and due to persistent gaps in the current regulatory framework, retail investors are unnecessarily exposed to risk. There are five major sources of this risk:

(i) Anyone can call him- or herself a financial advisor and offer financial advice.

Across Canada, other than in Quebec, anyone can hold themselves out to the public as a financial advisor, financial planner, investment advisor, or countless other titles, regardless of their training, experience or education. Neither the title of 'financial advisor' nor the scope of the work under that title is protected in law, so there is nothing to prevent an unscrupulous, incompetent or merely inexperienced individual from calling themselves a financial advisor and offering what is purported to be financial advice to the public.

This is a significant risk which must be addressed; time and again, research has shown that most consumers mistakenly believe that titles such as financial advisor are regulated and someone holding themselves out as such has earned the right to do so through education and experience. But unlike doctors, lawyers or architects, anyone can claim to be a financial advisor or offer financial advice and planning — which leaves the public vulnerable to incompetence or outright fraud.

(ii) Existing regulation focuses on products, rather than the most critical aspect — the ongoing relationship between financial advisors and their clients.

Much of our existing regulatory framework does not reflect the reality of how most consumers access financial advice and planning. Existing regulation is often based on the type of product being sold to the retail consumer. And while existing regulators are adept at regulating their member dealers or brokers, including regulating the constant product innovation in the industry, they do not have a focus on the retail consumer's complete advisory experience.

Considering the issue from the consumer's perspective is illustrative: many advisors hold multiple licenses which allows them to provide consumers with complete risk management and wealth solutions from across the insurance, mutual fund and securities sectors. But as a practical matter, most consumers do not conceive of the retail financial services industry as structured in such rigid 'silos.' Nor should they be expected to understand the laws and regulatory processes which have produced this model. Consumers work with their advisors to develop holistic financial plans which reflect their personal circumstances; they do not receive piecemeal product-centred advice. Above all, consumers want assurances that their advisors are professional, knowledgeable and accountable, so they can get the most out of the relationship.

Most consumers are not particularly interested in knowing that product *x* comes from the insurance universe and product *y* comes from the mutual fund universe. But, in the current regulatory framework which is so tied to product sales, it is often the case that the advisor-client relationship is not governed by a single regulatory entity, but by a combination of them. The result is that the protections which consumers currently receive vary widely as they are based on the sector from which the product originates. We have seen the importance of this distinction coming to light if problems arise, leaving consumers confused and disappointed.

This sectoral approach also explains why the existing regulatory framework cannot effectively regulate today's holistic advisory relationships. It is true that in recent years, regulators have given greater attention to the advisory relationship — such as the CSA's Client Relationship Model reforms. Despite this laudable effort, existing regulators are structurally limited by their jurisdictions of authority; for example, even if an insurance regulator were to completely overhaul its expectations of licensees, those changes would only impact the consumer's experience in regard to purchases of insurance products, leaving the consumer's experience with other products unaffected. This is what necessarily happens when consumer protections are ancillary to the sale of product.

In an ideal world, all regulators would set comparable standards so that clients would be equally protected, regardless of the product's origination. But a century of experience and general common sense tells us that when you have multiple regulators that were created on the basis of regulating products – rather than the advisory relationship – and which already have standards that (in some cases) vary widely from each other, coordinating policies on financial advice is nearly impossible. And even if regulators did manage to agree to a uniform set of policies, those policies would do nothing to capture those individuals who are not registered at all, such as a fee-only planner who does not sell product.

(iii) There is no firm, clear, and universal requirement for advisors to keep up-to-date their core areas of knowledge.

One of Advocis' core membership requirements is that advisors keep their knowledge up to date by completing continuing education courses each year, including courses on professionalism and ethics. But for the same reasons discussed above, the regulatory requirements for continuing education vary based on a product's sector of origination. For example, Ontario requires that life insurance licensees commit to 30 hours of continuing education every two years, without requiring a minimum learning component on professionalism or ethics. Several provinces do not have any CE requirements with respect to insurance licensees. And while IIROC has continuing education requirements for registered representatives, the MFDA only states that continuing education "should be provided" to its approved persons.[81] And those advisors who are not registrants with any regulator have no continuing education requirements whatsoever.

Advisors who do not keep their knowledge current fail to properly serve their clients and very likely puts their clients at risk. Moreover, the breadth of knowledge that advisors should have is continually expanding, as product change and innovation is constant. Therefore, static knowledge quickly becomes obsolete and impedes the ability of advisors to act in the best interests of their clients. We believe that all individuals who offer financial advice and planning to retail consumers should be required to complete continuing education on a regular basis, with an emphasis on education related to professionalism and ethical conduct.

(iv) There is no effective, industry-wide disciplinary process.

The majority of advisory relationships are beneficial to the public, but some inevitably do not work out as anticipated. Sometimes, this is a result of negligence, incompetence or fraud on the advisor's part. Accordingly, the industry requires a strong and effective disciplinary process, one which will ensure that those advisors who have committed misconduct are appropriately disciplined, and which will also protect the public and deter other advisors from similar misbehaviour.

Insurance regulators, the MFDA or IIROC are each empowered to impose a variety of sanctions, including the stripping from an advisor of his or her license or registration. However, the limitations of the existing product-based regulatory framework become most apparent when considering the practical impact of having multiple regulatory authorities investigate and act on matters of discipline: each regulator's enforcement powers are limited to its respective sector, creating unacceptable gaps in consumer protection.

Suppose, for example, an advisor engages in misconduct so egregious in the course of selling a mutual fund that the MFDA determines he or she is unfit to work in the fund industry and, as a result, revokes the advisor's registration. In such a case, there is nothing to prevent that same advisor from continuing to provide advice, and sell segregated funds through his or her insurance license.

We believe this sector-hopping represents an unacceptable consumer risk. The type of serious misconduct which warrants an advisor's outright expulsion from one sector, such as fraud or gross

[81] On June 22, 2015, the MFDA launched a consultation to consider whether it should require mutual fund dealer representatives to fulfill continuing education requirements. Available at www.mfda.ca/regulation/bulletins15/Bulletin0644-

negligence, is clearly indicative of that advisor's inadequate commitment to ethical and professional conduct. This is not a sector-specific concern. It is, rather, an industry-wide concern that speaks to larger underlying issues.

Permitting such an advisor to continue to service any consumer is a disservice to the public. And even if that advisor is eventually identified and removed by other regulators in their respective sectors (quite possibly, with a lag measured in years, not weeks), that person can simply continue offering advice on an unlicensed basis since the scope of work is not protected: for example, he or she could "advise" clients to invest in an affiliate's Ponzi scheme.

(v) There is no centralized, pan-sectoral way to review an advisor's credentials.

Also currently lacking is an effective, accessible and industry-wide mechanism through which the public can easily verify their advisor's credentials and disciplinary history. While several regulators, SROs and industry bodies maintain websites where the public can search for information on their advisor, the information returned is confined to the particular entity's sector. As discussed above, the general public does not understand the difference between the various regulatory bodies governing their one holistic relationship with their advisor and is not likely to canvass the registries or databases of each individual regulator to investigate a potential advisor.

In the example from the previous subsection, if a client were to review their prospective advisor's credentials and disciplinary history solely through the insurance regulator's website, they would not become aware of the advisor's expulsion from the mutual funds sector. The client might then mistakenly believe that the advisor's overall disciplinary history was clean.

Advocis strongly believes that consumers should have a one-stop access point for reviewing a prospective advisor's complete disciplinary history that is not limited to the domain of one product sector and respective regulator. It must also capture those individuals who offer advice and planning without the sale of product who are therefore not registered with any existing regulator. That is, rather than being based on today's archaic product-focused regulatory structure, this critical consumer tool must be reconceived at the level of the advisor-client relationship, in order to properly ensure regulation is informed by the consumer's perspective – as all good regulation should be.

These five major shortcomings of the existing regulatory framework expose consumers to unnecessary and unacceptable risk. They arise from the fact that current product-based regulation

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does not reflect the modern, holistic and cross-sectoral approach to financial advice and planning that most consumers receive. But these risks are addressable with the will and courage to re-align the regulation of financial advice with the consumer's perspective. It is to such a solution that this submission now turns.

The solution: Raise standards and make financial advice a profession

The solution to these problems is simple, straightforward, and does not require significant government resources to implement. What it does require is a willingness to re-think the regulation of financial advice, taking it away from its product-based roots to a client relationship-centric model.

The solution envisions recognizing the provision of financial advice as a true profession, through the creation or accreditation of a professional body that regulates financial advisors and the practice of financial advice in the public interest. The professional body would be responsible for the licensing, registration, standard-setting, investigation and disciplining of financial advisors. This would be akin to how other professional bodies operate, such as the College of Physicians and Surgeons of Ontario and the various provincial law societies.

The following is a high-level overview of the defining characteristics of the professional body.

(i) Mandatory membership.

Analogous to the professional bodies for engineers or accountants, the solution requires that anyone who holds themselves out as a financial advisor, or who is in the business of offering financial advice or planning services to the retail public, be a member in good standing of the professional body for financial advisors.[82] The membership requirement would cross traditional product sector boundaries, capturing everyone who offers retail-level financial services – thus introducing a unified oversight of all retail client-facing advisors, including financial planners and those that do not transact in product.

[82] Certain exemptions could apply to the mandatory membership requirement, such as professionals licensed by another recognized body that offer financial advice as ancillary to their main service offering, such as lawyers or real estate agents. It may also be desirable to distinguish between the holistic full-service financial advisor and those who purely offer one-time transactional services, such as discount brokers. The number of service providers falling into this latter group would likely be relatively small.

(ii) Enhanced proficiency and continuing education requirements.

The professional body would establish a mandatory minimum baseline of skills, education and other competencies which all financial advisors, including financial planners, would be obligated to meet in order to achieve membership. These requirements would apply across product sectors, thereby harmonizing advisor skill and competency and ensuring that clients interact with proficient advisors in all cases.

Continuing education would be a mandatory requirement, including content dedicated to topics on professionalism and ethics. The professional body would monitor and enforce continuing education requirements designed to ensure that all financial advisors maintain a high standard of proficiency. It would also require member advisors to maintain errors and omissions insurance to protect the clients they serve.[83]

(iii) Meaningful titles and designations.

Select titles such as “financial advisor” and “financial planner” would be defined as a professional title and protected from misuse by the unqualified, just like the titles of lawyer, doctor or landscape architect are protected by those respective self-governing professions. Additionally, it is of critical importance that title protection not only be about the use and misuse of specific titles. Rather, protections must encompass both the title and the scope and function of the work, as they do for other professions.

A number of leading designations would also be granted proficiency recognition by the professional body, as conceptualized in the figure below, and these areas would denote areas of specialization – for example, through designations such as the CFP®, CLU® and CH.F.C®. Specialization is common in established professions: consider the medical profession, where all doctors must meet a minimum standard to be called a medical doctor and be a member of their professional body. But within that larger group, there are smaller groups who have specialized further: while every member of the profession is a doctor, only those who have completed additional training are allowed to use designations which identify their specialization, such as cardiologist and oncologist.

The basic principle should be that an advisor cannot hold him- or herself out to the public in a manner that deceives or misleads – or could reasonably be expected to deceive or mislead – a client or prospective client with regard to the advisor’s proficiency, qualifications and service offerings (including specializations).

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[83] Current requirements to maintain errors and omissions insurance vary by province, industry sector and product type.

(iv) An enforceable code of conduct.

The professional body would have, at the cornerstone of its commitment to professionalism, a code of conduct that inculcates ethical norms in individual advisors. The code would address, *inter alia*, the duties surrounding conflicts of interest; the duty to provide competent service; the duty to act with honesty and integrity; the duty to preserve and protect client confidentiality; and the duty to cooperate with the professional body and regulators. At the core of the code of conduct, as its first tenet, would be the priority of the client's best interest; this is discussed in greater detail in the following subsections.

The code of conduct would be backed by a complaints, investigation and disciplinary process that empowers the professional body to suspend or cancel the advisor's membership. What is unique about this is that because membership in the professional body is mandatory across product sectors, discipline conditions or suspensions are not limited to one product sector. Instead, they are able to address the serious issues of negligence, incompetence or fraud directly in a complete manner, bolstering consumer protection.

(v) An accessible, consumer-facing central registry.

The professional body would maintain a public-facing database whereby consumers can conduct a "one-stop" check of a prospective advisor's credentials and disciplinary history. Unlike the registries maintained by existing regulators and SROs, which only contain information pertaining to the advisor's activities in the regulator's or SRO's respective sector, the professional body's registry would be based on the conduct of offering advisory services to the retail public. It would therefore transcend product sectors, addressing the "sector hopping" problem of miscreants. This focus on scope of work and conduct would also capture those advisors and planners who are currently not registrants of any regulator.

(vi) Advisor representation in their own regulation.

One of the hallmarks of a true profession is involvement of its members in their own regulation – this is true of lawyers, doctors, dentists, architects and so on. Involving members allows the professional body, including the government to which the body ultimately reports, to leverage the vast accumulated knowledge and real-world experience of the membership to set policy in a way that is more likely to achieve its objectives.

Financial advisors are currently regulated without representation. Advisor oversight is presently in the hands of regulators such as the MFDA, IIROC, and so on – these are product-based regulators who do not consider advisors to be true members of their organizations and refer to advisors as mere 'approved persons'. Indeed, because of how detached they are from the ground level of working with clients, these organizations often do not fully understand what advisors do in their day-to-day work.[84] And advisors lack true standing and a 'voice' within these organizations. For example, neither the MFDA nor IIROC mandate the presence of advisors on their boards of directors.

The professional body would have a board of directors comprised of financial advisors, members of the public, and government appointees, among other persons. The mandate of the body would be, first and foremost, the regulation of financial advisors and the provision of financial advice in the public interest. The professional body, through its board, would report directly to the provincial finance minister, rather than indirectly through a product regulatory body. As financial advice has

[84] While branch managers and other dealer staff receive and review paperwork documenting the advisor-client interaction, it is usually only the advisor that has a direct relationship with the client. As with any in-person, face-to-face interaction, there are many nuances that are difficult or impossible to distill into writing. The advisor's ability to understand the "human" elements in a client interaction is critical to the quality of that relationship.

evolved into a true profession, it is time to give professional financial advisors a dedicated voice in their own regulation.

Putting clients' interests first

We understand and appreciate that motivating the proposals in the Consultation Paper is the CSA's efforts to improve investor protection. We support that underlying objective. But rather than abolishing compensation structures in a top-down move that would create disastrous unintended consequences, the best way to achieve our shared investor protection goals is through the establishment of a profession for advisors which would have at its core a duty to act in a client's best interest. A best interest duty would better address the CSA's concerns about conflicts of interest relating to all compensation structures, including direct-pay structures, without disrupting access to the advice that consumers so critically need.

A significant feature – indeed, perhaps the defining feature – of the "best interest" concept is its moral ambition, which lies in the expectation by the client of absolute good faith on the part of the advisor. In this light, the ultimate focus of the duty is trained on the advisor's motives and actions in advancing the client's overall interests, and not merely on the state of the client's accounts at any given point in time.

The duty must be interpreted by the professional body. We believe that advisors must be granted professional standing before a best interest duty can be enacted. We are opposed to a best interest duty that is interpreted and applied by existing regulators that are not connected with the client-facing work of advisors and are therefore not positioned to understand the nuances of an advisor's real-world practice.

A best interest duty is a professional standard of care meant to ensure that a client receives the utmost in their advisor's care and judgment. It necessarily involves subjective assessments that take into account the client's objectives, risk tolerance and financial position, as well as the market conditions known at the time and projected out into the (sometimes distant) future. The breaching of a best interest obligation creates significant ramifications for the client, advisor, and the reputation of the industry as a whole, so a fair hindsight determination of whether a decision was in the client's best interest requires an understanding of the real-world practice dynamic in play when the advisor made that decision.

A best interest duty interpreted and enforced by a professional body would be enriched by the first-hand knowledge of its practicing member advisors, some of whom would serve as members of the profession's hearing tribunals. As in the case of any profession, it is the professionals within it who are best suited to understand how the concept should be applied to their peers. This flexible and evolving approach would be the ideal way to address novel situations or evolving market conditions.

It would be manifestly unfair to apply a best interest duty to a profession while failing to involve members in their own regulation. Critically, we draw attention to the fact that there is no other profession, whether it be law, medicine, or so on, whose members are subject to a best interest duty but who are not accorded professional standing and given a voice in their own regulation. Senior regulators or ministries in those industries recognize they have an important role to play in setting the basic framework, but they cannot, should not and do not attempt to regulate the nuances of the professional-client relationship or judge whether a professional's actions were in the best interests of the client. Instead, they respectfully defer to accredited self-regulatory bodies, such as the College of Physicians and Surgeons or the association of Chartered Professional Accountants.

We urge the CSA to take note that professionalizing advisors and involving them in their own regulation – including in regards to administering a best interest duty – is exactly what is proposed in Australia.[85] We urge the CSA to study Australia's efforts and take a similar enlightened path.

<u>All stakeholders would benefit from advisor professionalization</u>

In summary, the establishment of financial advice as a profession would create benefits for all market participants: first and foremost, consumers would benefit from working with true professionals that are driven by an underlying duty to place clients' interests first. They could rely on the fact that all advisors would meet proficiency and ongoing education requirements, just as they do with their architects or engineers. They would also benefit from a simple way to verify their advisor's credentials and disciplinary history without having to navigate the maze that is the current regulatory landscape. Finally, they would enjoy the support of a disciplinary system with teeth: it would be a system that actually protects the public, rather than potentially off-loading one sector's problem onto another product sector and a new set of unsuspecting consumers.

Professionalizing the industry would align regulation with what is most important from the consumer's perspective: the relationship of trust with their advisor, which is the key to establishing the gamma factor and unlocking retirement readiness. Advisor regulation could finally be moved away from being a corollary of the byzantine world of product regulation. And professionalization would permeate through all facets of the advisor-client relationship and would be far more

[85] Financial Standard, *Advisers to be judged by peers*, Available at: http://www.financialstandard.com.au/news/advisers-to-be-judged-by-peers-94256311.

effective than prescriptive rules ever could be in addressing consumer protection issues that arise in a rapidly-changing environment.

Financial advisors would benefit from enhanced public trust, status and confidence as true professionals, and we know that our members would be very supportive of seeing unethical advisors who tarnish their collective reputation being removed once and for all.

Governments and regulators would benefit from enhanced consumer outcomes, including reduced public financial reliance, and the expertise and support of the professional body in crafting and implementing their policy agenda. And product manufacturers and distributors would benefit from the professionalism of the advisors who represent their companies to the public on a day-to-day basis.

10. CONCLUSIONS AND NEXT STEPS

The CSA says its proposed ban on embedded mutual fund commissions will "put the investor's interest first." But, in reality, forcing all investors to pay directly for financial advice puts millions of Canadians at serious risk. This ill-conceived move would diminish choice and erode access to financial advice for those who need it most, like seniors on a fixed income and young people just beginning to save for retirement, for whom direct-pay arrangements are simply unaffordable.

The CSA acknowledges that those with less than $100,000 to invest are already underserved in the market, noting they are the "least likely to be receiving advice today and when they do receive advice, the range of services provided tends to be less than for those with higher levels of wealth." Considering approximately 80% of the population falls into this category, one would expect our regulators to look for solutions that expand access and improve the quality of financial advice available to all Canadians. Regrettably, this isn't the case.

Instead, the CSA is focused on doing away with commissions based on an incorrect belief that the value of financial advice lies in alpha, or the pursuit of excess returns. The CSA seems unwilling to accept the gamma factor: the power of changing ingrained human behaviour that favours present consumption, underestimates future needs and results in poor retirement outcomes. This behaviour is extraordinarily hard to change: frankly, if consumers could do it themselves, Canada would not be facing the retirement crisis that now looms large. But based on its flawed analysis, the CSA is now asking middle-income Canadians to take a leap of faith that they will continue to have options for financial advice.

Despite conceding that "independent fund dealers may choose not to continue to service these households" after commissions are eliminated, the regulators say we need not worry because the masses largely receive their advice from the big banks and insurance companies anyway, and they assume that will continue. In saying this, the CSA is setting the stage for further concentration of Canada's retail financial services sector in the hands of large, vertically-integrated firms – and the high-pressure sales tactics of commission grids and proprietary products that put small investors at particular risk.

While it's troubling that the CSA appears unfazed by Canadians having less choice over who helps them manage their financial futures, what's even more worrisome is that our regulators are turning a blind eye to overwhelming evidence that many households could lose access to advice altogether. In light of the U.K.'s failed experiment, it is staggering that the CSA continues to pursue a commission ban here in Canada, particularly at a time when financial advice is needed more than ever.

Canadian household debt has reached record heights and there is a growing need to be more financially self-reliant in retirement as less than a third of workers today are covered by an employer pension plan. While working families struggle with these challenges, independent academic research has confirmed that those who work with a financial advisor are better protected, accumulating nearly four times more wealth than those who don't.

And while market risks and the moral hazard inherent to the principal-agent relationship are real, non-participation in financial markets and poor investor savings practices and investment decision-making have much larger negative impact on individual household wealth accumulation – and society, in general, as those who fail to save adequately for retirement will necessarily demand more on the state. But governments are facing their own financial crises, with the 2016 census showing that, for the first time in history, there are now more seniors than children. Something has to give.

Make no mistake, no one is suggesting that investors be forced to pay commissions — but simply that they continue to have a choice in the matter. The second phase of the client relationship model (CRM-2) regulations, which only recently came into effect, are now working to increase transparency around fees on account statements and help investors better understand their investment performance and the associated costs. Why not assess the impact of these changes before moving hastily ahead with a regulatory overhaul that will put financial advice out of reach for so many?

Banning commissions is not the answer to protecting Canadians. A more pressing problem we should be addressing is that the current regulatory system is failing to ensure the proficiency and professionalism of financial advisors across the country.

Rather than debating about how advisors are paid, we should be working to create an environment where all Canadians—irrespective of their net worth—have access to sound financial advice delivered by competent and qualified professionals. The best way to do that is to oversee financial advisors as we do all other professionals that provide essential advice, from lawyers to accountants and engineers. Every financial advisor should belong to a professional body and be required to adhere to a common code of professional and ethical conduct, mandatory professional liability insurance, ongoing continuing education, and a disciplinary process with the authority to suspend an advisor who has wronged an investor.

Only then can we truly say that we are putting the interests of all investors first.

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We look forward to working with the CSA as it proceeds with this challenging issue that is so critical to the financial well-being of millions of Canadians. Should you have any questions, please do not hesitate to contact the undersigned, or Ed Skwarek, Vice President, Regulatory Affairs and Public Affairs at 416-342-9837 or eskwarek@advocis.ca.

Sincerely,

Greg Pollock, M.Ed., LL.M., C.Dir., CFP	Wade A. Baldwin, CFP
President and CEO	Chair, National Board of Directors

June 9, 2017

Via email : comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
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Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
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Dear Sir / Mesdames:

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

This comment letter is being submitted on behalf of the following RBC entities: Royal Mutual Funds Inc., RBC Global Asset Management Inc., RBC Dominion Securities Inc., RBC Direct Investing Inc. and Phillips, Hager & North Investment Funds Ltd. (collectively "RBC" or "we"). We are writing in response to the Canadian Securities Administrators' ("CSA") request for comment on Consultation Paper 81-408, published on January 10, 2017 ("Consultation Paper"). We appreciate the opportunity to provide further input on the issue of investment fund fees and, more specifically, to respond to the proposal to discontinue embedded commissions in Canada as outlined in the Consultation Paper.

I. Introduction

RBC's core purpose is to help clients thrive and communities to prosper. We offer advice, solutions and other resources to help clients meet their savings and investment goals at every stage of their lives. We offer a broad range of financial products and services to meet clients' diverse needs, which are accessible at their convenience whether in person, on the phone or digitally. We are committed to earning our clients' trust by building lasting relationships and aligning with their interests because we only succeed when we help our clients succeed.

At RBC, we fully support the principles of strong investor protection, market efficiency and competition. Our approach and business model have evolved in a manner consistent with the following fundamental beliefs, which remain consistent with our responses to earlier discussion papers related to this topic:

- mutual funds are an effective investment vehicle for all investors, particularly retail and mass affluent individuals,
- the total cost to investors of owning mutual funds in Canada is comparable with other developed markets[1],
- access to financial advice is valuable to investors[2],
- investor choice is important; specifically, investors have the right and the ability to choose whether to seek financial advice or not, and to choose how to pay for that advice and service,
- transparent disclosure of the cost of investing in mutual funds is important, including what investors pay the fund manager and the dealer, and
- a competitive market, where businesses determine what client segments to pursue, what products and services to offer, and what fee options to make available, is the best policy option for clients.

We believe investors are well served in an environment that fosters competition, which is enabled by investors having access to sufficient, comparable information to make informed decisions. Given sufficient information, access to advice and choice, investors will choose the model that best suits their needs, and will reward market participants based on their ability to deliver value through investment solutions and how well they serve clients' needs. There is ample evidence that the Canadian mutual fund market is efficient and highly competitive with relatively low barriers to entry. In May 2017, Morningstar Advisor Workstation's database listed 1,340 new individual funds that have been introduced in Canada since January 2010. Several notable Canadian-based and large foreign fund companies have entered the retail fund market since 2008. Finally, Canadian mutual funds face direct competition from thousands of ETFs listed on both Canadian and U.S. exchanges as well as individual stocks, bonds and deposit instruments.

We are proud of the mutual fund business that we have built to help clients meet their financial objectives. In responding to client and advisor demands, market opportunities and regulatory changes, our focus is to create value and choice for our clients. We have expanded our mutual fund business from a single distribution channel to a multi-segment, multi-channel approach that offers Canadians

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[1] Investor Economics and Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios. A Canada – U.S. Perspective*, November 2012.

[2] CIRANO Institute, *Econometric Models on the Value of Advice of a Financial Advisor*, July 2012. Clients with advisors are more likely to start investing earlier, invest regularly, save enough, diversify and have a financial plan. These behavioural activities are core attributes to investing successfully.

choice in how they access mutual funds, whether they seek advice and how they may choose to pay for that advice. Our commitment to serving our clients is demonstrated by our:

- continued enhancement of the advice capabilities across our distribution networks, including increased availability and access to advice and our financial planning and wealth management services,
- emphasis on a portfolio approach to investing, with a focus on asset allocation and risk appropriate diversification. We have expanded the asset classes, geographies and strategies within our expertise to improve our ability to construct effective portfolios and address investors' needs,
- focus on delivering value through some of the lowest MERs in the market. We introduced Series D in 2007, to lower the costs of investing for DIY investors, and
- continuing to identify opportunities to simplify and lower fees. In 2016, we lowered management fees even further by eliminating our High Net Worth Series and moving to one low fee on every dollar invested.

Our concern with the CSA's proposal to ban embedded commissions is that it is a blunt measure for addressing the three key investor protection and market efficiency issues identified in the Consultation Paper and that it could produce the following unintended adverse consequences for investors:

1) **reduced access to advice and choice,**
2) **increased costs, and**
3) **increased complexity.**

Our view is that the three key issues would be better addressed by a combination of more focused changes that we describe in the last part of our submission (page 7).

II. Potential for Reduced Access to Advice and Choice

The investment fund industry is vital to the Canadian economy and to the financial futures of Canadian investors at all wealth levels who use mutual funds to generate income and grow their financial wealth. Mutual funds, and access to advice, have enabled Canadians with minimal capital to participate in capital markets and access professionally-managed, diversified investment solutions. As a result, mutual funds have become the most widely-held investment vehicle, accounting for 31% of Canadians' financial wealth held by 33% (4.9 million) of Canadian households.[3]

In a recently released report, the Mutual Fund Dealers Association of Canada (MFDA) has produced data[4] showing that mass-market households comprise the largest segment of its members' client base and that they contribute 28% or $177 billion of MFDA members' total assets under administration, which are almost entirely held in mutual funds. Similarly, 60% of the client accounts of Royal Mutual

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[3] Investment Fund Industry of Canada (IFIC) statistics as of 2015.

[4] MFDA, *MFDA Client Research Project: A Detailed Look Into Members, Advisors and Clients*, May 23, 2017: 8.9 million households in Canada (56% of all households) are serviced by the MFDA advisors, 83% of which (7.3 million households) are mass-market households with financial assets of less than $100,000.

Funds Inc. (RMFI) hold mutual funds that total $25,000 or less, of which 23% of these clients are age 60 or older.

The Consultation Paper states that "*mass-market households make up the largest share of those that do not own investment funds*" and that *"investment funds are less popular than traditional savings vehicles with mass-market households".* These statements understate the importance of mutual funds to mass-market Canadian households. The Ipsos Canadian Financial Monitor that the CSA references shows that millions of mass market Canadian households own mutual funds. In fact, according to the data, mutual funds are more popular than GICs. The data also highlight that too many mass-market Canadian households are reliant on chequing and savings accounts, which will not contribute meaningfully to their financial goals. We have witnessed substantial growth in investment savings by mass-market households over the past 20 years, but there is still significant room for improvement. Any actions that potentially limit their access to advice or discourage investment savings should be considered carefully, as this is the segment of Canadians most at risk of not meeting their financial goals.

In addition to investment-specific recommendations and overall portfolio construction, advice can include ongoing monitoring and rebalancing of a client's investment mix, as well as retirement or goal-specific planning services. Numerous studies have confirmed the benefits to Canadians who work with financial advisors, including increased financial discipline, higher savings rates and larger asset balances at retirement. In a 2014 report entitled *Boosting Retirement Readiness and the Economy Through Financial Advice*[5], the Conference Board explored the link between the use of financial advisors, retirement readiness and the country's long-term economic growth potential. The report concludes that, "Overall, a scenario where savings are increased over the long term results in a large accumulation in savings, which Canadians can use to supplement their retirement incomes. It also has a positive impact on Canada's potential economic output, which results in a permanent increase in income and profits in the economy."

The CSA has acknowledged the possibility of an advice gap if embedded commissions were discontinued. However, it believes that such a gap could be covered by the use of online advisers (colloquially known as robo-advisors), the introduction of alternative compensation arrangements for clients for whom fee-based accounts may not be suitable and by allowing fund managers to facilitate investors' payment of dealer compensation by collecting payments from the investor's fund investment.

- While we agree that robo-advisors will be a service valued by some investors, we caution that it is unlikely to meet the expectations of all segments, particularly those who prefer their existing advice relationship. Projections on the adoption of robo-advisors vary considerably among studies[6], although a common view is that millennials are more likely to use robo-advisors than seniors.

[5] Antunes, Pedro, Alicia Macdonald, and Matthew Stewart. *Boosting Retirement Readiness and the Economy Through Financial Advice*. Ottawa: The Conference Board of Canada, 2014.

[6] HSBC Bank plc commissioned Ipsos MORI to survey 12,019 people in 11 countries, including 1,001 in Canada. The results for Canada were published in *Trust in Technology Country Report – Canada* and the accompanying News Release, May 24, 2017: Only 7% of the Canadian respondents would trust robo-advisors to make their investment choices and 18% believe that computer programmes provide more accurate advice than human advisors. By comparison, a *BMO Capital Markets Future of Banking Survey 2017*, which had 550 participants (about 40% of whom were below the age of 40), indicates that "only 1 out of 20 respondents had ever used a robo-advisor, but 6 out of 10 expressed some level of interest in trying one" and that "1 in 3 would consider investing more than 10%

- The CSA suggests that alternative compensation arrangements could include various direct pay or flat fee arrangements. However, as we explain in the next section, such alternatives could result in higher costs and consequently may not be considered an option by many mass-market investors.

- Some fund companies already facilitate fee payments to dealers by redeeming fund units from fund holdings. However, this option is currently manually administered. Replicating this model on a mass-market scale would require industry-wide system enhancements and additional resources by both investment fund managers and dealers to administer the program, at substantial cost.

Other potentially negative outcomes of reducing choice include driving investors to conservative products (e.g. GICs) that may not generate the income they require and creating a systemic incentive that favours higher-cost insurance-based investment funds that would continue to have embedded commissions.

III. Increased Costs for Mass-Market Investors

Trailer fees paid to the dealer not only pay for advice but also cover other service costs for the benefit of clients. These include:

- enabling clients to transact and manage their mutual fund holdings through multiple channels, including in-person, with telephone representatives and via online and mobile platforms,
- account servicing, reporting and production and delivery of account statements and other communications,
- compliance with rigorous regulatory requirements, and
- providing enhanced account features such as allowing clients to invest as little as $25 without a per-ticket trade commission at many dealers. Currently, 28% of RMFI clients invest regularly through pre-authorized contributions. Such features, in addition to Automatic Investment Plans, encourage Canadians to invest regularly without worrying about transaction costs. For example, 44% of all mutual fund purchases[7] at RBC Direct Investing Inc. are done for amounts of less than $500.

We are of the view that a ban on embedded trailers could harm investors by increasing costs and thereby limiting access to advice relative to alternative direct-pay-only models.

- An up-front flat-fee option is unlikely to be selected by clients, as the level of the fee required to cover the initial and ongoing advice, access and service costs would probably be seen as too high by most clients, especially those in the mass-market.

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of their savings in a robo-advisor" (BMO Capital Markets, *The Crow's Nest: A Focus on Digital Wealth*, March 3, 2017).

[7] Based on all mutual fund purchase transactions at RBC DI from March 1, 206 to March 6, 2017.

- A fee-based account option would likely be the most economically feasible option for the industry. For some firms, this would be a new service that would require significant up-front investment. For dealers who currently offer fee-based accounts, the arrangements typically involve a percentage fee applied at the account level, rather than on the type of assets, and, in almost all cases, involve an account minimum. It is likely that a flat or tiered percentage fee at the account level would be costlier for clients than the existing standard trailing commission model, particularly for more conservative investors whose investments may be primarily in fixed income funds with lower trailer rates. Lastly, due to the costs associated with the administration of fee-based accounts, the minimum fee charge / account is unlikely to be eliminated.

- Many firms currently allow clients to invest as little as $25 with no transaction-based commission, including the highly popular Automatic Investment Plans. Introduction of a transaction-based commission on these regular purchases to pay for non-advice services would make these transactions more expensive for clients. That is, even a nominal per-transaction fee charged to small periodic investments would amount to higher transaction costs due to the frequency of trading, as compared to the ongoing embedded commission option.

IV. Increased Complexity for Investors

Financial advice plays a crucial role in the lives of Canadians who face an increasingly challenging financial environment. Interest rates and financial literacy levels remain low. Disappearing employer-sponsored defined benefit plans are forcing more and more Canadians to take personal responsibility for ensuring their financial well-being in retirement. These challenges are recognized by government[8] and securities regulators.[9] Removing an option by which investors can easily access financial advice may lead investors to try a DIY approach to investing rather than pay for advice directly. The increased complexity of understanding and selecting suitable funds or other investment instruments is likely to produce sub-optimal returns for investors.

Under a direct-pay fee model, certain economies of scale are lost if fees are calculated and collected for each account, rather than across investors at the fund level. Further, investors would incur the added cost and complexity of reporting taxable gains or losses realized by redeeming units to pay fees. Errors in accounting for fees on personal tax returns may result in overpayment of taxes, penalties and/or audit costs. With embedded trailers, tax deductions are managed at the fund level for the benefit of all investors so that this risk is avoided. If embedded commissions are discontinued, the cost of account servicing would increase as dealers would face higher volumes of tax administration and reporting.

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[8] Final report of the Ontario government's Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives, November 1, 2016: "From older workers who need guidance on how to plan for retirement and draw down their savings to younger workers who may have no workplace savings options at all, Ontarians will increasingly need and depend on receiving quality Financial Planning or Financial Advice."

[9] In OSC Notice 11-777 – *Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018* ((2017), 40 OSCB 2579), the OSC recognizes changing demographics as critical to understanding investor needs and as a key driver of most investor-focused issues. "In particular, the need for retirement planning has increased, as the responsibility for saving and investing continues to shift from employer sponsored plans to the individual. The demand for accessible and affordable advice that meets individual investor needs is expected to increase."

For clients who invest only a portion of their assets in mutual funds (e.g. 5% invested in mutual funds within a segregated assets portfolio), it may not be suitable to move the entire portfolio to a fee-based account and incur additional ongoing costs. Requiring a client to open a separate, fee-based account for the mutual fund assets would be cumbersome for both the client and the firm. Client reporting would be fragmented and firms would be faced with a greater number of new accounts to administer for the same asset base.

For these reasons, we caution against regulatory action that may inadvertently affect investors' ability to obtain affordable advice or sever existing long-term advisory relationships. If the CSA were to proceed with the discontinuation of embedded commissions, there is a distinct possibility that many investors may choose not to seek advice. A recently released survey commissioned by AGF Investments Inc. found that 24% of the investors surveyed said that a change from indirect to direct compensation for advice and service would make investors like them less likely to seek advice from an advisor.[10]

As previously submitted in our comment letter to Consultation Paper 81-407 - Mutual Fund Fees, we firmly believe that preservation of investor choice should remain a key principle when considering any regulatory action. While we support regulatory efforts to address potential conflicts of interest between firms, advisors and investors, **we believe an alternative policy solution to the proposed discontinuation of embedded commissions would create better outcomes for Canadian investors.** Our alternative approach addresses the reality that no compensation structure is conflict-free and that the prohibition of one structure merely shifts the source of potential conflict to another compensation framework.

V. Proposed Alternative: Retain Embedded Commissions with Changes to Address CSA Issues of Concern

As an alternative to prohibition, we recommend the continuation of embedded commissions subject to certain changes.

While some of the changes have been considered by the CSA in the Consultation Paper, we think the combination of the changes together would address the CSA's three primary issues of concern regarding investor protection and market efficiency, while continuing to provide investors with the range of advice, access and service options that they use today.

Our alternative solution encompasses the following changes:

1. We propose enhanced disclosure and other means of improving investor awareness of typical trailer commission rates and any outlier rates to reduce the potential for conflicts of interest to arise from differences in compensation levels among similar types of investment funds.
2. We encourage the industry to offer a standard, low commission option (e.g. D series) for sale exclusively by Order Execution Only firms.
3. We propose that the industry take steps to discontinue deferred sales charge (DSC) and low load (LL) options to further reduce conflicts due to the variability in compensation options.
4. We encourage further review of the concept of disclosing full fund ownership costs to clients on an ongoing basis, in dollar value, as part of annual reporting on charges and compensation.

[10] Gandalf Group, commissioned by AGF Investments Inc., *The Canadian Investors' Survey – An Opinion Research Study on Fees & Advisory Services*, May 30, 2017.

The following details support this proposal and are organized according to the three key issues raised in the Consultation Paper:

i. Conflicts of Interest

The underlying premise for the CSA's concern about the potential conflict of interest associated with embedded commissions is that fund manufacturers are using higher trailers to encourage dealers to favour their products over other funds with lower trailers. If trailer rates are the same among fund companies for the same type of funds, they are no longer a differentiating factor. In fact, research by the Investment Funds Institute of Canada (IFIC) has found that trailer commission rates are being reduced to standard levels or lower to the extent that relatively few funds offer rates that could be interpreted as an incentive. As at December 2006, 322 funds or 17.8% of all equity and balanced funds paid a trailer commission greater than 1%. As at April 2017, only 113, or 4.3% of all equity and balanced funds paid a trailer commission greater than 1%. That is, almost 96% of funds in these categories had a trailer commission of 1% or lower[11]. There also appears to be a general standardization of trailer commission rates for money market funds at 0.15 – 0.20% and for fixed income funds at 0.50%.

We are not recommending that the CSA place maximum limits on trailer commissions rates, as we agree with the CSA's comment in the Consultation Paper that setting fee caps for investment products is not part of its traditional role. To the extent that fund companies do not voluntarily move their rates to a standard level, competitive pressure, disclosure and investor awareness should help to achieve this result. Similar forces would likely operate at the dealer level to encourage the adoption of standardized embedded commission options. To further advance this trend, the standardized trailer commission rates could be published on various websites, such as the Investor Education sites of the securities regulators and trade associations, and included in Fund Facts along with the actual trailer commission rate paid by the fund. These measures would enable the investor to discuss the reasons for any difference from the standard rate with their dealer representative and to make an informed decision whether to purchase the fund. Our expectation is that investor decisions and competitive pressures would eventually result in any higher-than-standard trailer commission rates converging with the standard rates.

In a similar way, removing DSC and LL commission options would prevent conflicts that may be created by large upfront commission payments versus smaller ongoing payments for service and advice.

ii. Limited Awareness, Understanding and Control for Investors

Awareness of fees has been improved by the current POS and CRM regulations which make fees and commissions highly salient and understandable to investors. The fee disclosures in Fund Facts documents would be simplified if DSC and LL options were removed and would be enhanced by including the standard trailer rate for comparison with the particular fund. Future enhancements to POS disclosure could further clarify overall costs and commissions levels, including a discussion about any difference from the standard trailer commission rate.

Clients' understanding of fees will be further enhanced by CRM reporting, which will continue to provide detailed cost and performance reporting in a manner similar to direct pay models. Further disclosure of

[11] IFIC research of all equity and balanced funds in Canada issued by prospectus, May 2017.

total MER costs would provide investors with full cost information and place trailers into context as part of the complete cost of the investment.

With no early redemption costs from DSC or LL options, investors would always be in control and have the choice to change their advice costs by moving to direct-pay or lower-cost options (e.g. Series D) without changing investments, realizing a taxable event, or incurring a redemption penalty (DSC or LL commissions).

iii. Alignment of Fees Paid to Value of Service and Advice

Direct-pay arrangements around the world provide market-based evidence that investors value the advice and service they receive from investment professionals. Furthermore, the value of advice is supported by other factual observations in Canada, such as:

- low financial literacy rates,
- increasing complexity of investment markets and savings programs (e.g. RSP, RESP, TFSA, RDSP),
- the growing trend of downloading financial responsibilities to individuals, partly through the elimination of employer-sponsored defined benefit programs, and
- the growth of direct-pay and discretionary offerings.

Numerous research studies support the role of advice in delivering value to investors through both tangible and intangible means.[12]

The recent enhancements to the disclosure of fees through POS and CRM2, supplemented by the additional measures we have suggested to increase awareness and understanding of trailer commissions, should enable investors to be better informed about the fees they are paying. We recommend that these measures be given an opportunity to support investors' decision-making process rather than taking the more extreme step of reducing the choices available to them.

VI. Conclusion

We believe our alternative solution would promote a fair, competitive and efficient market for investment products and advice. Canadians could continue to access a full range of investment options and freely choose between the wide array of advice and non-advice channels that exist today or that may emerge in the future.

Banning embedded commissions would remove an option for investors who prefer to obtain advice for a specific product at a much smaller threshold than would be required through a fee-based account. A ban would create a barrier for some investors who may encounter difficulties obtaining advice at a price they are willing to pay or sustaining current advisory relationships where they can consult a human advisor on a variety of financial matters. Also, some investors may be persuaded to move to investment solutions not affected by a ban on embedded commissions, which could result in clients owning more conservative options (savings vehicles) or higher-cost options (insurance strategies).

[12] For example, see Claude Montmarquette and Nathalie Viennot-Briot, *An econometric analysis of the value of advice in Canada*, CIRANO, July 2012, and *The Gamma Factor and the Value of Financial Advice*, CIRANO, August 2016.

By contrast, our proposed alternative solution would address conflicts of interest and simplify fee structures while reducing the potential for unintended consequences from regulatory arbitrage and supporting the efficiency and fairness of the market. In explaining our concerns about the proposal to ban embedded commission and our alternative solution, we have endeavoured in this letter to answer many of the questions listed in the Consultation Paper. The Appendix contains additional answers in response to other questions as elaboration of the points raised in our letter.

RBC is committed to promoting the affordability and accessibility of financial advice, products and services. In our view, the availability of high-quality advice, investor choice and innovation is in the interests of all investors. This includes a range of channels through which investors are able to access advice, which is a key element of a well-functioning market for financial advice. We urge the CSA to carefully examine stakeholders' feedback along with market-driven industry developments before deciding on next steps. To that end, we would be pleased to discuss our response with the CSA and provide additional information, as required, for the CSA's consideration.

Sincerely,

"Kirk Dudtschak"

Kirk Dudtschak
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Royal Mutual Funds Inc.

"Doug Coulter"

Doug Coulter
President
RBC Global Asset Management Inc.

"Dave Agnew"

Dave Agnew
Chief Executive Officer
RBC Dominion Securities Inc.

"Rosalyn Kent"

Rosalyn Kent
President and Chief Executive Officer
RBC Direct Investing Inc.

"Mark Neill"

Mark Neill
President
Phillips, Hager & North Investment Funds Ltd.

Appendix – Responses to Consultation Questions

Question 3: Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

Yes, a significant benefit of embedded commissions is that they are automatically deducted by the fund against its taxable income for the benefit of all taxable investors. This is significantly more efficient, cost effective and less prone to error than direct-pay models where each individual investor must calculate and determine how to deduct their advice costs on their personal tax return each year.

The current disclosure mechanisms for embedded commissions provide a level of public transparency that is not available from most direct-pay fee schedules. In direct-pay arrangements it is more difficult for investors to know how the fees they pay compare to the fees paid by other investors.

Also, an embedded low trailer fee option (e.g. Series D) allows Order Execution Only firms to provide access and service to mutual fund investors with no transaction-based commissions.

Question 4: For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**
- **structured note**

should the product be subject to the discontinuation of embedded commissions? If not:

a. **What would be the policy rationale for excluding it?**
b. **What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?**

We do not think embedded commissions should be discontinued. Investors should be allowed the freedom to choose whether they want to use a bundled or direct-pay model to pay their advisors. Current regulations ensure a high degree of disclosure of embedded commission levels paid both by individual investors and all other investors in a particular fund series. If embedded commissions are discontinued for some investment products but not others, the difference in compensation structure could incent market participants to favour certain products over others, such as segregated funds.

Question 5: Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

For the reasons given in our letter and in response to question 4, no type of mutual fund, non-redeemable investment fund or structured note should be subject to the discontinuation of embedded commissions.

Question 6: Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

RBC supports consistency of regulatory regimes across similar financial products to avoid opportunities for regulatory arbitrage. There are some indications that regulatory arbitrage is already occurring between mutual funds and segregated funds, in response to the recent regulatory changes in the securities industry. (See article: Rob Carrick, *Despite high fees, popularity of segregated funds on the rise*, Globe and Mail, May 7, 2015.)

Question 7: Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

No, we do not agree that elimination of bundled forms of payments is necessary or desirable. We think Canadians should be free to choose between bundled and direct-pay models based on their needs and preferences.

Question 8: Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

a. **the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;**
b. **referral fees; and**
c. **underwriting commissions.**

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

No, there are no other fees or payments the CSA should consider discontinuing. Our view is that the general and product-specific education permitted to be provided to advisors under Part 5 – Marketing and Educational Practices of NI 81-105 is consistent with investor interests.

Question 11: If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

To offer choice to investors, there may be value in a direct-pay model facilitated by investment fund managers. Expanded use of this compensation model, however, would require significant investments by both fund managers and dealers to transition from a paper-based to an electronic processing approach, with potential cost implications for investors. In contrast, embedded commissions are significantly more efficient to operate and do not require any new infrastructure.

Question 12: Based on a consideration of the data and evidence provided in this Part [Regulatory Impact], would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

The data and evidence do not provide a high degree of certainty that discontinuation of embedded commissions would address the key issues. The Consultation Paper presents and interprets information in a way that seems to support a pre-determined conclusion. Supporting evidence is presented as overwhelmingly strong while negating evidence is either excluded, dismissed or judged to be not worthy of consideration. Also, new research has recently been produced by the MFDA, IFIC and other organizations, as cited in our comment letter, which should be considered as part of the consultation process. In addition, little recognition is given to the many investors who are knowledgeable and choose to purchase and hold mutual funds with embedded commissions. It cannot, therefore, be concluded with certainty that a ban on embedded commissions would be more effective in addressing investor protection and market efficiency issues compared to the alternative we present.

Question 13: Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

Yes, our proposed alternative is the combination of measures described in our letter, which, together, would more appropriately address the CSA's three primary issues of concern while minimizing the risk of unintended consequences and continuing to provide choice to investors.

Question 15: What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- **Will investors receive advice and financial services that are more aligned with the fees they pay?**
- **What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?**
- **Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?**
- **What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?**
- **What effect will the proposal have on the cost and scope of advice provided to specific investor segments?**

We think that the removal of embedded commissions would have a negative effect on the ability of Canadian investors to freely choose the method of compensation that is best-suited to their needs and preferences. There is a very high level of fee transparency and regulatory protection provided to Canadian mutual fund investors today. Under this strong existing framework, Canadians can individually determine the extent to which their fees are aligned with the value they receive. In a free society, value in commercial transactions is an intrinsically personal and, at times, nuanced judgement that should not be dictated by anyone other than the individual.

Canadians should also continue to be free to choose whether to move to another form of advice, whether that be DIY, automated, fee-based, discretionary, online, face-to-face, digital or other based on their assessment of the value they receive. These choices, made freely under fair and transparent conditions, should determine how the market for advice develops.

Furthermore, Canadians who are happy with their existing embedded compensation arrangements should not be unwillingly forced to change to compensation formats that could lead to higher costs or formats that they may not be comfortable with. For example, elderly investors who have long-term relationships with their advisors and who do not feel comfortable moving to a direct-pay or online service model would be at risk of losing access to personalized advice to help manage the increasingly complex financial challenges of the later stages of life. Robo-advisors will likely be a valued option for certain investors. But other investors are likely to prefer the current level of personalized service they receive or, if the service model changes, forego advice altogether rather than use a robo-advisor.

Question 16: What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- **Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?**

Different delivery channels will evaluate payment arrangements according to the investor segment they serve and their business models. It is likely that a trend towards fee-based accounts would accelerate if the CSA proposal is adopted.

Question 17: Do you think this proposal will lead to an advice gap? In particular:

- **Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.**
- **Do you agree with our definition of an advice gap?**
- **Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?**
- **What types of advice or services currently provided today would be most affected by the proposal?**
- **Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?**
- **How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?**
- **Do you think that online advice could mitigate an advice gap? If so, how?**
- **Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?**

Yes, the CSA proposal is likely to lead to an advice gap based on the CSA definition of the term ["the group of investors who cannot obtain the amount of advice they desire at the price they are willing to pay – today"].

If investors who currently prefer an advice delivery method based on an embedded commission model are banned from using that option, a segment of that population may disengage entirely from seeking financial advice. Those investors would lose the benefits of advice (such as higher savings rates and larger financial balances over time) that they would otherwise have had access to if allowed to continue using the embedded compensation model that was best suited to them.

While we cannot be certain of which segment would be impacted the most, the largest population of mutual fund investors are those with smaller investment balances. It would be reasonable to assume, therefore, that Canadians who stand to benefit the most from better savings habits and improved financial wealth over time would be the most likely to be negatively affected by the advice gap.

Online advice may help to address this advice gap, but the availability, viability and effectiveness of these systems has yet to be demonstrated in Canada or elsewhere on a wide scale. For this reason and given the personalization associated with face-to-face advice, some investors are unlikely to be comfortable with using online platforms, such as robo-advisors.

Question 18: Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular: will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?

These changes are clear evidence that the market is operating in an efficient and competitive manner. We expect the trend towards fee-based and discretionary accounts will continue. As new entrants continue to enter the market, some will introduce new advice delivery and fee options.

Question 19: How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular,

- **Do you see payment options and business models evolving at present?**
- **How are they likely to change over time if the CSA were to choose not to move forward with the proposal?**

For the MFDA category for Deposit-taker owned firms shown in Figure 8, please note that Royal Mutual Funds Inc. has introduced a fee-based account with a minimum of $250,000.

With regard to IIROC-based deposit-taker owned firms, the chart shows fee-based accounts starting at $500,000. Based on information indicated by the Investment Industry Association of Canada (IIAC) and on the fee-based accounts offered by RBC Dominion Securities Inc., the minimums are significantly lower than $500,000. We support the IIAC's recommendation that the chart be amended for this channel as the current level shown does not reflect the mass and mid-market clients of deposit-taker owned firms with access to advice who could be adversely affected by the CSA' proposal.

Question 20: We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Comparisons across jurisdictions can lead to incorrect reasoning because of the unique characteristics of foreign distribution platforms, series options and other factors that are also at play. For example, it is relatively common in some jurisdictions for fund managers to be required to pay dealers a platform fee or some other form of revenue sharing for their products to be offered to that dealer's clients. These kinds of payments to access a dealer's platform are prohibited in Canada. Regardless, fee-based accounts are widely available at dealers in Canada and we expect demand for fee-based series will continue to grow with the demand for fee-based accounts in this country.

Question 21: Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- **Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?**
- **What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?**
- **What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?**

  - **Independent dealers?**
  - **Independent fund manufacturers?**
  - **Integrated financial service providers?**
  - **Mutual fund dealers?**
  - **IIROC dealers?**
  - **Online/discount brokers?**
- **What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?**
- **What would be the impact on dually-licensed mutual fund dealers and insurance agents?**
- **Will the proposal lead new, lower-cost entrants to the market? Why and how?**
- **Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?**
- **Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?**
- **Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?**
- **What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?**

Dealers would likely adapt to the rule by adjusting their systems and client accounts to allow for direct-pay arrangements, if they have not done so already. Fund manufacturers would likely consolidate the number of series. Regulatory arbitrage would likely result in increased sales of segregated fund products, to the detriment of market efficiency.

Based on the current low barriers to entry, we expect new entrants (either low cost or otherwise) will continue to enter the market at a healthy pace regardless of whether the proposal is implemented or not.

With respect to the effects of online advice, those cannot be foreseen with any degree of certainty. However, the significant number of new online advice providers in the market today is further evidence that the market structure is efficient and competitive.

Question 27: How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

a. **access to advice for investors,**
b. **choice of payment arrangements for all investor segments, and**
c. **a level playing field amongst competing investment products?**

As the mitigation measures focus on new technologies, new business models, new educational programs and new attempts to liaise with other regulatory bodies, none of these measures have been tested or proven to work at an industry-wide level. Therefore, there is a risk that these measures would not be put into practice successfully within a reasonable timeframe.

Question 28: What other measures should the CSA consider to mitigate the above unintended consequences?

Please refer to the alternative option we have described in our comment letter above.

Question 29: Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

- **Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.**
- **To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?**
- **What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?**

There is the potential for investors under a direct-pay model to incur additional costs to correctly calculate and deduct investment costs in their personal tax returns. With embedded compensation, tax deductions are managed at a fund level for the full benefit of investors. With the move to direct-pay models, many investors would incur the added cost and complexity of reporting taxable gains or losses realized by redeeming units to pay fees. In addition, any errors in accounting for fees on personal tax returns may result in overpayment of taxes, penalties and/or audit costs.

Question 32: For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- **Are there unique costs or challenges to specific businesses?**
- **What transition period would be appropriate?**
- **Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?**

Many fund manufacturers would need to make changes to series options and add new systems capabilities to allow for redemption of units to accommodate a new direct-pay model.

Dealers and manufacturers would need to develop new systems and processes to relay ongoing compensation rates to fund manufacturers and generate information related to fees to help clients with tax reporting.

All affected clients would need to be contacted and provided with education on the changes and agree to new payment arrangements or make other arrangements.

Existing DSC and low-load arrangements should be maintained until the DSC/low-load charges have expired.

Question 33: Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

If the CSA ultimately decides to proceed with the discontinuation of embedded commissions, substantial investment would be required by firms to continue to serve clients' investments in mutual funds through direct-pay arrangements. This would include a very large administrative effort to transfer clients fund holdings and engage with investors to explain such impacts as cost and tax. Our view is that transition option 1 – transition to direct pay arrangements within a defined time period – would be most suitable to effect the required changes.

However, we recommend that the impact of this change be mitigated by grandfathering current unitholders as long as they continue to hold or buy additional units of a particular fund. Grandfathered unitholders could choose at any time to switch to or buy different funds, which would not have embedded commissions.

Question 34: As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

As outlined in our comment letter above, instead of a fee cap, our alternative approach proposes that enhanced disclosure and other means of improving investor awareness of typical trailer commission rates versus outlier rates and the discontinuation of deferred sales charge (DSC) and low load (LL) options would address the potential conflict of interest associated with variability of compensation rates.

Question 35: Please explain whether you think each of the initiatives discussed above [POS, CRM, CP 33-404, compliance reviews] will, either alone or in combination:

- **address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and**
- **address or not address any additional harms or issues that you have identified.**

The existing POS and CRM2 regulations make trailing commissions highly salient and understandable to investors. The Consultation Paper offers no conclusive evidence that a ban on embedded commissions would further enhance levels of investor awareness, value assessment and control over the services they receive.

Question 36: Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

Please refer to the alternative approach we have described in our comment letter.

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June 9, 2017

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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
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Financial and Consumer Services Commission
New Brunswick Superintendent of Securities
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RE: CSA Consultation Paper 81-408 - *Consultation on the Option of Discontinuing Embedded Commissions*

Thank you for the opportunity to comment on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commission* ("**CP 81-408**").

CI Financial Corp. ("**CI**") is a diversified wealth management firm and one of Canada's largest independent investment fund companies. Our principal business is the management, marketing, distribution and administration of mutual funds, segregated funds, exchange-traded funds, structured products and other fee-earning investment products for Canadian investors. CI's business is carried on through two main business segments: asset management through our subsidiaries CI Investments Inc., Marret Asset Management Inc., CI Private Counsel LP, and First Asset Investment Management Inc., and asset administration, through our subsidiary Assante Wealth Management (Canada) Ltd. ("**AWM**"). We also carry on our asset management business in Australia and New Zealand through our subsidiary Grant Samuel Funds Management Pty Limited.

As at May 31, 2017, CI, through our subsidiaries, managed approximately 245 conventional mutual funds and 70 exchange-traded funds, closed-end investment funds or limited partnerships which are sold under various fund family names, with assets under management of $123.3 billion. As at May 31, 2017, AWM, through its subsidiaries and affiliates, administered approximately $41 billion in mutual funds, stocks, bonds, GIC's, insurance products and other investments for its clients.

Accordingly, we believe we are well positioned to comment, both from the standpoint of an investment fund manager and a securities dealer, on CP 81-408 and the effects we expect it to have on the mutual fund industry and the capital markets more broadly.

General Comments

While we support the initiative of the Canadian Securities Administrators (the "**CSA**") to protect investors, we believe the approach proposed in CP 81-408 is premature and based on assumptions about the industry that may not be correct. Furthermore, and perhaps most importantly, we are concerned that the proposed approach may result in negative unintended consequences for investors and the capital markets.

Our concerns with the CSA's proposal in CP 81-408 fall into three broad categories:

a) The CSA's proposal will likely have a negative impact on investors and the capital markets.

b) The proposal is premature, given the capital markets, CSA members and industry regulators have not yet had time to digest and understand the impact of the recently enacted Point of Sale ("**POS**") and Client Relationship Model ("**CRM**") reforms.

c) The CSA's proposal may not be fully informed by all available and relevant research, as certain data we have reviewed contradicts the data relied on by the CSA.

A. Negative Impact on Investors and the Capital Markets

In our view, the discontinuation of embedded commissions would negatively impact both investors and the capital markets generally.

Investor Impact

First and foremost, we believe the CSA underestimate the advice gap that will likely develop for lower wealth investors.

With the decline in employer-offered pension plans, investors have come to rely more and more on mutual fund investing to save for retirement, and lower wealth investors are often the ones that most benefit from financial advice in connection with such investing.

If embedded commissions are discontinued, it is not clear how investors with small account sizes would obtain the advice they require in order to appropriately plan for retirement. Such investors are unlikely to have enough assets to meet the minimum account size requirements that many dealers impose for fee-based accounts which allow dealers to charge fees directly to clients. Further, the idea that such investors could or would want to enter into fee arrangements with dealers for advice is not realistic, given the cost of the advice relative to their account size.

As noted in CP 81-408, concerns of an advice gap have arisen in the United Kingdom after embedded commissions were banned there, given the high costs of advice relative to the small amounts many investors had to invest. One doctoral dissertation, looking at the situation in the United Kingdom, indicates that, as a result of the prohibition of embedded commissions, advisors have moved to servicing only wealthier clients, and the author, citing other research, concludes that advisors would not be expected to work with a client who had investable assets of less than approximately £150,000.[1] In fact, the same dissertation states that nearly a fifth of advisors in the U.K. have asked their smaller clients to leave and 69% of such clients had investible assets below £50,000.[2]

The impact of this advice gap will be that investors will have much less capital available by retirement, as studies have shown that investors who work with financial advisors accumulate more wealth than those who do not. One 2016 Canadian study found that, within four years, households using a financial advisor had 69% more assets than comparable households not using a financial advisor. Further, this effect was compounded over time, such that households using a financial advisor had 3.9 times the value of assets after 15 years than comparable households without a financial advisor.[3] The same study also found that the savings rate of investors who worked with a financial advisor was higher than for those investors who did not (10.75% vs. 6.70%).[4] Another earlier study had similarly found that investors who work with an advisor have an average net worth nearly three times greater than those who do not.[5]

In addition, the discontinuation of embedded commissions, which would also result in the discontinuation of deferred sales charge ("**DSC**") options, is harmful to lower-wealth investors, given the smaller amounts such investors have to invest. A DSC option allows more of the investor's capital to be invested initially (as a portion is not used to pay the dealer an up-front sales charge), thereby allowing more opportunity for growth over time.

[1] Kendall Wesley Yeomans, "Facing Canada's New Financial Regulations and the Widening Advice Gap", thesis submitted in accordance with the requirements of the University of Liverpool for the degree of Doctor of Business Administration, April 2017 at 21.
[2] Ibid. at 22.
[3] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO, Montreal: August 2016 at 24.
[4] Ibid. at 26.
[5] Investment Funds Institute of Canada, *The Value of Advice: Report* (November 2011) at 2.

Given the importance provincial governments, particularly in Ontario, have been putting on pensions, and the concern with retirement savings, we do not believe the CSA should proceed with any discontinuation of embedded commissions without a complete understanding and appreciation for the potentially harmful impact on lower wealth investors and their ability to save for retirement.

We also note that, in her seminal 1995 report, Glorianne Stromberg expressed reluctance towards any ban on trailer or service fees given the potential for negative unintended consequences of doing so.[6]

Impact on Capital Markets

In addition to the negative impact on investors, there is currently a concern with the increasing regulatory burden on participants in Canadian capital markets. The Ontario Securities Commission has already recognized this increasing regulatory burden and is looking for ways to reduce it in the capital markets.[7]

One result of lower wealth investors being unable to access financial advice, as discussed above, is that such investors, anxious to invest may move into passive investment funds. While these funds generally have lower fees, they may not be the most suitable investment. In our view, policies that focus on costs without a balanced discussion of potential benefits, perhaps unintentionally, promote certain investment strategies that, while easy to execute, may not be in the long term interests of the investor.

We strongly believe that that the entire financial system benefits from an active, diverse mutual fund industry, as it injects liquidity into the capital markets. Active managers play an important role in capital raising by providing much needed financial support to small and medium cap companies and new entrants to the marketplace. On the other hand, passive managers are required to invest in the issuers that comprise the benchmark their funds are tracking. Therefore, an issuer will only attract investment from passive fund managers to the extent that it is included in such a benchmark. This means that issuers coming to market for the first time in initial public offerings, and the majority of small and medium sized enterprises, would not attract passive fund investment.

Another important consideration is that active managers seek out well governed companies and hold management accountable. Passive fund managers, on the other hand, only invest in companies that are in the benchmark their funds are tracking. Accordingly, good corporate governance is not directly a consideration for passive fund managers.

We believe these factors result in active mutual funds being a stabilizing force in the Canadian capital markets, which will be lost if assets move to passive funds.

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[6] Stromberg, Glorianne, "Regulatory Strategies for the Mid-90s -- Recommendations for Regulating Investment Funds in Canada", January 1995 at s. 10.01.

[7] OSC Notice 11-777 – *Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018*, (2017), 40 OSCB 2579.

B. CSA's Proposal is Premature

The CSA have recently completed implementation of the POS and CRM reforms, which are meant to improve investors' awareness and understanding of the costs associated with their investments.

In CP 81-408, the CSA state that they do not believe disclosure alone will fully address the inherent conflicts of interest created by embedded commissions, and therefore, the CSA may consider a ban on embedded commissions as a complement to the disclosure-based POS and CRM initiatives. However, CP 81-408 also states that the CSA have begun a multi-year research project to measure the impacts of POS and CRM on investors and the industry, which project is expected to be completed in 2021.[8]

In our view, the CSA will not be in a position to say with any degree of confidence that the conflicts of interest created by embedded commissions cannot be addressed through disclosure until the monitoring of the POS and CRM reforms has been completed. It is inconsistent for the CSA to state on one hand that they must wait until 2021 to fully assess the impact of the POS and CRM reforms, but then also say that they know now that these reforms are not sufficient to address the conflicts of interest created by embedded commissions.

For example, we note that according to a study prepared for the British Columbia Securities Commission, after receiving their CRM2 reports, investors became more aware of fees, both direct and indirect (76% and 59% compared to 67% and 47% in November 2016).[9] Further, investors with small portfolios became substantially more aware of direct fees (61% from 31% in November 2016). The same study also found that investor knowledge of different fees and how fees impact returns increased after receiving CRM2 reports.

Further, we would like to better understand where the CSA ends up in respect of their initiative regarding the targeted reforms and introduction of a best interest standard in Ontario and New Brunswick. Some of the targeted reforms discussed in Canadian Securities Administrators Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* relate to the mitigation of conflicts of interest between financial advisors and investors. Therefore, before implementing any discontinuation of embedded commissions, we respectfully submit that it is necessary to first understand the CSA's plans with respect to the mitigation of conflicts in the context of a best interest standard. We submit that, until this is done, any discussion or commentary on the discontinuation of embedded commissions would be premature.

Therefore, we believe that the increased transparency of fund costs resulting from the POS and CRM initiatives should be permitted to have its effect before additional measures are brought in that may be unnecessary and have unintended consequences.

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[8] CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*, January 10, 2017, at 87.
[9] "Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2", Prepared for the British Columbia Securities Commission by Innovative Research Group (April 26, 2017).

C. CSA's Proposal Not Fully Informed

While we fully support the CSA's desire to use data driven research in crafting policy, we believe that the universe of relevant and available research has not been incorporated into CP 81-408.

Importance of Performance for Fund Flows

CP 81-408 draws upon research showing that embedded commissions reduce fund flow sensitivity to fund performance. From this, the CSA conclude that the conflict of interest created by embedded commissions may diminish an "investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns."[10]

However, a study by Environics Research found that the top two reasons cited by advisors for choosing a mutual fund company to invest with are product range or quality (37% of advisors) and good performance (28% of advisors).[11] This is supported by research from Morningstar which shows that, globally, most fund flows among equity, fixed income and balanced funds are towards funds that have five star Morningstar ratings.[12]

Accordingly, we believe that investment fund managers that wish to increase fund flows are generally quite focused on the returns of their funds, as this has a large impact on sales and redemption activity, rather than embedded commissions, which, in our experience, are generally the same across funds in the same sector or asset class.

Benefits of Other Compensation Arrangements Unclear

While CP 81-408 contemplates other compensation arrangements that it considers preferable to embedded commissions, the research on the benefits of other compensation arrangements is unclear. Even the CSA's commissioned report from the Brondesbury group concludes that there is not enough evidence to state with certainty that a fee-based compensation model will lead to better long-term outcomes for investors.[13] Further, the Brondesbury group states that "there is ample evidence" that types of compensation other than embedded commissions can lead to biased advice.[14]

Conclusion

In light of the above noted considerations, we submit that the proposals will not further the CSA's objectives of investor protection and promotion of efficient capital markets. We respectfully suggest that at the very least further study is required as to the potential negative impacts of introducing such

[10] Ibid. at 10.
[11] "2015 Advisor Perceptions in Canada: A Focus on the Future & Consumers", Environics Research, (http://environicsresearch.com/wp-content/uploads/2016/02/Infographic-E_FINAL.pdf).
[12] Warren Miller, "Asset Management Trends: Flows and Risk", Morningstar Direct Forum, Toronto (July 21, 2016). Cited with permission.
[13] Brondesbury Group, "Mutual Fund Fees Research", Spring 2015, https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_engwr.pdf at 74.
[14] Ibid. at 20.

CI Financial

legislation. Further, we strongly feel that the issues addressed in this paper are inextricably linked to those being considered under the targeted reforms initiative and, therefore, should be considered in tandem.

Yours truly,

Sheila A. Murray
President and General Counsel
CI Financial Corp.

Steve J. Donald
Executive Vice-President; President
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Via Email

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commissions, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Me Anne-Marie Beaudoin, Corporate Secretary
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Dear Sirs / Mesdames:

Re: **Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (CP 81-408) ("the Proposal")**

Edward Jones welcomes the opportunity to provide comments with respect to the Proposal.

<u>Background</u>

Edward Jones is a limited partnership in Canada and is a wholly owned subsidiary of Edward D. Jones & Co., L.P., a Missouri limited partnership. Edward D. Jones & Co., L.P. is a wholly owned subsidiary of The Jones Financial Companies, L.L.L.P., a Missouri limited liability limited partnership. We are registered with the Investment Industry Regulatory Organization of Canada (IIROC) as an investment dealer and have more than 675 financial advisors located across Canada.

We help individuals achieve their serious, long-term financial goals by understanding their needs and implementing tailored solutions. At Edward Jones, we build close, ongoing relationships with our clients, beginning with a meeting between client and financial advisor to identify the client's specific long-term goals.

We then develop a thoughtful investment strategy and a diversified portfolio of quality investments. Edward Jones believes that all clients, regardless of the amount of investable assets, deserve the services of a financial advisor and the benefits of professional advice.

We choose to conveniently locate our branches where our clients live and work. We believe a financial advisor office with the dedicated support of an office administrator is the best way to deliver a consistent, ideal client experience. Our clients can work face-to-face with local professionals who better understand them and make investing a personal process. As a result, we do not offer online investing or online advice.

Overview

We agree with, and fully support, the spirit of the Proposal, in that fee transparency and client choice of payment to financial advisors is in the best interest of clients. We know that clients deserve transparency about how much they are paying as well as a full understanding of the value they are receiving for that payment.

We support any efforts to eliminate, where possible, conflicts of interest, and where it isn't possible, to mitigate or disclose conflicts of interest. Our primary principle at Edward Jones is that the clients' interests come first.

In support of our value proposition that our clients should be served in a manner best suited to their needs, we continue to offer choice through traditional brokerage, fee-based and managed accounts. Offering a suite of investment options including equities, fixed income, mutual funds and other quality investment solutions allows us to provide investments suitable for a wide range of client needs.

Comments

Below are our specific comments to the Proposal.

Mass Market Households

The Proposal cites industry data suggesting that investors with fewer investable assets are less likely to save using funds and/or securities and are more likely to save with deposit products. We believe this suggests the existence of an 'advice gap' in the industry where clients with smaller asset balances are less likely to be offered tailored, personalized, investment advice. We are concerned that any proposed changes would have an adverse impact on the ability of investors with fewer investable assets to obtain professional, high quality financial advice – something we believe should be available to all investors.

Making changes to embedded commissions may have disproportionate impact on investors with fewer investable assets. For example, our internal data suggests that households with fewer investable assets have a greater percentage of their assets in mutual funds compared to households with greater investable assets. Mutual funds represent an effective way for investors with smaller asset balances to achieve a properly diversified portfolio. We are concerned that any change could negatively impact the ability of smaller investors to build an appropriate portfolio for their needs.

Costs

We would like to understand what data or analysis is used to support the CSA's assertion that, due to the prevalence of integrated asset management and broker/dealer and financial advisor businesses (e.g. the business model of large Canadian banks), eliminating embedded fees and commissions would result in significant cost reductions. We believe this is an unlikely outcome in the absence of significant changes to the structure of the industry as there is no incentive for entrenched, vertically integrated market participants to dramatically lower their fees.

If the changes under consideration were implemented, we expect you will see more clients encouraged to move to fee-based accounts and likely incurring higher fees.

Value Proposition

We strongly disagree with the assertion that clients do not receive value for services provided beyond the initial trade. We have conducted considerable research into what our clients' value and external client studies corroborate our own findings. Clients want us to understand what's important to them and their financial goals. Clients want to partner with a financial advisor throughout their life and appreciate following an established process to build, track and adjust their financial strategies as they work to achieve their financial goals. Our business model is designed to help all clients work with a local advisor who can help them as their lives change. We would be concerned if our financial advisors did not provide ongoing service to clients, as this would result in a less than ideal client experience.

We agree that cost is an important factor when determining the suitability of a product for clients and is a key element of the value an investor receives from dealers. However, there are other factors as well, and acting in the best interests of clients does not rely solely on providing the lowest cost to clients. We urge the CSA to consider that any rule ensure that lowering costs does not impede the ability of advisors to provide high-quality products and services to investors.

We also disagree with the suggestion that investment fund managers and dealers are not focused on performance. Our Product Review and Mutual Fund Research departments factor in performance when assessing an investment fund manager, an individual portfolio manager, and a particular mutual fund. As our financial advisors focus on helping clients achieve their financial goals, they are fully aware that clients assess the value they are providing which naturally includes a concern with performance. Based on our ongoing discussions with investment fund managers, we believe that they too are focused on performance. The investment fund industry is competitive and the compensation structures are similar within an asset class; performance, particularly over the long-term, is an important factor when considering an investment fund manager.

Product/Regulatory Arbitrage

We believe that investors, and the public as a whole, would be well-served by ensuring that this view of transparency of fees and expenses is extended across the financial services industry, including banking and insurance products and services. In the absence of harmonized regulation, there will be advisors who recommend products and services in order to avoid the more stringent requirements imposed by one regulatory body. This would place increased pressure and costs on firms and on individuals in a supervisory capacity to identify and address these situations.

While we applaud the CSA's efforts to continue to liaise with other regulators to discuss these concerns, we do not believe that is sufficient. We ask that the CSA lobby the federal, provincial, and territorial governments to have the appropriate regulators take a more active role in addressing this regulatory imbalance. We would be pleased to partner with the CSA on this effort.

Client Relationship Model (CRM) / Point of Sale (POS)

CRM and POS, both just fully implemented within the last year, have resulted in increased transparency and greater client understanding. CRM, as intended, has enhanced the relationship between the client and the financial advisor. Financial advisors are required to explain costs more often, more clearly and to provide clients with information they can reference at any time.

While there has been an immediate positive impact, it is too early to assess the full impact of CRM and POS. In the *CSA's Discussion Paper and Request for Comment 81-407 Mutual Fund Fees*, the CSA indicated that it intended to monitor the impact of CRM and POS. We recommend the CSA continue to do so in order to be able to fully assess the impact on transparency and share any lessons with the industry that might quicken the pace towards greater transparency.

With that said, we do believe there is an opportunity to enhance the impact of CRM. Specifically, we are referring to the annual cost disclosure requirements. We firmly believe that the investing public would be well-served by extending the disclosure to provide investors with a 'total cost of ownership' view including the costs, in dollar terms, of all embedded fees, expenses and sales taxes included in investment products (e.g. mutual funds).

Supervision

We believe that the direction the CSA is considering will create additional complexity with respect to the monitoring of suitability. The Proposal contemplates a negotiated compensation arrangement that, among other factors, reflects the level of service desired by the client. We have a concern that the suitability of the compensation arrangement may be determined by the regulator through the benefit of hindsight. To help mitigate that risk, we ask that the CSA provide practical guidance on supervising for appropriateness of the compensation arrangement.

Miscellaneous

We would like to understand the data or analysis used to support the CSA's assertion that embedded fees represent a barrier to entry. The number of new providers of ETFs and online 'robo-advice' platforms in recent years appears to contradict this.

In summary, we agree with, and fully support, the spirit of the Proposal, in that fee transparency and client choice of payment to financial advisors, is in the best interest of clients.

We would be pleased to discuss and elaborate if requested.

Yours truly,

Wayne Bolton
Chief Compliance Officer

c. Tim Kirley, UDP, Edward Jones
Nawaz Meghji, General Counsel (Canada), Edward Jones

June 9, 2017

BY ELECTRONIC MAIL: comments@osc.gov.on.ca , consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
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Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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RE: CSA CONSULTATION PAPER 81-408 - CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

Serving one in three Canadians, Manulife is a leading financial services organization offering a wide range of protection, estate planning, investment, and banking solutions through a diversified multi-channel distribution network.

Manulife Investments, a division of Manulife Asset Management Limited, represents the wealth management arm of Manulife's Canadian Division. As one of Canada's leading integrated financial services providers Manulife Investments offers a variety of products and services including mutual funds, non-redeemable investment funds and exchange traded funds. As of April 30, 2017, Canadian mutual fund assets for Manulife Investments were approximately C$53 billion.

Manulife Securities, consisting of the IIROC regulated Manulife Securities Incorporated and the MFDA regulated Manulife Securities Investment Services Inc., are wholly owned subsidiaries of the Manufacturers Life Insurance Company (Manulife). Our advisors and life agents provide investors with access to stocks, bonds, mutual funds, and other investment products as well as a suite of insurance solutions.

We are pleased to provide our thoughts on CSA Consultation Paper 81-408 and we note that our response intends to complement and support the submission made by the Investment Fund Institute of Canada (IFIC) to CSA Consultation Paper 81-408.

We provide opening comments below before reviewing the value of financial advice, providing our thoughts on embedded and fee-based payment arrangements, and discussing the possible impacts of the CSA proposal on the market for financial advice and investments.

Opening Comments

Canadian investors are best served when the regulatory framework for investment funds supports strong consumer protection and facilitates access to a wide-variety of financial services, products, and professional advice.

Our assessment of the CSA's proposal suggests that banning the use of embedded commissions (i.e. payment by an investment fund manager to an investment dealer, which is used in part to pay an advisor) will disrupt the market for financial advice and make it difficult for average Canadians (i.e. those with less than $100,000 to invest) to afford this valuable service.

The mechanics of embedded compensation arrangements permit fund managers to off-set the costs of collecting and calculating client account fees and expenses for participating investment dealers. Many investment dealers rely on this business model to service smaller investors.

A ban on embedded commissions would inhibit this business model and require these costs to be borne by the dealer and passed through to customers; increasing the overall cost of the service.

We expect these higher costs will disproportionately affect smaller investors who will be unable to afford access to financial advice or will lack the investible assets to attract an advisor.

Rather than pursuing a ban on embedded commissions, we encourage the CSA membership to pursue the alternative regulatory approaches being presented by IFIC in its submission to CSA CP 81-408. Taken by themselves or in combination with existing regulations, these alternative approaches should appropriately address or mitigate the CSA's concerns regarding possible conflicts of interest in embedded compensation arrangements and avoid disruption for average Canadian investors, to the degree possible.

If these conflicts are effectively contained, then we believe that embedded compensation can continue to serve as a complementary payment option for investors alongside fee-based arrangements.

Value of Financial Advice

Rather than focusing solely on stock picking or trying to out perform the market, financial advisors also play an important role as the coach and partner of their clients by providing them with valuable investment discipline, confidence and planning. This behaviour is especially important for smaller and newer investors who need the benefit of time to build their retirement savings as early and consistently as possible.

Well-trained advisors work hard to instill life-long savings habits through the regular knowledge transfer that is the hallmark of the advisor-client relationship. And for most investors, access to advice has a measurable influence on their long-term success. Advice is important, especially in the early years of investing, because informed investors make better decisions and they are more disciplined about staying the course during changing markets and uncertain economic times.

Independent studies continue to show that individuals who work with an advisor over time benefit from more savings, more confidence in their investment decisions, and a more disciplined approach to their savings behavior.

For example, in 2012, the Center for Interuniversity Research and Analysis of Organizations (CIRANO) released a study entitled, *Econometric Models of the Value of Advice of a Financial Advisor*, by Claude Montmarquette and Nathalie Viennot-Briot examining the value of financial advice.

The CIRANO study drew four main conclusions about financial advice in Canada:

1. Advice has a positive and significant impact on financial assets after factoring out the impact of almost fifty socio-economic, demographic and attitudinal variables that also affect individual financial assets. This positive impact is more pronounced the longer the tenure of the advice relationship.

2. The positive effect of advice on wealth accumulation cannot be explained by asset performance alone. The greater savings discipline acquired through advice plays an important role. For example, the paper finds that advised households save at twice the rate of non-advised households.

3. Advice positively impacts the retirement readiness, even after factoring out the impact of other variables.

4. Having advice is an important contributor to levels of trust, satisfaction and confidence in financial advisors; a strong indicator of value.

In August 2016, Montmarquette and Viennot-Briot revisited their 2012 study with updated and new data to address potential bias and criticisms of their previous work. With this new study entitled, *The Gamma Factor and the Value of Financial Advice*, the authors reaffirm, and in fact strengthen, the results found earlier (i.e. that clients with an advisor grow their assets at substantially higher rates than clients without advice).

It is also important to recognize that investment intermediaries provide a valuable and legitimate service for millions of Canadians and are entitled to fair and reasonable compensation for their efforts.

Many independent investment fund dealers are small and medium sized-businesses. Fees and commissions paid to the dealer by the client and/or the investment fund manager, either directly or indirectly, are used to cover the dealer's operating, administrative, and labour costs and encourage owners of these businesses to grow their practice, hire new staff, and expand their expertise to the benefit of Canadians.

Consumer Choice

The investment industry offers consumers choice in how they pay for their services, allowing Canadians to select a payment method they feel is appropriate based on their personal preferences.

Embedded commission mutual funds, with options such as front-end or back-end loads (e.g. deferred sales charge), provide an affordable payment option for thousands of average Canadians.

Rather than eliminate payment options we believe that disclosure and transparency regarding fees and commissions should be enhanced, both at point of sale and on an ongoing basis. Specifically, Manulife supports controls on the sale of deferred sales charge mutual funds as proposed by IFIC to protect and serve the interests of investors, including seniors and investors with shorter time horizons.

Over the last decade, the Canadian market has seen a dramatic increase in the number of investors and dealers adopting fee-based arrangements, whereby the client pays a direct fee, often based on a percentage of the investments in their account, to the dealer. The February 2017 Investor Economics Insight, for example highlights that in recent years, mutual fund growth has been largely accounted for by funds with unbundled distributor fees (F-Class), particularly in full-service brokerage.[1]

As both a fund manufacturer and investment fund dealer, Manulife expect sales in this structure will continue to grow in popularity, regardless of the position the CSA ultimately takes in respect to banning embedded commissions.

We think it is important to note however that, in our experience, the growing trend towards fee-based arrangements, and particularly the purchase of F-Class series funds, is primarily occurring with investors who have enough assets to make the costs of these programs worthwhile.

As such, we encourage the CSA to allow smaller investors, for whom fee-based arrangements are not economical, to continue to have access to financial advice through commission based accounts.

Impact of a Ban on Average Canadians

As noted in our opening comments, the CSA's proposal to ban embedded commissions has the capacity to disproportionately impact smaller and first time investors and make it difficult for average Canadians to access affordable financial advice.

Under a ban, we expect most investment dealers will move to some variation of a fee-based arrangement. While fee-based accounts provide a cost-effective and efficient payment option for many Canadians it may not be an appropriate or affordable model for all investors or investment dealers.

[1] Investor Economics Insight, Investment Funds Advisory Service – Canada. Strategic Insight. February 2017

<u>Mechanics and Costs Associated with Dealer-Sponsored Fee-Based Accounts</u>

Manulife Securities is familiar with the mechanics and costs associated with offering a dealer-sponsored fee-based account platform and it is important for the CSA membership to have a strong understanding of these costs as well.

Due to the business-sensitive nature of this information, we would feel more comfortable sharing these details in a separate, private communication. We will direct our Manulife staff to follow up directly with CSA member staff in the coming weeks to provide a written, detailed overview of the mechanics and costs associated with our dealer-sponsored fee-based accounts.

More generally, for the purposes of this consultation, please consider that to replace an embedded commission with a dealer-initiated fee, a dealer must:

1. Calculate fees plus taxes based on the market value of the account using an in-house or outsourced fee engine.
2. Administer fees by accepting fee agreements, setting up fees in the fee engine, processing and reporting fees, remitting sales taxes on the fee to the respective jurisdictions.
3. Execute sells to clear fee debits that have been posted to the account (Note: since dealers have the authority to clear indebtedness *only* in nominee accounts, client name accounts are not eligible in fee-based account programs).
4. Settle trades onto the custody system.
5. Print and mail a trade confirm.

For each of these functions there are tangible, quantifiable costs to the dealer that do not exist when fund companies calculate and pay embedded commissions.

If the CSA moves forward with a ban on embedded commissions, we expect investment dealers will pass the costs of these functions to investors. Consumers who choose to continue to invest with advice will pay more to get the same products/service/advice. Consumers who become disenfranchised with the increased cost of investing with advice will voluntarily abandon the advice channel.

Alternatively, dealers that are forced into offering a direct pay model for all their accounts will likely raise their account minimums creating an advice gap. Dealers faced with setting up a fee-based platform, or extending an existing platform, to cover tens of thousands or hundreds of thousands of new accounts will face an overwhelming challenge both operationally and financially. To bring the number of accounts and the expected dealer revenue per account into a zone that makes it financially viable, dealers will raise their minimum account size thresholds. Dealers that currently operate solely in client name, faced with the prospect of converting to both a nominee name platform and a fee-based platform at the same time, will not likely have the financial wherewithal to make the shift.

To put the scope of the consumer impact of an increase to minimum account sizes in perspective, Pollara research from 2016 suggests that Canada-wide, 68% of investors had less than $50,000 when they first met their advisor and 37% had less than $10,000.[2] Moreover, new research from the Mutual Fund Dealers Association of Canada (MFDA) indicates that about 83% (or 7.3 million households) of the almost nine million households that invest with a MFDA representative have less than $100,000 in assets.[3]

Although discount brokerages and robo-advisors provide an attractive, and low-cost alternative for a niche segment of investors, research by Ipsos suggests that many Canadians, especially older Canadians, prefer face-to-face professional advice and do not have the desire to invest through a robo-advisor.[4] Moreover, these channels are generally restricted, either by regulation, business model, or technology, in their ability to offer comprehensive financial advice, planning, and other services. Ultimately, without access to an attractive option, many Canadians will choose not to invest, hampering their ability to save for retirement and other large events.

Conclusion

Given the possible impacts that the CSA's proposed ban on embedded commissions could have on the ability of average Canadians to afford access to traditional financial advice, we recommend that the CSA evaluate and pursue the package of alternative reforms proposed by IFIC in its submission to CSA CP 81-408.

These alternative reforms, taken by themselves, or in combination with existing regulation will address the concerns raised by the CSA, allow investors to continue to have affordable access to the Canadian financial marketplace, and avoid the unintended disruption created by a prohibition.

Thank you again for the opportunity to provide feedback to CSA Consultation Paper 81-408. We would be happy to provide further information upon request and answer any questions that you may have.

Sincerely,

Bernard Letendre
President, Manulife Investments,
Senior Vice President and Head of Investments
Manulife

Rick Annaert
President & CEO, Manulife Securities
Senior Vice President, Advisory Services
Manulife

[2] Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry. Pollara Inc, prepared for the Investment Fund Institute of Canada. 2016

[3] MFDA Client Research Report: A Detailed Look Into Members, Advisors, and Clients. Mutual Fund Dealers Association of Canada. May 2017.

[4] Canadians & Financial Advice 2016. Ipsos 2016.

June 9, 2017

Response to CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions – January 10, 2017*.

Dear Sirs,

The CSA Consultation Paper 81-408 advocates both a total, wholesale repeal of a fully accepted norm of commerce and the Canadian investment industry (the manufacturers' sales agency agreement), and a proposes to replace this norm that has operated in competitive market conditions for over 5 decades with a conjecture for a format of a payment-for-service contracting between investors and their registrant dealer that displays no understanding of the costs inherent to back office operational structures or transaction processing within the Canadian investment industry.

No Evidence of Harm or Advantage

CSA Consultation Paper 81-408 is a proposal that inherently maligns all Canadian registrants and regulators, openly and without offering any documentation or evidence.

It is a paper that does not undertake, nor provide sourcing from others, of any monetary analysis of the systemic harm and abuse to investors to substantiate its allegation, nor does it provide any data from enforcement actions on this alleged systemic abuse.

As to the allegations of asset managers gaining systemic advantage, CSA Consultation Paper 81-408 does not present even a single funds that has outperformed its peers in the accumulation of assets under administration (AUM) due to the cited conflict of interest of registrant dealers or advisors.

It is staggering that a 165 page paper shows no documented analysis of the value of the damage sustained by investors, nor offers any proof of an asset manager's profiting, from what the paper claims cannot be permitted to continue.

No Understanding of the Operational Costs in Back Offices

CSA Consultation Paper 81-408 does not investigate or detail the different costs structures that dealers encounter when their investors purchase and hold managed assets as opposed to those costs arising from transactions of any of security, whether exchange-traded or traded on the debt market.

CSA Consultation Paper 81-408's failure to appreciate and include references to the substantially higher cost inherent to managed assets, underpins Consultation Paper 81-408's advocacy for dealers to be required to openly and continually highlight a comparison of pricing, directly to investors, that places all mutual funds and managed funds at an enormous competitive disadvantage.

Advocating for massive competitive disadvantage to managed funds, inherent to the strict pricing in a new fee-per-service alternative will prove exceedingly costly, devastating to all mutual funds and asset management in Canada and structurally damaging to the Canadian investment industry.

Emotive Phrasing Shaping the Fate of the Canadian Investment Industry

Having highlighted the existence of a conflict of interest that is navigated by registered advisors at point of sale, Consultation Paper 81-408 claims, without providing any evidence, systemically investor abuse the CSA does not ask for public comment upon “Whether Fund Managers Are Being Allow to Pay Dealers Too Much” would elicit much less angst, but no less interest from the public, Consultation Paper 81-408 instead purposefully chooses the emotively charged, impugning phrasing, “Discontinuation of Embedded Commissions”.

Choice of phrase has created a politicized environment that now threatens the existence of the mutual fund industry in Canada and the global stature and viability of Canadian exchanges and debt markets.

Repealing a Business Practice Honed Within Competitive, Highly Regulated Markets

The advocacy for repeal of a time-honoured, established by highly competitive conditions, and proven as an on-going business structure under Canadian regulation, is based upon unsupported conjecture.

Posing to resolve the inherent conflict of interest that faces any sales agency (they must always navigate the multitude of limitations within any product they represent between the desires of manufacturer and consumer), Consultation Paper 81-408 does not present any evidence to justify a need for its radical solution.

Even though this conflict of interest has been part of the investment industry for decades prior to being noted and discussed in the 1980s by the Stromberg Commission, a 165 consultation paper published in 2017 proclaims systemic investor abuse to have occurred and continues to occur, but cites no history of investor complaints and no enforcement actions.

Consultation Paper 81-408 should be enumerating those harmed, or specifically identify those individuals or corporations who have been found, publicly, to be perpetrators of harm, before undertaking to a public maligning of all Canadian regulators and registrants and advocating wholesale change to business practices.

Fee-Per-Service – No Definition; Multitude of Inherent Conflicts of Interest.

Worse still, after maligning regulator and registrant alike and advocating an immediate discontinuation of a norm, Consultation Paper 81-408 advocates an alternative does not exist, without any analysis of the present conditions that govern the cost of securities transactions and the holding of securities, let alone attempting to define in terms of the time, manpower, software systems and processes, or potential financial costs the implementing any version of its proposed solution/alternative.

It is entirely unprofessional for the authors of a 165 page paper, to back away and leave a required structure to replace a suddenly “discontinued” business practice to the investment industry to figure out, design, amass the resources for, and implement in time. Worse still, the paper proclaims this non-alternative, both unknown in scope and extent, and wholly unanalyzed - to be superior – even though fee-per-service is commonly accepted within the investment industry to have far more inherent conflicts of interest for an advisor than imbedded commissions.

No Analysis of Resources Require by Canadian Investment Industry

Even a brief survey of these requirements or a structured “fee-per-service” alternative (one is provided below) will establish as obvious that Consultation Paper 81-408’s recommendations are far beyond the resources of the Canadian investment industry.

Moreover, it was not demonstrated by Consultation Paper 81-408 that Canadian investors can reasonably expect an increase to their net investment performance as a result of the advocated changes.

Consultation Paper 81-408 advocates a “mandated redistribution” of fund management revenues; halting the forwarding of managed fund and managed account revenues that are presently being paid by the manager to a dealer to defray the higher costs involved in purchasing and owning mutual funds (including manual processing of purchases, withdrawals, and reinvestment, T3 tax forms, etc.).

Consultation Paper 81-408 envisions that these same dramatically higher costs will be presented to the investor by the dealer, in a posted schedule that openly contrasts each of these high costs against the low fees charged for the efficient, automated events for exchange traded and debt securities.

What is self-evident from Consultation Paper 81-408’s proposals is that investors will see more and higher charges from dealers and higher total costs towards maintaining their managed investments, without observing measurably superior investment results from these assets.

K-Y-C is a Factor at Point of Sale (POS)

Consultation Paper 81-408 also clearly avoids reference to K-Y-C when it issues its collectivizing statements about mutual fund commissions. The commission rates paid to dealers/advisors by managed funds rise in direct relationship to the risks inherent to the assets within the fund; moneymarket funds being the least expensive, equity and alternative asset management being the most expensive.

In every investor account, K-Y-C regiments the portfolio mix recommended and maintained by a dealer and advisor and K-Y-C inherently defaults towards the lower cost, lower risk alternatives. Also true is that investors seek professional management for their assets with a multi-year horizon. This allows the investor a longer amortization period for the higher purchase costs of professional management, thus over time this horizon reduces to insignificant the impact of any slightly higher commission that might be charged between two funds of the same asset class.

If one starts with the primacy of K-Y-C under Canadian regulation and the expected long term amortization of a fund’s purchase cost at Point of Sale (POS), it becomes exceedingly difficult to construct a scenario of systemic investor harm. However, Consultation Paper 81-408 cites neither; it simply repeats allegations of investor harm from a conflict of interest we know is already carefully circumscribed and restrained by an advisor’s regulatory obligations and the dealer’s compliance department.

Sales Commission Are Different From Trailer Fees

Consultation Paper 81-408 regularly obfuscates the two distinctive forms and structures of payments that occur between fund managers and dealers; sales commission and trailers fees. Consultation Paper

81-408 casually enlists any resulting confusion from its use of the emotive phrasing, "Embedded Commissions" to elicit support for the paper's recommendations.

Investor Recollection

Consultation Paper 81-408 claims that investor interview surveys have shown that Canadian investors do not often recall the terms or percentages of the fund manager/dealer sharing of fund MERs for the assets they hold.

No mention is made in Consultation Paper 81-408 of the regulatory requirement that investors be apprised of this distribution at the time of purchase (POS). This is a glaring omission. It is the structural cornerstone to the paper's core and fundamental allegation and "blanket statement" that the conflict of interest, inherent to the present commission payment structure income, is systemically resolved to the harm of the investor.

Specifically to this point, Consultation Paper 81-408 states because advisors are paid by commission asset managements "incent dealers and their representatives to sell funds that compensate them the best".

It deserves to be repeated that no statistics, no documentation of complaints on this issue to regulators, or history of enforcement actions against such dealer or advisor non-compliant behaviour are provided in support of Consultation Paper 81-408's existential allegation – there has been investor harm. Indeed, Consultation Paper 81-408 provides no evidence to demonstrate that investor harm results from differences in commission rates in a systemic fashion or even that is it a statistically significant problem in the Canadian investment industry.

Perhaps even more importantly, ignored and unstated by the Consultation Paper 81-408 is that the same Canadian consumer/investor who was surveyed would also not be aware that the exact same form of manufacturers' sales agency agreement/contract was imbedded into the price of the blue jeans they are wearing, the groceries, articles of jewellery, telephones and telephone services (which are regulated industries), and the energy forms (including natural gas and electricity, which are regulated industries) they purchase or even within the financing they might obtain for costly products like homes, furniture, and recreational vehicles.

Clearly, as consumers, Canadian investors show themselves to have no problem with the conflict of interest arising from minor, less than ½%, differences in commissions rates between the alternative long-term investments they have been asked to choose between. This reality appears to be purposefully lost by Consultation Paper 81-408 as it clear, the paper does not entertain any alternative interpretation to the survey or potential for an alternative interpretation; only its own.

Maligning the Canadian Industry

Consultation Paper 81-408 does not make any reference Industry Regulations which require written and verbal disclosure of these agreements/contracts by registrants at point-of-sale (POS). It neither investigates whether registrants fail to meet obligations, nor raises the question whether Regulators have abjectly failed to monitor its registrants, which, of course is a systematic, wholesale failure of all Canadian regulators to perform their mandate of investor protection.

Consultation Paper 81-408 simply, in blanket statement fashion, maligns all Canadian regulators and registrants.

Costs of Process to Dealer Back Office

Consultation Paper 81-408, does not mention, take into consideration, nor does it analyze the highly significant, higher costs of mutual funds to dealer back-offices. There is no mention of costs, whether transaction related processes, safekeeping costs, tax form preparation costs, or otherwise. Nor does Consultation Paper 81-408 recognize there are a diversity of business practices between fund managers' back offices, creating different costs of process between fund managers and funds, even nearly identical mutual funds or funds from the same manager.

As a result of this oversight, Consultation Paper 81-408 fails either recognize or acknowledge that payments to dealers encompass more that the costs of investment selection.

Fee-for-Service – An Open-Ended, Unlimited Matrix

The cost, complexity, and openness to abuse of the proposed Fee-per-service model, as an alternative system to fund manager to dealer sales commissions and trailer fees advocated by Consultation Paper 81-408, is staggering.

To begin with, a strict relational fee-per-service at a dealer level represents an absolutely limitless number of security related event prices, levels of service, the product, activity, overhead, and compliance involved, back office practices, and more. None of these unique pricings can ever be directly compared by the investor or regulator at reasonable cost.

To create its own matrix, each dealer will have to begin with the operational differences between fund managers, operational costs in the dealer per account type come next, then a matrix of the vast and growing multitude of managed investment products and hundreds of different transaction types, all of which will need to be priced distinctly and separately Then there is the advisor conversation with the investor for which every service an advisor provides is to be billed for itself (be it one, two, three or more investments to consider; review of price history, percentage allocation to the portfolio, or relative income analyses of a portfolio; then whether the recommendation(s) pertain to one portfolio or a group of portfolios, etc.). There is no fashion by which Consultation Paper 81-408's advocacy of fee-per-service and its limitless matrices can be more easily understood and within the control of the investor, than the present POS advisor presentation of the costs to the mutual fund investor.

A schedule of charges that an investor will be subjected to an invoiced upon simply cannot be compared between dealers, or even advisors.

Consultation Paper 81-408 does not comment upon the costs to regulators for its alternative, fee-per-service; perhaps for good reason. The difference in regulatory cost between ensuring investor protection with the existing advisor payment system vs. the Consultation Paper 81-408's proposed "Fee-for-Service", presently appears to be beyond calculation.

Other Factors in Investor Decision-making

Within the Consultation Paper 81-408 there is no supporting evidence to justify the paper's attachment of an overriding importance to a differential of mere basis points between mutual funds' sales agency commission rates, even when narrowed to nearly identical funds (e.g. same asset class, performance, strategy, risk profile)

Consultation Paper 81-408 cites investor harm but undertakes no investigation, nor does it list the many other factors within an investor's decision between funds. As a result, the paper also does not delve into what level of importance the investor has placed upon the marginal commission or trailer fee cost within his/her decision.

The paper fails to even discuss what the rate of commission offered by a fund relates to. This includes,

a. the difference in past performance between nearly identical funds within an asset category
b. the difference between the investment strategies pursued by fund managers
c. the inherent importance of non-volatile performance to the investor
d. the importance of fund manager name recognition to the investor
e. the expected holding period for the fund, thus the amortization period inherent to the sales commission

It is therefore difficult to accept Consultation Paper 81-408 allegations of systematic harm to investors is the result of modest differences in sales commission rates when Canadian regulations mandate that all of the above factors be considered by investors before they purchase a managed investment.

New Amounts to be Paid by the Canadian Investor – the impact of Fee-for-Service

Consultation Paper 81-408 will cause the immediate increase annual cost/fees to Canadian investors of between 0.5% and 2.0% or more for all fund/managed assets presently owned by Canadian investors ($1.5 trillion managed assets cited; between $7.5-30 billion/yr in additional costs to Canadian investors).

Because the Canadian investment industry presently does not charge annual fees or additional commissions on client assets invested in managed funds Consultation Paper 81-408 will require investors to immediately begin to pay their regular dealer account charges for these assets. For fee based accounts, managed products will become subject to what is commonly in full service dealers, a 2% annual fee.

Fund managers may or may not reduce their MER by the ½ % trailer for fee-based dealer accounts because they must immediately re-organize their sales, marketing and branding strategies to find new means to, and more directly engage, Canadian investors. (see below, fund managers must undertake and implement new, more expensive marketing costs).

The added investor expense of up to 2% will not change the performance of an asset, it will however, significantly reduce the investor's net investment performance.

If fee-based accounts are discontinued in favour of Consultation Paper 81-408 fee-per-service regime, the existing costs to buy or sell for mutual funds will remain unchanged, but they will be enumerated to the investor by the dealer. Since the up-front fund sales commission for managed assets are much higher than the trading costs investors prominently advertised for exchange traded securities, in all likelihood, the higher commission rate on fund trading slips and the constantly reporting of larger fees for fund holding and asset maintenance activities will inevitably dissuade most investors from buying non-exchange traded investments. (see below, unintended consequences)

The discontinuation of the present fund manager/dealer revenue sharing relationship as envisioned in Consultation Paper 81-408 will make fund investment appear significantly more costly to Canadian investors. The 37% of Canadian households who invest in funds will see between $ 7.5-30 billion drawn from their wealth annually, a charge to investor wealth that risks the survival of fund management in Canada.

Significant Additional Back Office and Compliance Costs

Consultation Paper 81-408 envisions that dealers will be allowed and expected to invoice fund managers to withdraw from the investor's assets under their management, for the activity related charges or structured fees owed to the dealer by that investor.

To meet the fee-per-service proposals of Consultation Paper 81-408's by both fund managers and dealers will have to purchase highly sophisticated invoicing and payment systems.

Dealers

Dealers do not presently possess an invoicing system or sufficiently sophisticated re-imbursement payment monitoring system(s) to address Consultation Paper 81-408's proposed alternative.

It is quite possible that invoicing systems capable of drawing the records of fees charged from the dealer's existing back office account management computerization, and shift them to or between fund managers have not yet been built. Nor are invoicing systems designed to parse an investor's total fees into invoices to be sent to one or more fund managers, identifying specific fund assets to be drawn down by the fund manager. Investor tend to want to draw down more from one fund than another.

While core to Consultant Paper 81-408 fee-per-service proposal is a system for tracking payments invoiced, a system to adjust holding of mutual fund units accordingly, it may not actually exist. Compliance demands and issues increase as well, in that the new balance of holdings may contravene the primacy of K-Y-C.

Certainly, if the dealer is expected by the investor to draw down from a fund that is actually held in another of investor's inter-related accounts at the dealer instead of in one where the fee(s) was generated, such a system does not exist.

If the simpler systems do exist, integrating it with dealer legacy systems and converting the existing system's format to account structures and pricing matrices within each dealer will be prohibitively expensive.

To attempt fund manager invoicing of this complexity using human resources is certainly not within the means of any Canadian dealer.

The cost of a dealer system (automated or human resource based) to fulfill the fee-per-service accuracy sought by Consultation Paper 81-408 is likely to be beyond the financial resources of a vast majority registrant dealers. It will certainly become a regulator-required barrier to entry within the Canadian investment industry.

Fund Managers

Fund managers do not possess the means or systems to handle Consultation Paper 81-408's envisioned a deluge of invoices, let alone invoices that request money from a fund to be transferred into more than one of an investor's related accounts at a dealer. The fund manager is not likely to be aware of the investor's related accounts at the dealer or the relationships. All of the relevant K-Y-C information is presently held by the dealer and fund managers do not possess systems to accommodate and keep current dealer held K-Y-C information.

Compliance at the Fund Manager Level

Consultation Paper 81-408 envisions the discontinuation of contractual arrangements between the fund manager and dealer, but each dealer account invoice inherently arrives at the fund managers back office with a legal obligation to the fund manager, as trustee, for each investor's assets; an obligation to protect those assets from wrongful disbursement.

Therefore the fund management industry will be confronted with the compliance problem of how to ensure that only the appropriate amount of money is being sent to the dealer. This is not Consultation Paper 81-408's simple proposal - fees can be drawn against the AUM under the fund manager – the industry to which it has been proposed faces tough realities for any request for fees from assets under management (AUM) from managed funds.

Designing and building such huge and sophisticated compliance and payment systems, quite probably, is beyond the resources of any fund manager. A required implementation certainly creates a barrier to entry into the Canadian investment industry.

It is safe to say, trailer fees have been the industry's means to avoid these costs and issues. Trailer fees are a proven, simple, and elegant way to deal with a dealer's costs arising from mutual fund investment. A discontinuations will create costs that will ultimately be borne by Canadian Investors, even though none of the costs will enhance net investment performance.

Dealer Compliance Departments

Compliance departments of dealers will have to monitor, test, and supervise fees paid within the expanded matrix of investor activities and account types within every dealer.

Dealers and fund managers will be required to monitor fees and investor costs for compliance purposes in more complex and intricate ways, including the attribution of fees to unrelated fund manager's AUM whose assets are in an investor's related dealer account and the potential need for K-Y-C related rebalancing of asset weightings after fund redemptions have been completed for the payment of fees.

Compliance departments will have to expand significantly in manpower and computerization.

The costs for the compliance systems needed to monitor, test and supervise the invoicing, payment and payment tracking systems to support Consultation Paper 81-408's are presently incalculable, but these too will ultimately have to borne by Canadian investors, who will derive no benefit to their net investment performance resulting from these costs.

Canadian Regulators

To fulfill their mandate to protect investors, all Canadian regulators will be required to monitor and review all fees paid by investors within the envisioned, vastly expanded matrix, including the pricing for all activities in dealers, funds, and managed accounts Regulators will also have to measure the efficiencies and inefficiencies of every fund management back office in order to evaluate "fair pricing" by a dealer.

To meet their investor protection mandate if Consultation Paper 81-408 is implemented, the audit departments of Canadian regulators must substantially expand beyond their present levels of human resources and computerization.

These increased regulation costs must ultimately be passed along to the registrants, who must then attribute these "operational/overhead" costs into the fees charged to the investor. None of these new costs advance Canadian investor wealth creation nor will they increase a fund management's net investment performance.

No Analysis of Regulatory Costs

Consultation Paper 81-408 does not include comment upon or provide insight into the increased cost of regulatory oversight inherent to its proposals. CSA certainly has the means to enumerate and quantify expected regulation costs (software, audit time, staffing, financial, etc.), therefore it is disturbing that Consultation Paper 81-408 omits this information.

Consultation Paper 81-408 proposes major structural change to the business practices and costs that underlie the marketing and sales of managed investment. The Canadian investors deserve a report, in dollar terms, of the both the benefits they can expect to receive and the costs they will bear, from Consultation Paper 81-408's proposal to replace existing fund manager/dealer sales agency agreements.

No Evidence to Support Allegations

Fund Manager's Benefit

Consultation Paper 81-408 cites no evidence, whether from industry analyses or internal CSA investigation, to demonstrate to what degree any specific mutual fund(s), ETF(s) or other managed account(s) gained observable marketing advantage over their direct competition and arose from a particular fund manager/dealer payment structure.

No evidence of Enforcement Actions or Naming of Victims

Although 165 pages in length, Consultation Paper 81-408 alleges that differences in advisor payouts have systemically harmed Canadian investors, but provides no facts, consultant presentations, or enforcement actions to provide the reader with specific offenders or victims (whether individuals or as an identifiable demographic of investors).

The underlying conflict of interest issue was publicly identified during the 1980's, certainly during the intervening three decades the industry should have produced ample fact-sets and records of enforcement that could have been referenced in Consultation Paper 81-408.

It appears appropriate to criticize the absence of enforcement records to support or contradict the point of sale, because in its place, Consultation Paper 81-408 provides a 24 page survey of the demographics of investment holdings and multiyear surveys of the change in holdings of managed product by Canadian investors. These 24 pages are entirely void of insight, or discussion, of point of sale issues, they are totally irrelevant to the issue and should not have been included.

Mischaracterization

Because Consultation Paper 81-408 does make any attempt to identify or reference any of these highly relevant sets of facts, the reader is left without appropriate scope regarding the issue of systemic investor harm, permitting Consultation Paper 81-408 to inherently mischaracterize the Canadian investor as someone who has always been victim, never seeing appropriate information regarding the costs of mutual fund ownership.

Maligning Regulators and Registrants

This mischaracterization maligns, dealers and advisors, as registrants, for failing to abide by regulatory POS requirements and all Canadian regulators who are inherently alleged to have totally and abjectly failed to fulfill their mandate of investor protection.

It is not clear why Consultation Paper 81-408 has issued such a broad maligning of all levels of the Canadian investment industry.

Role for Sales Commission When Investors Want to “Hold Managed Funds for the Long Term”

Sales commission act to motivate the advisor to recommend investors to undertake a regular review to consider culling their worst performing assets. This is a positive for investors as the advisor is seeking to enhance the investor’s net performance over both the near and long term. In these cases, trailer fees, even a differential in trailer fees, is highly unlikely to incent an advisor to not recommend a review of the portfolio, or to recommend an investor retain the higher trailer fee fund even though it is an underperforming asset.

Portfolio reviews

To replace the existing system that inherently promotes both investor review and timely review of their portfolio(s), which is what Consultation Paper 81-408 advocates, and replace it with a “sticker shock” type, “in your face”, barrage of fees, each unique to a specific service (including recommending and assisting with the portfolio review) should appear counter-productive.

Consultation Paper 81-408 does not address the fact that the exact same large commission payment that is not earned by suggesting a portfolio review, becomes new substantial cost to the investor after the investor agrees to first pay for a portfolio review.

Consultation Paper 81-408’s advocacy of precision item by item, fee-per-service, it will require investors to agree up-front to pay for regular and timely portfolio reviews, of costs that cannot be defined because it is inherently unknown as to how many services will be provided within the review, until after the review is completed.

Fee-per-Service, Incenting the Advisor

The above does to begin to address the dealer/investor relation complexities and brand new conflicts of interest regarding an advisor, who is tasked with proposing alternatives to under-performing assets under the advocated structure of fee-per-service in Consultation Paper 81-408. For example, each of the alternative investment proposed represents a separate services and thus its own fee. At what point is the advisor unduly incented by the number of fees he/she can charge for suggesting a further investment alternative or another overview service?

Unlike the proposal of fee-for-service, the present system of fund managers to dealer payments caps what investors pay. No matter how often there is a review, no matter how many alternatives are reviewed, the investor is in control. In the end, there will be one sales commission paid to the advisor, but only if the investor believes a change of assets will benefit his/her future net investment performance.

Unsubstantiated Conclusions and Recommendations

1. **Reduction in fund series and in fund fee complexity**

Fund series are a result of both a fund managements' attempts to disguise the extensive costs of their fund, designing new ways to present the same costs to an investor in a more palatable manner and a manager's need to innovate "brand extensions".

To an investor who continues to leave assets in the control of the fund manager, there are no differences between the funds in the present form of "series". It is only in a scenario of withdrawal from the fund that the investor must consider the different alternatives in a series.

Recognizing that consumers search for deals, fund managers will continue to seek new ways to make the investor feel that they have a "best" deal or the most "appropriate" alternative. For Consultation Paper 81-408 to pretend that fund managers will not innovate and implement means to appear to make an investor feel they better manage the costs of fee-per-service is either inappropriate or a failure to understand the marketing requirements facing fund managers.

Moreover, there is no limit to the marketing creativity of fund managements. For example, creating a "series" of funds to extend the brand of fund with successful performance, by designing variants to the initial fund's "strategy", permits the launching an entire "series" of funds based upon strategies, rather than amortization structures of advisor payments.

To expect a reduction in series is to misunderstand commerce.

Fee Complexity

Contrary to its conclusion that there will be a drop in fund fee complexity, Consultation Paper 81-408 requires that each dealer create their own payment-for-service matrix. Inherent to its requirement, dealers will have to enumerate reams of unique fees for

- each activity
- for every fund
- for every management back office

- by dealer account
- by product purchase or sale (not all funds at a manager may cost the same to process as a transaction)
- by investment product holdings within the account
- by formats for cash withdrawal or reinvestment
- by size and numbers of partial fund redemptions
- by number of and complexities of K-Y-C compliance supervision

And on and on.

We cannot comprehend how Consultation Paper 81-408 can possibly conclude that their recommendation to eliminate an established system of two-party agreements between fund managers and dealers to be replaced by an unlimited matrix of fees-per-service will decrease fee complexity.

2. **New lower-cost product providers may enter the market**

Consultation Paper 81-408's proposal for precise fee-for-service matrices will necessitate new, highly sophisticated invoicing and payment systems and will require enormous structural investments by fund managers and dealers alike.

Many registrants presently do not have the capital to undertake these new requirements, thus they will be forced to merge or close. All registrants will have to charge more per year to every investor to repay their required investment.

For new entrants the added costs, systems, relationships, and marketing procedures, all of which will have to be fully in place and operational on "Day one", will be even more prohibitive.

For fund managers, Consultation Paper 81-408's removal of their existing indirect access to investors through advisors will require asset and fund managers to find new, but far less efficient marketing procedures, driving their operating costs higher.

The cost of the fee-per-service matrices will increase the investment, operation and compliance costs of every dealer and make all fund management products appear very expensive. Rather than low-cost, all surviving registrants will be required to charge clients substantially more than they do presently.

It seems highly implausible that "lower-cost product providers may enter the market"

3. **Increased price competition/decrease in fund management costs**

Price Competition

Consultation Paper 81-408 requires fund managers to cease paying dealers. It is unclear how this promotes "price competition" between funds. At a dealer level, each will have to produce an overbearing schedule of unique fees that cannot be compared at reasonable cost. This too will not promote "price competition".

Decrease in Fund Manager Costs

Consultation Paper 81-408 mandates that fund managers make no payments to dealers except for reimbursements from investor funds. Marketing costs that presently pay for dealer/advisor participation in sales and product support may cease. But, to survive and grow, fund managers must continue to market their products.

Any basic understanding of commerce inherently recognizes that marketing budgets are existential to business; they cannot and will not diminish, if a commercial enterprise intends to sustain itself and grow. The operating cost structure of a fund is not reduced.

Under Consultation Paper 81-408 fund managers will have to investigate new forms of marketing and determine how to anticipate investor portfolio review. Their ability to act at the point of time when an investor will be undertaking a review his/her portfolio is crucial to successful and efficient marketing.

The costs for this will not diminish because of fee-per-service. Managers will have to find a means to entice investors to pay for their fund's inclusion within a portfolio review, then pay for the high purchase cost of the fund and the higher position maintenance costs.

In that Consultation Paper 81-408 only changes the recipient of a fund manager's presently paid marketing dollars, it is unclear how Consultation Paper 81-408 can perceive that operating and marketing costs will be diminished by having a new recipient for the marketing dollars.

Unintended Consequences

1. Reduced trading on Canadian exchanges and Canadian Debt Markets

Mutual funds are significant participants in the Canadian securities markets. Part of the trading volume they provide to Canadian markets is driven involuntarily by the purchases and redemptions of their fund units.

The fee-per-service envisioned within Consultation Paper 81-408 transforms the portfolio review into a new, distinct, and separately invoiced cost to investors, which will clearly reduce the number and frequency of reviews, thus portfolio changes. Ultimately this will reduces the trading volume within the Canadian markets, which are already finding themselves increasingly marginalized within the framework of global trading due to its less than significant volume of trade.

2. Protection and perpetuation of non-performing funds and fund managers

The fee-per-service envisioned within Consultation Paper 81-408 will clearly reduce the number and frequency of reviews, allowing non-performing funds and assets to remain within portfolios for longer periods. Consultation Paper 81-408 will also make the investor perceive as "costly", the replacing an underperforming mutual fund asset. This clearly protects the incompetent fund managers, who will be assisted by Consultation Paper 81-408's dissuading investors portfolio reviews and denying advisors opportunities to replace them. Inept performing managers will be allowed to continue to charge for their inept performances; to profit at the expense of the competent and to further deteriorate investor wealth.

3. Creating barriers to entry to new fund managers and dealers

As previously raised; the need for fee-per-service matrices, invoicing, payment and compliance systems, and the new alternative marketing strategies in all fund managers, each of which will be inherently required by Consultation Paper 81-408, will expand operating costs and skill needed by a registrant exponentially. To any potential, new dealer or fund manager Consultation Paper 81-408 embodies a huge barrier to entry.

Consultation Paper 81-408 might stimulate innovation, creativity, and new business for software companies, however, it will stifle entrepreneurialism within the Canadian securities industry.

4. Reduction of mutual fund investing in Canada

Investors, when regularly faced by the higher commission rates of managed product over the costs to purchase exchange traded or debt market securities, can logically be expected to gravitate to lower commission options. Virtually all investors can model diversification using exchange traded and debt market securities, thus reap immediate cost savings when rebalancing portfolios.

Faced with new costs and less efficiency within the fund manager's marketing and sales process, investors gravitation away from the higher mutual fund purchase commissions will become even more pronounced, even if the investor has asked that the fund be included in their portfolio review. Fund managers will find themselves perpetually at significant and growing disadvantage to exchange traded and debt market securities.

Such a major pertpetual disadvantage can only lead to a substantial reduction in managed fund investing and an inevitable consolidation within the managed fund sector of the Canadian securities industry.

Conclusion

Consultation Paper 81-408 does not cite investor complaints nor any records of enforcement to prove that the conflict of interest created by a fund managers paying dealers (a process renamed to incorporate emotive response; "Embedded Commissions") to prove that there has or is systemic harm to Canadian investors. In fact, there appears to be no evidence, no documents or studies to support Consultation Paper 81-408's claim of investor harm.

Consultation Paper 81-408 simply maligns all Canadian registrants and regulators, openly and without clear evidence.

The recommendations within Consultation Paper 81-408 will create enormous costs for the Canadian securities industry and ultimately the Canadian investor to absorb. It does not demonstrate how or whether the investor will find better net investment performances for their portfolios arising from its recommendations. In all likelihood net investment performance will be harmed.

It is also unknown whether the Canadian investment industry has the human talents, available time, and financial resources to build all of the systems that are inherently required by Consultation Paper 81-408. It is also clear that nothing in Consultation Paper 81-408 promotes more successful net investment performance in Canadian investor portfolios.

Consultation Paper 81-408 does not hold up to scrutiny and it advocates recommendations that will prove exceedingly costly and damaging to the Canadian investment industry.

"Robert Goldberg"

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June 9, 2017

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To Canadian Securities Administrators:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Re: *CSA Consultation Paper 81-408 – Consultation on the option of discontinuing embedded commissions*

The Canadian Association of Independent Life Brokerage Agencies (CAILBA) wishes to briefly comment on the consultation paper.

CAILBA is a voluntary trade association that acts as the single voice for Managing General Agents (MGAs) across Canada. Working closely with our insurance carrier counterparts, we help our members to stay abreast of change and to effectively implement compliance and regulatory updates that support fair treatment of consumers. We foster best practices across Canada in order to better the insurance industry and build unity in the MGA community nationally.

CAILBA
Canadian Association of
Independent Life Brokerage Agencies

MGAs contract with independent advisors who work with Canadians to help them plan for their financial futures, including selling risk and investment products. The majority of our contracted advisors are also securities licensed through MFDA or IIROC. We are, therefore, interested in the CSA's concerns that embedded mutual fund commissions raise issues of potential conflicts of interest, impeded investor compensation cost controls and misalign compensation relative to the services provided to consumers.

Having considered your detailed consultation paper, and having discussed the issues with (and in consideration for and in support of the position of) other industry stakeholders such as Advocis and IFB, we feel a move to discontinue embedded fees eliminates Canadians' choice in how they pay for advice and is not the solution. Banning embedded fees presents the very real risk of limiting access to investment advice to middle-income Canadians (the majority of Canadians), a consequence seen in other jurisdictions who've taken similar measures, at a time when data clearly shows Canadians are not saving enough for their financial futures.

We would instead encourage regulators and industry stakeholders to collaborate, to provide:

- Choice for consumers, including offering funds without embedded fees and options to move to fee-based compensation models
- Time to allow recent CRMII measures to take effect
- Financial education to improve Canadians' financial literacy and empower consumers to make informed choices
- The Canadian Council of Insurance Regulators (CCIR) an opportunity to launch enhanced disclosure measures for segregated funds, and as appropriate, to work toward greater harmonization with exiting mutual fund conflict of interest disclosure requirements and existing sales practice prohibitions and rules (addressing unsuitable investment recommendations and a duty to act honestly, fairly and in good faith)

We feel strongly that without solid plans in place to manage and mitigate the risk of harm to consumers that result from discontinuing embedded fees, unintended or not, the consequence to Canadians are far too grave.

We appreciate the opportunity to provide input on the consultation paper.

Best regards,

Earleen Moulton | Eric Wachtel

CAILBA Board, Regulatory Compliance | CAILBA Board, Legislative Matters

June 9, 2017

The following are some thoughts I have gathered with regards to the banning of embedded commissions and the effect this will have on both the industry and investors alike.

Due to widely varied Industry experience, I believe I have developed a somewhat more nuanced perspective than most. As an industry participant for over 30 years, I have worked as multiple award-winning advisor, as both a Branch and Provincial Manager for an MFDA firm, as an industry pioneer who built and ran Canada's first Internet-based online trading system, as software provider of secure communications technology to both public and private mutual fund dealers and now as a consultant. I am also a financial consumer.

Reflecting back on three decades of working with clients, advisors and their firms, I am struck most of all by the effect of properly balanced incentive in the advisor/client relationship. In my experience, it has been the incentive that has done more than anything to generate and/or maintain wealth - that is, when the incentive has been properly aligned. Accordingly, it is the optimization of incentive that the CSA should ideally look to balance that will ensure the continuation of Canada's wealth growth.

Our countries wealth has been built in large part thanks to the efforts of independent financial services professionals. With the wealth they have helped generate has come peace, stability, tolerance, education, artistic culture and a whole host of other benefits. Despite the fact that the compensation system might not have been the cheapest or ideal, it worked. As a nation, we are idealized by the world. The wealth we have grown is an integral part of that. So to radically change the recipe or formula that lead to our world class success should be looked upon with skepticism.

I refer to the question of generation of wealth, (particularly with clients where there was none before), as to whether the banning of embedded commissions will ultimately end up generating more wealth for Canadians as a whole? As mentioned, along with the freedom that wealth brings, come a whole host of other beneficial attributes which help our society as a whole. So if the CSA gets the decision right, the benefits will cascade for years or even generations to come. Destroying the source of our success however, may see the opposite also come true.

A few examples from my history that have led to my opinion...

I was first licensed to sell mutual funds back in 1985. Back in the mid-1980's, the mutual fund business was a sales industry above all. Back then, there was no option for DSC, no fee-based options, and no no-load mutual funds. At that stage, there was only a non-negotiable 9% front-end load if you wanted to purchase investment funds.

Although confining, the approach generally worked well. As discussed above, the incentive of just having paid 9% off the top meant both that investors were in for the long term and advisors were well paid for their sales efforts. It was expensive, but a mostly balanced approach to sales compensation that worked - as long as there was relative stability in the markets that is.

A 9% fixed commission environment was far from ideal however. Apart from being very expensive for the consumer, the lack of ongoing compensation meant that sales reps spent all of their time chasing new money - as opposed to helping their clients increase their wealth on an ongoing basis. When the crash of 1987 hit, this became apparent as about 80% of reps went out of business due to a complete dearth of new investments.

After 5 years of stagnancy, the industry managed to mature to a quasi-professional nascent financial planning industry with the help of Mackenzie Financial and their Industrial Horizon Fund. They saw the need to professionalize the industry (and no doubt maintain distribution). The Horizon Fund ushered in the DSC age and in doing so enabled the meager subsistence the industry needed to sustain itself through tough times.

Once again, we see targeted incentive guide the market and a result literally millions of Canadians benefited from basic financial planning. Our nation today is wealthier as a whole because of it.

About 4 years into my career as a mutual fund salesperson, I was suddenly thrust into a management position due to the untimely passing of the branch manager. Over the following 18 months, we were able to grow our branch advisor base to over 50 reps while we took our branch assets up to $80M from $5M through the use of technology, training, and aggressive marketing.

Looking back, of great significance during that period was the role that incentive played in generating new wealth that was simply not there before.

More junior advisors started selling savings plans with restrictions. United Financial had an innovative savings program called the Own and Loan which enabled some level of front end loading of commissions to the advisor - not unlike how an insurance policy commission works today.

The upfront commission payment was backed by the need for the clients to retain their money in the funds for a number of years or suffer a significant penalty. In principle, what the product did was enable the time an advisor needed to deal with someone who had no savings whatsoever. In a sense, it created the incentive for both the advisor (to write up the client) and the saver (not to spend their money).

And it worked incredibly well. In fact, I cannot recollect one instance over all of the years of a client who actually cashed in early and suffered the penalty. All people who had no money before, created a little nest egg. But none of that would have been without the incentive built into the product. You could say that it was the well-balanced incentive that helped turn a poor person into one with some long term savings.

Now perhaps the members of the CSA board reviewing this submission would never personally invest in such an onerous back end loaded product. Perhaps the relatively small amounts of money that we're talking about ($50-$100/m) seem insignificant. But to a middle aged worker who has never had any stability in their financial affairs, any help from anyone - even with only limited financial knowledge, along with the ongoing encouragement, was truly a life changing decision.

This is of fundamental importance to our society. Because along with wealth comes a myriad of other benefits - social and otherwise. Wealth brings with it a share of pride. It enables dignity while inspiring hope. So to bring this to the working poor was highly beneficial to both the client and community as a whole. Incentive, properly balanced with a relationship is ideal. A properly compensated financial planner is like a coach. And everybody, even Wayne Gretzky, can use a coach. So in forming policy, we need to be looking at how we can grow more coaches, not less - particularly in light of record levels of Canadian debt and the likelihood of significant financial turbulence down the road.

Which brings us to culture and the need for ensuring proper service for the coveted incentive.

As a general rule, in dealing with and providing services to well over a thousand independent advisors, it is clear that the vast majority of them put their client's first and deal with them in a highly ethical manner. What is also evident however, is that there is no industry-wide commitment to servicing those accounts in return for the trailer fees that are paid annually. The majority of advisors and firms provide little in the way of meaningful ongoing service to anything other than their most important accounts. This is unfair to clients rich and poor that today have little choice but to continue to pay on going management fees and this is particularly where the CSA can and should seek to incent action through policy.

Yes, once again, incentivization can come to the rescue.

Case in point...

About 7 years ago, I went through a particularly vicious divorce and ended up with a fair settlement that resulted from the sale of our nearly paid off house. At the time, my investment account was midranged and as a result I received no ongoing support from the investment firm I had the account with. Instead of seeking out help, I really did nothing and as a result slowly saw my saving dwindle as I refused to deal with leaky business matters head on.

The reality of the situation is that any objective financial professional could have pointed out what was clearly going on but not necessarily recognized by myself at the time. The reason that I have not heard from that rep for 7 years now is that he is under no obligation to do so. The account is not so big that it warrants attention from his perspective, but he's happy enough to collect the trailer fees on it every month.

As a consumer, if I am going to pay ongoing trailer fees out of my investment portfolio, I have a right to some guidance along with it. I don't think that anyone would dispute that. The onus for delivering such annual advice should be on him, not me. (In practice, this might be enforced in a similar manner to the annual KYC obligation registrants have).

So the simple answer to the complex question the CSA is faced with is to tweak the existing system by obligating advisors to annually sit down with their clients or to forfeit the year's annual compensation that is generated from the trailer fees.

There is no need however to upset the whole system that is the backbone of our successful society in the hope that it might, maybe become better. The policy world is littered with unintended consequences so why take the chance by removing consumer choice of compensation and thereby favoring a centralized big bank environment (with their culture of moving employees around, specifically so they do not form long-term bonds with their customers).

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June 12, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Re: Canadian Securities Administrators Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

HSBC, Retail Banking and Wealth Management (collectively, **HSBC** or **we**) are writing in response to the Request for Comment on the Consultation on the Option of Discontinuing Embedded Commissions published by the Canadian Securities Administrators (the **CSA**) on January 10, 2017 (the **Proposal**).

HSBC is one of the leading asset managers in Canada. Our investment management services include the offering conventional public mutual funds to the Canadian public (the **HSBC Funds**). HSBC Investment Funds (Canada) Inc. (**HIFC**) acts as the Principal Distributor for the HSBC Funds that are available for direct purchase. Except for the HSBC Funds, HIFC does not distribute or offer for sale any other investment funds or structured products. The HSBC Funds include a wide range of money market, fixed income, equity and balanced mutual funds, and include mutual funds which invest in a diversified mix of HSBC Funds. HSBC Global Asset Management (Canada) Limited (**AMCA**) acts as the investment fund manager (**IFM**) and portfolio advisor for the HSBC Funds.

We would like to thank the CSA for the substantial amount of work and effort that went into the Proposal. We would also like to thank the CSA for the opportunity to provide our comments on the Proposal. We support the CSA's initiative to enhance investor protection by eliminating actual and perceived conflicts of interest related to the Canadian dealer compensation structure. We respectfully caution however, that *some* aspects of the Proposal, if implemented, may have unintended consequences that may harm Canadian investors and the Canadian wealth management industry as a whole. We view some of these aspects, as further detailed below, as being on the periphery of the core objectives of the Proposal. As such, we urge the CSA to take into consideration both the Canadian investing public and the various business structures that will be negatively impacted by the implementation of the Proposal.

Below are some general comments on the Proposal, followed by comments on some of the specific questions posed.

The Advice Gap

We are of the view that the elimination of the DSC sales option is consistent with the CSA's goal of enhancing investor protection in the Canadian marketplace. AMCA, much like numerous other IFMs in Canada, has discontinued the DSC sales option for the HSBC Funds in 2014 to eliminate any potential misselling and to enhance the overall investor experience.

We respectfully caution that an advice gap may be created if the Proposal, specifically the ban on trailing commissions, is implemented. We believe that an advice gap may develop due to a number of reasons, including (i) a fee-based account being more expensive to administer than a commission-based account; (ii) a direct pay commission model is likely to be unpopular among the Canadian investing public and may create different types of conflicts of interests among dealers and dealing representatives; and (iii) technology may not be used as widely as hoped by various investors, specifically those in the "mass-market" segment.

Added Costs for Fee-based Accounts

We respectfully ask the CSA to consider the fact that administering a fee-based account is more expensive than a commission-based account. Dealers that do not currently offer fee-based account options will be required to make significant investments in infrastructure (e.g. computer software and systems, account agreements etc.) to facilitate fee-based accounts, and such costs will likely be passed onto the end investor. In addition, if advisory fees will be paid by redeeming an investor's mutual fund holdings, additional redemption orders will have to be processed at the mutual fund level, as well as at the dealer level. This will increase the operational costs for both the fund and the dealer, and ultimately, the end investor. We note that these added costs are already factored into current business models in the industry given that fee-based accounts usually require a substantial minimum of investment (typically set at $100,000).

Should the industry lower the current minimum investment and offer fee-based advisory services to those investors in the mass-market segment, we anticipate that these added operational costs will result in various dealers introducing minimum annual account fees to recover some of the additional costs incurred to serve investors at the bottom range of the mass market segment. As an example, an investor with $5,000 invested in a mutual fund that currently pays a 1% annual trailing commission who will be moved to a fee-based account may be subject to an account fee of 1% of assets, or $125 (whichever is greater). As a result, the total annual fee the noted investor will pay for advice will increase by $75, or 150%. We also note that the lack of mass-market investor access to fee-based accounts was also articulated in the recent MFDA research paper which stated that such clients are "less likely to be able to afford direct pay arrangements and less likely to be eligible for fee-based programs…"[1]

Finally, the Proposal refers to the fact over 80% of Canadian investors in the mass-market segment purchase their investment funds through banks or insurers. However, this distribution channel is likely to experience the same added cost when administering fee-based accounts that include non-proprietary mutual funds, potentially requiring such dealers to instill a similar minimum annual fee. Alternatively, this distribution channel may only offer proprietary mutual funds, thereby offering investors less choice.

[1] *MFDA Bulletin #0721-C* (May 23, 2017), at page 11.

HSBC

Direct Pay Commission Model
We respectfully submit that a direct pay commission distribution model may not address the advice gap created by the banning of trailing commissions, nor will it result in the removal of conflicts of interest in the mutual fund distribution channel.

We are of the view that the Canadian investing public will likely not embrace a mutual fund distribution model that requires investors to pay per transaction. The MFDA reached a similar conclusion in the research paper referenced above when it noted that a certain segment of clients is “less likely to be able to afford direct pay arrangements”.[2] We are also of the view that some investors will likely experience “sticker shock” given the move in industry over the last decade towards the DSC sales option, and more recently, towards the no load sales option. This unintended consequence may lead certain groups of investors to forgo investing in mutual funds which can impact their ability to adequately plan and save for retirement.

In addition, should the markets experience a positive return during the period soon after the investment is made, investors may experience lower total returns since they will have less money invested in the market as a result of having to pay the commission up-front.

Lastly, and perhaps most importantly given the stated objectives of the Proposal, due to the fact that dealers would only get paid per-transaction, such a distribution model creates an inherent conflict of interest to churn the portfolio excessively. There have been numerous enforcement cases in the IIROC distribution channel[3] that highlight the materiality of this type of conflict, both within discretionary and non-discretionary accounts. As such, we respectfully submit that it is not in the public interest for the CSA to create an environment where advice may be tainted by this conflict of interest.

Technological Innovations
We agree with the CSA that new dealer platforms will likely enter the market as the technological and regulatory landscape transforms. As a result of various efficiencies, such dealers may be able to offer a fee-based program at a cheaper rate and with a lower account minimum. We, much like the rest of the industry, made significant investments in technology to make our operations more efficient and enhance customer experience. Based on our experience, unlike day-to-day banking which has gained significant traction in the online space, many mutual fund investors prefer dealing with a human representative, in person. This is consistent with an international survey of 12,019 people (1,001 of which were Canadian) conducted by Ipsos MORI in 2017 which found that only 7% of Canadian respondents would likely trust robo-advisors to make their investment choices, and only 18% indicated that they feel robo-advisors are able to offer more accurate advice than their human counterparts.[4]

If the current mass-market distribution channel will no longer serve the segment at a price that those investors are willing to pay, the Proposal may force investors who prefer to make

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[2] *MFDA Bulletin #0721-C* (May 23, 2017), at page 11.
[3] See *Crandall* (Re), 2016 IIROC 18, *Matthews* (Re), 2014 IIROC 56 and *Darrigo* (Re), 2014, IIROC 48 as examples
[4] The survey was commissioned by HSBC Bank Plc, but was written independently of HSBC. See http://www.hsbc.com/trust-in-technology-report and http://www.google.ca/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjCgeCXk6_UAhWK7IMKHZx6COIQFggmMAA&url=http%3A%2F%2Fwww.about.hsbc.ca%2F~%2Fmedia%2Fcanada%2Fen%2Fnews-and-media%2F170524-trust-in-tech-news-release-en.pdf&usg=AFQjCNGgyec6cb1OIe_btvCnaf0kceS_qQ

their mutual fund investment decisions in person to adopt technology and use the new distribution models out of necessity (i.e. lack of affordability). This may lead to less advisor use, as fewer investors experience a positive advisory experience, and as a result, a reduction in the number of mutual fund investors in the mass market segment.

Internal Transfer Payments

The Proposal proposes to ban all internal transfer payments from affiliates to dealers within an integrated financial service providers that are directly tied to an investor's purchase or continued ownership of an investment fund security or structured note (**internal transfer payments**). The premise of this ban equates such payments to trailing commissions. We respectfully submit that this premise creates a false equivalence — while the quantum of money received by a dealer may be similar, the reasons for the payment and the conflict of interest are not. As further detailed below, in certain cases, such an equivalence creates unnecessary restrictions for Canadian market participants while not advancing any of the stated goals of the Proposal.

As previously noted, HIFC is the Principal Distributor for some of the HSBC Funds. HIFC does not distribute or sell any non-HSBC investment funds or structured notes. As such, HIFC, and any other mutual fund dealer within an integrated financial service provider that only sells mutual funds offered by a single IFM (**non-conflicted dealer**), is not subject to the same conflict of interest that a mutual fund dealer that distributes mutual funds of multiple IFMs (**conflicted dealer**) is.

In the section below, we will explain why the three issues identified by the CSA that the Proposal attempts to address are not applicable to internal transfer payments to non-conflicted dealers.

Issue 1 - Embedded commissions raise a conflict of interest that misalign the interests of IFMs, dealers and representatives with those of investors

Sub-Issue 1.1 – Internal IFM COI
The CSA used Professor Cumming's study to propose that embedded commissions give rise to a conflict of interests for IFMs as embedded commissions reduce the sensitivity of fund flows to risk-adjusted performance, thereby making IFMs less focused on increasing their AUM using the generation of performance and more focused on increasing their AUM by incentivizing dealers through the compensation offered (the **IFM COI**). Although we do not agree with this conclusion because IFMs have a regulatory obligation to act honestly, in good faith and in the best interests of their funds, we respectfully submit that the IFM COI does not exist in respect of internal transfer payments to non-conflicted dealers. Given the captive nature of a non-conflicted dealer (i.e. the dealer can only sell mutual funds of the affiliated IFM), IFMs do not need to incentivize the sale of their funds by increasing the quantum of the internal transfer payments (this argument is further supported by the Profit Consolidation, as defined below). As a result, fund flows for such IFMs are not sensitive at all to the quantum of the internal transfer payments and the IFM COI does not exist.

Sub-Issue 1.2 – IFM Selection COI
A key underlying premise of Issue 1 is that a mutual fund representative *may* recommend one mutual fund over another as a result of a higher dealer compensation paid by the IFM (the **IFM Selection COI**). We assume this premise to be true for the purposes of our submissions.

The IFM Selection COI does not exist within a non-conflicted dealer. A non-conflicted dealer can only sell mutual funds from a single IFM and as such, the different levels of dealer compensation offered by different IFMs have no impact on its investment recommendations.

Sub-Issue 1.3 – Product Selection COI
An argument can be made that non-conflicted dealers may have an incentive to sell mutual funds or other bank products that pay the highest level of internal transfer payments (the **Product Selection COI**). As will be demonstrated below, such conflicts do not actually exist and any perceived conflict is mitigated by the current regulatory regime and internal procedures.

A non-conflicted dealer, by definition, is part of an integrated financial service provider. As such, any profits made by it, regardless of the product sold, will simply be consolidated at the controlling entity level. The same consolidation occurs with the profits made by the other business divisions of the entity, including the IFM member (the **Profit Consolidation**). As such, it can be said that irrespective of how you “slice the pie”, the size of the pie for the controlling entity is the same.

Given the Profit Consolidation and the Product Selection COI, one may conclude that the non-conflicted dealer may still be incentivized to sell one product over another, irrespective of client interests. However, such a conclusion does not account for the suitability obligations of the dealer (i.e. the dealer will not be able to sell an equity mutual fund, even if it results in a higher level of internal transfer payment, if it is not suitable). In addition, such a conclusion does not take into account what actually transpires once the internal transfer payment is received by the non-conflicted dealer. In the case of HIFC, any internal transfer payments received are not in its direct interest, as they are forwarded to the controlling entity, HSBC Bank Canada and do not result in any direct compensation for the HIFC sales representatives.

In addition to the suitability obligations at the dealer level and the fact that internal transfer payments do not translate to compensation at the individual HIFC sales representative level, HSBC Bank Canada has implemented a performance recognition program (the **Program**) that does not incentivize any of its sales representatives to sell higher management fee mutual funds or higher margin bank products. Specifically, the Program is product agnostic – compensation and recognition of staff are not tied to which product (e.g. mutual fund, personal loan, mortgage etc.) they sell, its profit to any HSBC entity, or its associated internal transfer payment (if any).

In summary, given the Profit Consolidation, certain internal controls and compensation structures and the regulatory obligations noted, the non-conflicted dealer and its sales representatives would be indifferent to the quantum of internal transfer payment received since both the amount received and the amount retained by the IFM get consolidated at the controlling entity level. The amount of the internal transfer payment becomes a zero-sum game on a consolidated basis – as the internal transfer payment gets larger, the IFM’s retained earnings get smaller. As such, internal transfer payments do not result in a Product Selection COI, or any other conflict of interests that the Proposal attempts to address.

Issue 2 – Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

We respectfully submit that internal transfer payments should be viewed as entity-level accounting issues, and accordingly are not relevant to any limitations on investors’ awareness, understanding and control of dealer compensation costs. We further submit that investors are likely indifferent with respect to how the management fee paid to the IFM by an investment fund is allocated **internally** between an IFM and a non-conflicted dealer within integrated financial services providers. Further, as you are aware, CRM2 already requires the disclosure of the dollar amount of the internal transfer payment received by dealers, per account, as part of the annual report on charges and other compensation. However, we submit that unlike how this information can be used when dealing with a conflicted dealer (i.e. judging if the advice received warrants the payments), this information is of a different, and arguably lower, value to investors when dealing with a non-conflicted dealer as all fees paid, regardless of how they are allocated internally, are likely viewed as fees paid to the controlling entity (e.g. HSBC Bank Canada) as part of the cost of investing in the investment funds offered.

Issue 3 – Embedded commissions paid generally do not align with the services provided to investors

We respectfully submit that internal transfer payments are not meant to align with the services provided to investors, and rather, as we stated above, they are simply a part of the corporate accounting framework. Irrespective of how their quantum is calculated, we are of the view that investors would be indifferent towards them as they likely view the management fee that the HSBC Funds pay as a fee paid to the controlling entity (e.g. HSBC Bank Canada), irrespective of how the fee is subsequently allocated internally.

To summarize our submissions on internal transfer payments, we are of the view that such payments should not be prohibited for non-conflicted dealers. We are of the view that such a ban would not address any of the issues that are identified by the CSA in the Proposal while restricting various accounting practices of integrated financial service providers without a conclusive benefit to investors. We understand that it may be tempting to group “trailer-like” payments, such as internal transfer payments, together with “embedded compensation”, but urge the CSA to consider the nuances and the differences of such payments when compared to trailing commissions vis-a-vie the stated objectives of the Proposal.

Specific Questions

17. Do you think this proposal will lead to an advice gap? In particular:

- *Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.*
- *Do you agree with our definition of an advice gap?*
- *Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?*
- *What types of advice or services currently provided today would be most affected by the proposal?*
- *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*
- *How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?*
- *Do you think that online advice could mitigate an advice gap? If so, how?*
- *Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?*

As noted above under *"The Advice Gap"*, we are of the view that the Proposal may result in an advice gap for the lower end of the mass-market segment as account fee minimums will increase the total cost of advice and deter some investors from obtaining advice. With respect to direct commission arrangements, we respectfully submit that investors may find such arrangements uninviting and more importantly, respectfully submit that such arrangements create a conflict of interest whereby dealers are incentivized to excessively churn the portfolio. Lastly, based on our experience, we are of the view that any technological innovation that the CSA hopes will step in to fill the advice gap will face a segment of the Canadian population that today, appears to be reluctant to adapt and will forego mutual fund investing altogether. These unintended consequences may lead certain groups of investors to forgo investing in mutual funds which can impact their ability to adequately plan and save for retirement.

10. With respect to internal transfer payments:

a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?

b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?

c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?

As noted above, we are of the view that internal transfer payments (as defined above) should not be discontinued for non-conflicted dealers (as defined above) as the fundamental issues that the Proposal addresses are simply not present within such arrangements. Such payments are based on internal accounting decisions and should be outside the scope of the Proposal and possibly, the mandate of the CSA. We respectfully submit that no investor protection or market efficiency concerns are triggered by these payments.

Thank you again for the opportunity to provide you with our comments. Please do not hesitate to contact me should you have any questions or wish to discuss our submissions.

Sincerely,

Larry Tomei
Executive Vice President and Head of
Retail Banking & Wealth Management
HSBC Bank Canada