OSC Staff Notice 11-787
Improving Fee Disclosure Through Behavioural Insights

August 19, 2019

Introduction

The Ontario Securities Commission (the **OSC**) is committed to improving the investor experience. Reflecting this commitment, the OSC Investor Office partnered with the Behavioural Insights Team (**BIT**)[1] on a project to identify tactics for improving fee disclosure.

The report arising from this project (the **Report**) examines how investment fees are communicated to investors, with a focus on annual reports on charges and other compensation (**annual fee reports**) required to be delivered to investors by registered dealers and advisers (together with their respective registered representatives, **registrants**). The Report is appended to this staff notice (this **Notice**).

Purpose

The goal of this project was to further our work identifying practical applications of behavioural insights that will lead to better investor experiences and market participant outcomes. The OSC is also exploring further ways to improve the investor experience,[2] including in collaboration with its Canadian Securities Administrators (**CSA**) counterparts.[3]

Background

To provide registrants' clients with 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, the CSA introduced the second phase of the Client Relationship Model amendments (**CRM2**) to National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**). CRM2 came fully into effect in 2016.

One of the requirements imposed under CRM2 is that registrants deliver an annual fee report to their clients detailing the fees the client paid to the registrant (whether directly or indirectly) in respect of the client's investments. This requirement is set out in s. 14.17 of NI 31-103.

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[1] BIT is a social purpose company part-owned by the U.K. Government. Initially formed as the "nudge unit" within the U.K. Government, BIT was the world's first government institution dedicated to the application of behavioural sciences.

[2] See OSC Staff Notice 11-784, *Burden Reduction* (2019), 42 O.S.C.B. 550, at p. 551.

[3] See CSA Notice and Request for Comment, Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (2018), 41 O.S.C.B. (Supp-1) 1.

We note that various studies have been published suggesting that there is room for improvement with respect to the way firms' reports are designed and delivered to clients: these studies find that, while many investors are benefitting from the information included in their annual fee reports, others may not be noticing these reports or may not understand how their dealer or adviser is compensated for their services notwithstanding their receipt of these reports.[4]

Behavioural insights examine how people are often neither deliberate nor rational in their decisions in the way that traditional models, strategies, and policies assume. They illustrate the challenges people face engaging with financial disclosures: literacy or language challenges, innumeracy, and low familiarity with specialized concepts and terminology used in the investment sector can impede individuals' understanding and use of these disclosures.[5]

The OSC Investor Office partnered with BIT on behavioural insights research that speaks to how registrants can work to maximize the effectiveness of their annual fee reports in the context of their relationships with their clients, and how other stakeholders can support investors' review and use of the annual fee reports delivered to them. This continues the OSC Investor Office's focus on improving the investor experience through the application of behavioural insights,[6] promoting the use of plain language, and other initiatives.

We note that the CSA is undertaking research to measure the broader impacts of CRM2 and related reforms with respect to point of sale disclosures on investors and the investment industry.[7] We expect this study will provide insight into how these reforms are working together to help investors make better-informed investment decisions.

We also note the behavioural insights research released by the Investment Funds Institute of Canada (**IFIC**) in March 2019, which had a scope similar to that of the research described in this Notice. Without opining on the specific findings and recommendations of that research, we welcome IFIC's commitment to carrying out this type of research and to making their findings public. We believe there is much to be gained from stakeholders' not only carrying out, but also publishing and sharing the results of, behavioural insights research that has the potential to serve the public interest.

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[4] See *e.g*. British Columbia Securities Commission, News Release, "Significant improvements in investor knowledge following new fee disclosure requirements, BCSC study finds" (2 October 2017); "Low investor awareness of CRM2 a challenge for firms and advisors," *Investment Executive* (16 August 2018); Autorité des marchés financiers (Québec), *Report on principal findings of Autorité des marchés financiers focus groups with individual investors* (2018), available at <https://bit.ly/2IJEc7G>.

[5] See OSC Staff Notice 11-778, *Behavioural Insights: Key Concepts, Applications and Regulatory Considerations* (2017), 40 O.S.C.B. 2773, at p. 26.

[6] See *supra* note 5; OSC Staff Notice 11-782, *Getting Started: Human-Centred Solutions to Engage Ontario Millennials in Investing* (2018), 41 O.S.C.B. 5567; OSC Staff Notice 11-783, *Encouraging Retirement Planning through Behavioural Insights* (2018), 41 O.S.C.B. 6148.

[7] CSA, News Release, "Canadian Securities Regulators to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model" (22 August 2016).

Research findings

Our work with BIT involved qualitative research and a randomized experiment, the results of which are described in a report (the **Report**) appended to this Notice.[8]

The Report identifies 24 concrete tactics registrants and other stakeholders can use to mitigate the following key barriers to investors' using annual fee reports as intended:

1. *Barriers to engagement*: Investors may not notice or recognize the importance of their annual fee report amid the various other disclosures provided to them.

2. *Barriers to comprehension*: Investors may be confused by the terminology and information included in their annual fee report. They may not understand which fees are included (and which are excluded) from the report, and lack reference points to determine whether their fees are higher or lower than the norm.

3. *Barriers to action*: Even if investors see and understand the report, they may not know how to act on the information it provides.

The tactics identified in the Report complement many of the higher-level recommendations reflected in the IFIC research referenced above.

Several of the tactics identified in the Report were tested in a randomized controlled trial (**RCT**). Approximately 1,900 Canadian investors were recruited online for the RCT; each reviewed one of four prototype annual fee reports designed by BIT with input from OSC staff, and then were asked several comprehension questions to test how well they understood the information presented to them in their prototype report.

The baseline (or "control") prototype was based on the sample annual fee report included as Appendix D to Companion Policy 31-103CP, *Registration Requirements and Exemptions* (**31-103CP**). Two other prototypes omitted much of the information required under s. 14.17 of NI 31-103; these prototypes were included to test the hypothesis that simplifying the reports by removing information would improve investor comprehension. A final prototype included all of the information required under s. 14.17 of NI 31-103, but presented this information in a slightly different way from the control. These differences are described in the Report.

Significantly, the only prototype that outperformed the control by a statistically significant margin (meaning that it is unlikely that the difference in score was the result of chance) with respect to investor comprehension was the prototype that included all of the information required under s. 14.17 of NI 31-103. In light of this outcome, the Report does not recommend any changes to s. 14.17 of NI 31-103. Rather, the tactics and trial outcomes suggest that registrants can make their annual fee reports more effective by presenting the required disclosure in clearer, more engaging ways.

We also note that while the margin of outperformance was statistically significant, it was not dramatic. Investors who saw the redesigned prototype answered 4.4 questions out of seven correctly on average,

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[8] The Report also reflects feedback from PureFacts Financial Solutions, which was subcontracted to review and provide additional perspective on potential policy and other implications of the research conducted.

while investors who saw the control prototype answered 4.1 questions correctly on average. This outcome suggests that the sample report included in Appendix D to 31-103CP, which was designed based on research and testing carried out while CRM2 was under development,[9] is fit for purpose as a baseline for registrants looking to develop annual fee reports for their clients.

Conclusion

Disclosure testing, informed by behavioural insights, can help ensure that disclosures are "clear and meaningful" as contemplated under s. 1.1 of 31-103CP.

The sample annual fee report included in Appendix D to 31-103CP is intended to serve as a baseline example for registrants. As noted in s. 14.17 of 31-103CP, it is intended only as guidance to support registrants' design of these reports.

We encourage registrants to review the findings of the Report and consider testing and, if proven effective, integrating the tactics suggested in the Report into their current practices. More generally, we encourage registrants to test methods of designing and presenting annual fee reports that they believe their clients may find more intuitive, including through presenting disclosure in non-traditional formats—for example, as an interactive webpage rather than as a non-interactive hard copy or PDF. We also encourage registrants to share their findings with us and with other stakeholders that could benefit from them.

We look forward to engaging with investors, registrants, and other stakeholders with respect to the Report findings and our broader work to improve the investor experience.

Questions

If you have any questions or comments about this Notice or the Report, please contact:

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[9] See "Investor Research Reports and Document Testing," online: <http://www.osc.gov.on.ca/en/SecuritiesLaw_oth_20120614_31-103_research-rpt-testing.htm>.

Improving fee disclosure through behavioural insights

Prepared by the Behavioural Insights Team in collaboration with the Ontario Securities Commission Investor Office

August 19, 2019

OSC ONTARIO SECURITIES COMMISSION | INVESTOR OFFICE

THE BEHAVIOURAL INSIGHTS TEAM

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Introduction

Disclosure requirements are a well-established regulatory approach to supporting the needs of consumers and helping them make better decisions for themselves. The underlying rationale is that consumers will review and understand the disclosed information and then take it into account when making decisions (e.g. when selecting an investment firm or choosing which securities to purchase). Things do not always work out quite so well in practice, however. Consumers may fail to read the proverbial "fine print" or may not understand it. The field of behavioural science can help improve consumer disclosures and make for a better client experience.

The Investor Office is a regulatory branch of the Ontario Securities Commission (OSC) that leads the OSC's efforts in investor engagement, education, outreach, and research. The Investor Office also has a policy function, and provides leadership at the OSC in applying behavioural insights and improving the investor experience. A key priority for the Investor Office is helping Ontarians get smarter about money and make better-informed investment decisions.[i]

In recent years, the OSC, together with other Canadian securities regulators, implemented the "Client Relationship Model — Phase 2" project (CRM2), which became fully effective in July 2016. CRM2 is designed to provide investors with more meaningful information about their investments. Among other things, it requires registered dealers and registered advisers to provide clearer information to clients about the cost and performance of their investments. (Throughout this document, we will refer to these types of firms collectively as "investment firms" or simply "firms.")

One of the rules introduced under CRM2 requires investment firms to send their clients an annual report summarizing all charges that clients paid to them and all other compensation received by the registered firm that relates to the client's account. (Throughout this document, we will refer to this report as the Annual Fee Report.) These charges must be displayed in dollar values, with totals shown for each type of fee.

The Annual Fee Report offers significant potential benefits to investors, especially because it requires disclosure of charges paid directly by those investors *and* indirect charges, like trailing commissions paid by fund managers to investment firms. One of the goals of CRM2 is to clarify to investors how their investment firm is compensated. The transparency around fees can help investors understand the true cost of different investment choices and make better-informed decisions as a result. Disclosure rules can also prompt industry to

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[i] This report uses the terms "fees" and "charges" interchangeably to refer to all types of compensation received by investment firms, including compensation received directly from investors and compensation provided by third-parties like investment fund managers.

proactively change practices and foster innovation.[1] Investment firms may anticipate client questions and concerns and reduce fees or increase the level of service provided, improving the investor experience. However, there are limitations to the effectiveness of disclosure, including ones that are particularly relevant to the Annual Fee Report, given the complexity of investment firm fees and the fact that Annual Fee Reports, by their nature, can be provided only *after* fees have been incurred.[ii]

As noted, consumer disclosures and, in turn, the client experience can be improved through the application of behavioural insights. Behavioural science is the study of how people process information, make decisions, and behave. By combining insights from behavioural economics, social psychology, and other disciplines it provides a more nuanced, realistic model of human behaviour than the traditional understanding offered by classical economics. The term “behavioural insights” (BI) is often used to refer to concrete, real-world applications of behavioural science findings. BI is well suited to developing and testing innovative tactics to address the limitations of disclosure requirements, and significant work has already been done in this domain by the Behavioural Insights Team, the Investor Office, and others.[2]

This report, prepared by the Behavioural Insights Team in collaboration with the Investor Office, examines how BI can be used to improve the impact of Annual Fee Reports. We want to unlock the potential offered by CRM2 to enable investors to make better-informed decisions and reach their financial goals. This report identifies 11 key barriers that may limit the impact of the Annual Fee Reports and proposes 24 tactics (i.e. new approaches) that investment firms, regulators, and other key stakeholders can further develop, test[iii] and implement to address them. Most of these tactics would be simple and low-cost to implement, and would not require any regulatory changes (or exemptions from existing rules).

We identified these barriers and developed the tactics over five months through a variety of research methods including:

- A scan of the relevant behavioural science literature;
- A review of current and leading practices (in both industry and regulatory oversight); and
- A series of qualitative interviews with investors in Ontario.

We also had an opportunity to empirically (i.e. experimentally) test several of our ideas using an online randomized controlled trial. Using a platform called Predictiv, we recruited about 1,900 Canadian investors to take part in our research. Each investor saw one of four versions of a sample Annual Fee Report. They were then asked a series of questions to test

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[ii] Other disclosures, such as “Fund Facts” (in the case of mutual funds) and “ETF Facts” (in the case of exchange-traded funds) are required to be provided at point of sale and include general information on fees. These disclosures are beyond the scope of this report.
[iii] We strongly encourage organizations to rigorously test the tactics we propose (or other ideas they develop) before implementing them at scale, potentially using methods similar to those we describe below. Behaviour is complex and context-dependent; while we believe our ideas have significant merit, we cannot say what impact they would have without empirical evidence.

their comprehension. We found that a simple summary of the most critical information, supplemented with a more detailed description of fees that included explanations of why those fees were incurred, was most effective in boosting comprehension. For more information about this innovative approach and our findings, see the “Testing our ideas” section below.

This report is organized into four main sections. The first three sections of this report focus on different barriers to using the Annual Fee Report. The first focuses on barriers to seeing and reading the Annual Fee Report, the second focuses on barriers to comprehension of the information in the Annual Fee Report, and the third examines barriers to making better-informed decisions on the basis of that information. Tactics informed by behavioural science that might help address the barriers are provided after the description of each barrier. The fourth section of this report describes the results of our randomized controlled trial.

For clarity, we note that the recommendations made in this report are being made by BIT to investment firms, regulators, and other stakeholders. In the discussion surrounding these recommendations, references to “we” refer to BIT.

Addressing barriers to engagement

Although it may go without saying, investors cannot learn from a disclosure they do not see and read. Even this basic level of engagement is a significant challenge for mandated disclosures like the Annual Fee Report. For example, in the U.K. fewer than 1% of online shoppers click to open the information about terms and conditions regarding their retail purchase.[3] People are constantly bombarded with information, and we filter out that which does not grab our attention or otherwise seem important. If Annual Fee Reports are going to help investors make better-informed investment decisions, addressing barriers to investors seeing the report and reading it may be just as important as improving the content of the reports.

1) Investors may not see the report

Although CRM2 was fully phased-in by mid-2016, research completed in 2017 and 2018 indicates that, while many investors are benefitting from the information included in their annual fee reports, others may not be noticing these reports.[4, 5] In our qualitative research for this report, only one of nine people we interviewed said that they had received an annual report detailing investment firm fees, and that person described a report that did not seem like the type mandated by CRM2. Even investors who indicated that they were very diligent in reviewing financial documents were unaware of it.

It is clear that a significant number of investors are not engaging with their Annual Fee Report at all. Through our research, we identified several key issues:

1. The Annual Fee Report is sometimes included with or added to the end of another document (e.g. an account statement), meaning that an investor would need to read or browse through multiple pages before getting to the report.[iv]

2. Mailed reports, whether included with other documents or only with an annual performance report (also required under CRM2), can go unopened because they appear to be "just another document."

3. Similarly, electronically delivered reports are rarely salient (i.e. easy to notice), getting lost among a volume of other "e-documents" and email notifications.

[iv] Investment dealers that are members of the Investment Industry Regulatory Organization of Canada (IIROC) are required under IIROC Rule 200.4(b) to deliver the Annual Fee Report together with the client's annual performance report (also required under CRM2).

To address these challenges, we present a handful of simple ideas (i.e. “tactics”) informed by behavioural science that might increase the chance that investors actually look at their Annual Fee Report(s).

Tactic 1A

Provide the fee report as a standalone document. Instead of combining the Annual Fee Report with a more frequent communication like an account statement (which arrives quarterly or even monthly), investment firms could make the report more salient by providing it as a separate document or alongside the annual performance report required by CRM2, which is also an important annual document.[v]

Tactic 1B

If the report is sent by mail, **use language or visuals on the envelope itself to call out its importance.** Mailed communications can better attract attention by adding compelling language or visuals to the envelope. In particular, handwritten notes have been effective in increasing engagement. BIT used this tactic in Lexington, KY to reduce the likelihood that citizens would make delinquent payments on their bills.[6]

Figure 1: BIT’s courtesy letter envelope tactic to increase timely payment of sewer bills in Lexington, Kentucky.

Tactic 1C

If the report is provided electronically, **send investors an alert or notification that grabs their attention.** Alerts could include an email, a pop-up notification on an online brokerage, or even (and perhaps most effectively) a text message. The notification should serve as more than a reminder to review the document; it should also communicate that the Annual Fee Report is important. Potentially effective key messages for the alert could include that it is annual, simple to review (e.g. one page), or can help clients understand their fees. More creatively, the alert or notification could appeal to the investor’s identity by suggesting that informed investors care about fees and review their Annual Fee Report, or that their peers review the report.

Tactic 1D

If the report is provided electronically, investment firms could **monitor whether recipients have opened the fee report and send them a reminder if they have not**. These

[v] Note that IIROC Rule 200.4(b) does not preclude the preparation of performance and fee reports as separate documents—it requires only that these documents be “sent … together” (for example, in the same envelope).

reminders could be provided through email, text or online notification systems, as appropriate. Reminders may help people who intended to read the report but failed to follow through and would also help communicate the importance of the document.

2) Investors may open the Annual Fee Report but not really read it

Investors are bombarded with financial documents: proxy circulars, trade confirmations, performance reports, account statements, prospectuses, and more. They are only willing to devote so much time to reviewing financial information, and it's hard to know which are most important. As a result, when investors open these documents, they are likely to skim them without truly engaging with the material.

We have identified several reasons why investors may open but not meaningfully engage with their Annual Fee Report:

- At first glance, the Annual Fee Report may appear unimportant (e.g. it may not be immediately evident that the report can meaningfully inform investment decisions).

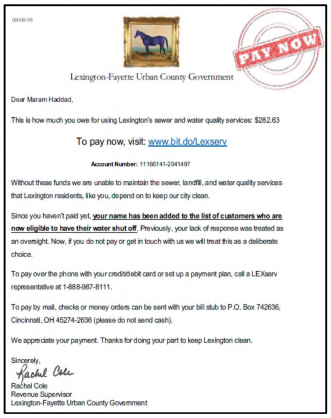
- Investors may avoid engaging with the report because the information it contains is unpleasant. When investors see that the report is about fees, they may not want to engage further.

- The purpose of the report may be unclear, limiting the impetus to read and digest it. At BIT, we've coined the phrase "flip test" to capture the importance of recipients being able to quickly understand the intent of a communication. In the flip test you put a communication face down then flip it over. If you can't understand the purpose within seconds of flipping it over, it has failed the flip test. The sample Annual Fee Reports BIT reviewed for this project would not pass this test.

- The report may appear to be complex, long, or otherwise taxing to read. Behavioural science research has repeatedly shown that when the perceived complexity of choice increases, people become more likely to rely on rules of thumb or to take no action at all.[7] Thus, when getting investors to read a document, the perceived complexity can be a significant barrier to engagement. This is a particularly important consideration for investors with multiple accounts, as CRM2 requires an Annual Fee Report for each one.

We identify one tactic below that may help address some of these barriers. We also note that many of the tactics listed in the next section of this report, which focuses on barriers to comprehension, may also help address them. For example, simplifying language and reducing the volume of information may improve both engagement and comprehension.

Tactic 2A



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We appreciate your payment. Thanks for doing your part to keep Lexington clean.

Sincerely,

Rachel Cole

Rachel Cole
Revenue Supervisor
Lexington-Fayette Urban County Government

Clearly indicate the nature of the report and its importance. Investment firms could make the significance of the report more salient. For example, they could add a large, bold title or "stamp" that says something like: "Important Annual Fees Report – Please Read – Fees Impact the Value of Your Investments." BIT has found success in the past in getting document recipients to read and comply with a request by including a stamp that concisely describes the purpose of the document.

Figure 2: BIT's courtesy letter tactic to increase timely payment of sewer bills in Lexington, Kentucky.

Addressing barriers to comprehension

The goal of the fee disclosure component of CRM2 is to help investors assess whether they are receiving value for their fees and make better-informed choices in light of this assessment. Better choices can in turn lead to greater prosperity and financial security. Enabling better-informed choices requires that investors go further than simply reading the Annual Fee Report; they need to understand the information and be able to link that understanding to their own circumstances and choices.

Investors face significant barriers to understanding the information contained in Annual Fee Reports. The language used to describe different types of investment firm fees and charges is not intuitive. Most people outside the investment industry are unlikely to know what a trailing commission or a front-end load is. The volume of information can also be a challenge given that people have limited attention (a barrier exacerbated by complexity).[8] Our level of attention, and therefore comprehension, can ebb as we wade deeper into a document.

Investors may experience confusion related to the scope of the report. In our qualitative interviews, most participants presented with a sample report assumed that it included fees charged and retained by investment fund managers (referred to in this report as "product fees"),[vi] which they do not. (The reports are required to disclose only the amount paid directly or indirectly through a client's account to the client's investment firm.)

Indirect fees, like commissions paid to investment firms by fund managers, create real confusion among investors. Most of our qualitative research participants did not readily grasp the relationship between investment fund managers and investment firms and therefore how indirect charges work. We also believe that investors may underestimate the cost of indirect charges, as a result of their being less psychologically "painful" than direct charges.

There are also more subtle barriers to understanding how the information relates to the individual investor, their choices and their long-term investment goals:

- Investors may not understand that indirect charges reduce the value of investments in the same way that direct charges do, as they are not directly debited from their account. (For example, they may misattribute the impact of these charges to poor performance in the market.)

[vi] Investment fund managers are businesses that manage the mutual funds, exchange-traded funds, or other investment products that investment firms, in turn, may buy or sell on behalf of clients.

- Even if people understand the direct and indirect compensation that investment firms receive, it is hard to evaluate whether that compensation is appropriate. Investors do not have a benchmark or other reference point to compare their fees and charges to.

- The exponential trajectory of compounding is not intuitive, and so people may underestimate the impact of fees over time.

The remainder of this section provides more detail about each of these barriers and presents promising tactics to address them.

3) Certain critical but complex terms may limit investor comprehension

Complex language and terminology can quickly confuse readers. In our interviews, almost all participants had never heard of or didn't understand terms like deferred sales charge (DSC), trailing commissions, and third-party compensation. Even the terms "compensation" and "commission" were unclear to many interviewees. This problem is made worse by the inconsistent use of terminology across investment firms.[9]

There will always be different terms needed to describe investment fees because of the variety of investment firm compensation structures. However, it is still possible to improve investor comprehension by simplifying, standardizing, and more clearly defining complex language.

Tactic 3A

Use simpler terms to describe key concepts and different types of fees. Much of the language used in Annual Fee Reports is complex, limiting comprehension. While we expected terms like "deferred sales charges" to generate confusion, our research also suggested that some broader terminology like "third-party compensation" and "commission" is not intuitive. While some of this complexity may be unresolvable, exploring simpler language is worth the effort. For example, in the versions of the Annual Fee Report we tested, we substituted the term "indirect charges" for "third-party compensation." We recommend that the investment industry explore and share best practices for simplifying specific phrases that generate confusion. Ideally, this would be an empirical process to see what phrases and words are most likely to get the accurate message across, similar to the trial we ran for this report. For example, investors could be randomly assigned to view one of four different options for describing trailing commissions, deferred sales commissions, and other key terms. Whichever term or phrase leads to participants having the highest scores in a subsequent comprehension test should be adopted.

Tactic 3B

Where complex language is unavoidable, include a plain language explanation of the term in the Annual Fee Report or on a linked website. CRM2 recognizes the importance of defining complex terms. It prescribes the inclusion of a specific definition (or language substantially similar to the prescribed definition) for one type of indirect charge, trailing commissions.[10] This approach, whether mandated in regulation or not, could be extended to other terms that cause confusion (e.g. “switch fees,” “DSCs,” etc.). It is important that the explanations be sufficiently clear and use plain language. Our qualitative research suggests, however, that even the mandated definition for trailing commissions may not be enough, at least on its own, to communicate this complex concept.

The use of examples is an important strategy in defining and explaining abstract concepts. In trying to reduce confusion related to third-party compensation (i.e. indirect charges), the tested versions of the Annual Fee Report explained third-party compensation by saying “Investment firms like us can receive payments from third-parties, *such as fund managers* [emphasis added], when our clients have investments in their funds.” Another promising strategy is to explain what services were provided for that fee.

While the inclusion of plain language definitions and explanations can help comprehension, this does need to be balanced against the preference for short documentation that reduces cognitive load. One solution is to use hyperlinks for explanations (or to enable explanations to “pop up” when moused over), but that is only an option for electronic Annual Fee Reports. On a printed Annual Fee Report a link could be included, but that would impose a “hassle factor” on users and we would not expect many to make it to the website with the explanations.

Tactic 3C

Standardize how different types of fees are referred to across investment firms. Standard terms would reduce investor confusion by reducing the number of terms that investors need to learn. It would also facilitate comparison between the fees charged by different investment firms. Standardized terms should be chosen with care, using the most intuitive and empirically-supported options (see Tactic 3A). While the desire to standardize terminology is implied in CRM2 (and supported by the sample fee report the CSA published), there is much more that can be done.

Tactic 3D

A **plain language guide or handbook for investment firms** could encourage the use of clearer terminology. This guide could provide industry with general strategies for simplifying complex concepts and terminology. The handbook could address fee disclosures and a broader range of topics. This idea was inspired by the Securities and Exchange Commission’s plain language guides for industry.[11] Using plain language could be mandated in some circumstances deemed critical to investor protection. If use is mandated, industry should have opportunities to propose alternatives that improve investor comprehension, especially as new products or services are introduced.

4) The volume and format of the content may overwhelm the reader, leading to poorer comprehension

Annual Fee Reports contain quite dense information about the various types of fees and charges that investment firms levy. Counter-intuitively, providing more information can sometimes *reduce* comprehension. People have a limited amount of cognitive resources (i.e. ability to perform mental work) at any given time, and some of those are already taken up by internal cognition, like worrying or planning other activities. When the rest of a person's cognitive resources are exhausted, for example by reading a report, they suffer from cognitive overload and tend to lose focus and struggle to make decisions.[12] Cognitive load requirements depend on both the volume and format of information. Depending on how things are presented people may be able to digest more or less of it. Including a substantial amount of dense information in an Annual Fee Report may induce cognitive overload and cause investors to miss key information (as they expend their attention on less important details). There are three potential approaches we have identified for reducing the cognitive burden associated with reading Annual Fee Reports.

Tactic 4A

Eliminate non-essential or redundant information. One way to reduce cognitive load is by eliminating non-essential or redundant information presented in the Annual Fee Report. For example, investment firms could decide not to include reference to categories of fees that do not apply to a given client.

We also considered whether presenting less detailed fee information (e.g. by aggregating all transactions into a single item on the Annual Fee Report) might increase comprehension. We were able to test this experimentally but did not find a significant, positive impact. As a result, we would not suggest aggregating fees at a higher level without also providing a breakdown of how the fees were incurred (as currently contemplated under CRM2).

However, the broader point about reducing cognitive load by providing less information overall is sound. Investment firms should think carefully before adding further information to fee reports.

Tactic 4B

Present the essential information up front. Where it is not possible or desirable to significantly reduce the amount of information provided, investment firms could ensure that the most important information is presented near the beginning of the Annual Fee Report. Information at the top of documents gets more attention and is more likely to be remembered than information in the middle. This is called the *primacy effect*. [13]

This could be accomplished by providing the most critical information in a summary page with only the most critical information, with the additional information provided on a subsequent page (or two). We tested this idea in our online experiment (see "Testing Our Ideas") and it was the most effective of the versions that we developed. This approach provides flexibility to suit investors with different levels of interest and attention.

Tactic 4C

Format the report to highlight the most critical information. In addition to putting the most important information front and centre, formatting can help ensure that people's scarce attention is spent on the right content, such as the purpose of the report and the total fee amount. Using bold font, larger font, text boxes, icons, or other visuals can attract reader attention. In a study that is forthcoming, BIT found that including content-related "icons" helped readers pay more attention to contract terms and conditions. Last, highlighting too much information should be avoided; if everything is in bold, nothing will stand out.

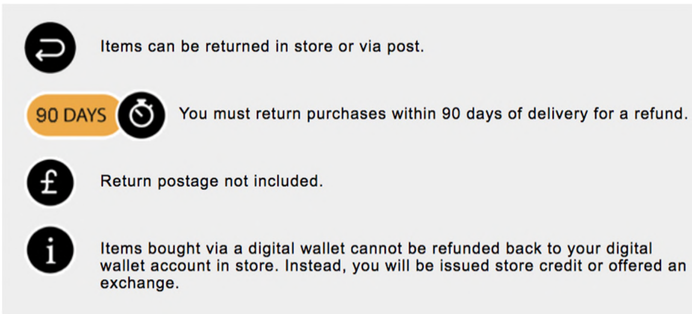

Figure 3: Screenshot from BIT trial that used content-relevant icons to improve participant comprehension of retail terms and conditions.

5) Investors may believe that the Annual Fee Report includes product fees

Understanding which types of fees are included in the Annual Fee Report is a key element of comprehension. We believe that many—perhaps even most—Ontario investors who receive the report believe that it includes all fees associated with their investments. When we informed our qualitative research participants that product fees were not included in the report, most were surprised.

Some stakeholders have proposed expanding the scope of the Annual Fee Report to include fund product fees.[14] While the question of whether product fees should be included in the Annual Fee Report is largely outside the scope of our research, from a BI perspective, **providing all of the relevant fees to an investor in one place makes it more likely they will be considered.** This is because individuals tend to be poor at noticing when relevant information is omitted.[15] If product fees are not included in the Annual Fee Report document, it is likely that a substantial portion of investors will incorrectly believe that the document is comprehensive. However, we recognize some of the challenges that such an approach would create (e.g. providing transparency on indirect charges without double-counting those charges, which come out of product fees). In the interim, we would suggest that investment firms explicitly note that product fees are not included as they are not paid to the firm issuing the Annual Fee Report. Further, Annual Fee Reports should avoid the phrases "total charges" and "total fees," and instead clarify that they are "total charges for our services" or "total charges we received."

6) Third-party compensation is not well understood, and investors may be underestimating its significance

One of the most significant changes introduced under CRM2 was the requirement for clearer disclosure of third-party compensation that investment firms receive related to their clients' accounts. This closes an important gap in enabling investors to make informed decisions, but the concept of indirect charges is not well understood. This was evident throughout our qualitative interviews and stemmed primarily from lack of clarity on the difference and relationship between investment firms and fund managers. (As noted above, the term "third-party compensation" adds to this confusion). Improving understanding of indirect charges is important. First, depending on the investments a client holds, indirect charges can have a significant impact on the client's returns over the long-term. Second, investors should consider indirect fees when reflecting on advice they receive from their investment firm and its representatives. The compensation firms and/or their representatives receive may give rise to conflicts of interest, an important and much broader topic that is the subject of other regulatory policy development work.[16]

In addition to Tactic 6A, below, we recommend that investment firms include a plain language explanation of indirect charges (see Tactic 3C) and avoid the term "third-party compensation" (see Tactic 3A). More broadly, we suggest that the investment industry make explaining indirect charges a priority in their communications with investors.

We also think that investors may not take indirect charges into account to the same extent as direct charges. There's an old saying that "a dollar is a dollar." The author of this quote is unknown, but you can be sure that they were not a behavioural economist—depending on the circumstances and method of payment, the exact same charge can feel more or less painful to pay.[17] We tend to feel the *pain of payment* much more substantially when we are paying directly in cash, rather than paying less directly such as with a credit card or an automatically renewing subscription. Investors may experience less pain of payment for indirect charges than they do for direct charges; direct charges are taken out of the investor's account while indirect charges never get into their account in the first place. As a result, they may pay less attention to indirect charges than they should.

We recognize that this dynamic may cut both ways—if costs feel too painful, people may focus disproportionately on these costs and discount the potential benefits of making investments, which may also lead to suboptimal outcomes. The tactics outlined below are aimed not at changing the way in which firms are compensated for their services, but on making indirect charges easier to notice and understand.

Tactic 6A

Develop compelling visuals or narratives that explain how indirect charges work and build knowledge about the different actors in the investment industry. It is often easier to learn an abstract or difficult concept through images or stories than through traditional definitions. These might help investors understand indirect charges, and the underlying relationships between investment firms and their representatives, on the one hand, and fund managers, on the other. These firms and other organizations should consider developing such resources. One idea is a "flow diagram" that depicts the flow of services and payment between investment firms and their representatives, fund managers, and investors. Another approach would be a simple, illustrated story that places indirect charges into an easy-to-understand context.

Tactic 6B

Include a prominent statement in the Annual Fee Report that both direct charges and indirect charges affect investment returns. We believe that a simple and clear indication may be enough to meaningfully address this challenge. Today, many investment firms already state that direct and indirect charges reduce investment returns, following a sample fee report developed by the CSA.[18] In the versions of the report that BIT developed and tested, we used the phrase "Both direct charges and indirect charges are important because they reduce the value of your investments."

7) Without a reference point, it may be difficult for investors to know whether their fees are appropriate or not

When making decisions that involve the weighing of costs and benefits, people tend to depend on comparisons to make their choice. That is, people often evaluate the benefits of a choice by seeing how it compares *relative* to something else, as opposed to understanding its benefits on its own.[19] It's hard to know the right price for a nice big-screen TV—we might need to know how much it costs to manufacture, and what a fair mark-up is for consumer electronics. It's a lot easier to compare two similar models and select the one that is less expensive.

When we have nothing to compare a price to, we find it hard to evaluate whether something is a fair deal or not. This is exactly the situation that most investors find themselves in after receiving their Annual Fee Report. This challenge was raised explicitly in our qualitative research. In looking at a sample Fee Report, one research participant noted that "I don't know if that [amount] is reasonable or not" and another said, "without any context, is $1,035 (the total amount of charges in our example) a great deal, a terrible deal, more than the average, less than the average?" In making better-informed choices about investment firm fees, investors may benefit from a point of reference for their fees.

Tactic 7A

Establish a series of benchmarks (i.e. guidelines) that investors could use to gauge the appropriateness of their fees and charges. A benchmark provided by a trusted organization would likely be perceived by investors as an *injunctive norm,* a statement telling people that that's how much they *should* pay in fees, so it would need to be done quite carefully. The benchmarks could be presented in the Annual Fee Report (e.g. in a table or bar graph), or online. They could be based on the type of fee (e.g. a fair amount for an RRSP account administration fee) or it could be aggregated at the account level (e.g. the percentage of total portfolio value fees should amount to).

For a benchmark to be relevant and appropriate, it needs to be quite specific to the context of the individual investor. Benchmarks will need to be informed by the level of services provided by the investment firm, the value of the investor's portfolio and the type of securities they hold, among other potential factors. We recognize the inherent challenges in presenting this type of guidepost to investors, and that developing them would require significant analysis. However, we believe the potential value to investors suggests this may be worth exploring.

There are also risks in providing benchmarks to investors. Investors currently paying less than a benchmark rate may choose not to take any action, even though they could still save substantial amounts of money by seeking out a cheaper alternative. As a result, we think this tactic in particular should be empirically tested before it is implemented at scale.

Tactic 7B

As an alternative to providing a benchmark, which tells investors about how much they *should* pay, an organization could **inform investors how much other investors like them pay**. The behavioural science literature refers to this as a *descriptive social norm*, and these norms can have a strong effect on peoples' behaviour. In one of BIT's earliest projects, we found that adding social norms to tax collection letters in the UK brought forward hundreds of millions of pounds in revenue each year.[20] The same caveats and considerations from Tactic 7A apply here: the comparison must be appropriate and specific to the given investor. Large investment firms might be able to develop meaningful comparisons from within their own client base, but we believe the positive impact on consumers may be greater if the comparison included clients of all investment firms. However, the data required to enable this type of comparison is dispersed among individual firms. Aggregating data in this way may give rise to costs and other issues that are beyond the scope of this report.

8) Investors may underestimate the impact of fees over time

Investors may underestimate the impact of fees on the value of their investments over time due to a set of heuristics (i.e. mental shortcuts) and biases:

- When the absolute value of fees is small in a given year, investors may mentally round it down to zero and neglect to consider it as a real cost. This phenomenon is referred to as the *peanuts effect*.[21] This is problematic because even small fees can have a substantial impact given a long investment horizon.

- Fees reduce our returns, which in turn reduces the amount that we can continue to invest (or use for other purposes). This is the opportunity cost of fees, and opportunity costs are not something that most people grasp intuitively; the behavioural science literature refers to this as *opportunity cost neglect*.[22]

- Opportunity costs are particularly relevant when it comes to investing because returns compound over time. Like opportunity costs, the effect of compounding is not intuitive. This is because of what is known as the *exponential growth bias*—we intuitively treat exponential growth as though it were linear growth. This leads people to intuitively underestimate the effect of compounding growth. In this context, investors are likely to underestimate how rapidly the impact of their fees will grow with time.[23]

- More broadly, people systemically undervalue long-term outcomes compared to nearer-term outcomes. We see this effect, called *hyperbolic discounting*,[24] in everything from savings to exercise habits. This means that investors are likely to pay too little heed to the long-term impact of fees even before we account for the peanuts effect, opportunity cost neglect, and exponential growth bias.

Tactic 8A

Create an interactive online tool that shows a projection of how investment firm fees impact returns over time. The OSC Investor Office maintains an online mutual fund fee calculator that shows users how much their mutual fund fees have cost them (both in total fee amount and opportunity cost) over a given timeframe.[25] A similar tool could be created by investment firms or other organizations for investment firm fees. An investor would enter their current fees, the value of their portfolio, growth assumption, and timeframe. The tool would then display a graph or table illustrating the aggregate impact that these fees have on the user's portfolio.[vii]

WHAT IT COSTS	FUND 1	FUND 2
Sales fees	$0.00	$0.00
Other fees (MER, redemption fees)	$7,182.38	$11,694.66
Total fees	$7,182.38	$11,694.66
? Average annual costs:	1.58%	2.65%
? Opportunity cost	$5,841.67	$11,363.73

Figure 4: A segment of an example result from the OSC's online mutual fund fee calculator.

Ideally, we would also like to make the long-term opportunity costs of fees more salient by providing investors with those costs as a dollar amount over a 5-, 10-, or 20-year period on the Annual Fee Report itself. However, doing so would require assumptions about fees and returns over time, and we recognize that investment firms' making these assumptions (in contrast to investors inputting them) could cause unintended consequences. For example, it could give investors false confidence or certainty about what their returns will be.

[vii] This approach could be combined to with Tactic 7A or 7B to illustrate the impact of paying fees at the level of the benchmark or peer comparison.

Addressing barriers to action

The goal of CRM2 disclosure requirements is to enable investors to make better-informed investment decisions, helping them meet their financial goals and increase their financial security. Improving investor comprehension of investment firm charges is an important step towards this goal, but it is not enough.

For example, imagine an investor who receives their Annual Fee Report and fully understands it. They realize that they are paying fees for services that they do not require, but they have no idea what to do, and so they take no action. Comprehension has not translated into better-informed choices, and for this investor, the policy aims of CRM2 disclosure requirements have not been achieved.

The gap between understanding and action is a core focus of behavioural science. Unlike traditional economic models of human behaviour, behavioural scientists recognize that a wide range of barriers can interfere with people making choices that they want to make or know are correct.

In this section, we identify important barriers to informed action and propose potential solutions informed by behavioural insights. This is a difficult task because there is no single action or set of actions that will be right for all investors. We cannot say, for example, that all investors should seek to reduce their fees. Relatively high fees will be right for some investors based on their investment strategy and the level of service they desire. In some cases, investors will already be paying the right level and types of fees for them, and so the best action would be no change at all.

However, there are some actions that would signal that investors are moving from comprehension to better-informed choices. Some of these actions would be steps to learn more about the investor's options (e.g. contacting their investment representative to learn more). Other actions might more directly "right-size" fees to align them with investor's personal needs and goals. These actions include but are not limited to:

- Renegotiating fees;
- Reducing transactions;
- Choosing different investment products or strategies; and
- Switching their investment firm.

Our research indicates that the following barriers may be significant in investors' moving from comprehension to the types of actions listed above:

- Gaps in knowledge;
- Discomfort;
- Friction costs (i.e. "hassle factors"); and
- Belief that action is not necessary because fees have been disclosed.

The rest of this section describes these barriers in more detail and proposes tactics to address them.

9) Investors may be unaware of their options for reducing fees

The simplest reason that investors may not take steps to reduce investment firm fees (or increase the value they receive from those fees) is that they don't know what options are available to them. Some investment firms will renegotiate fee structures on behalf of their clients, but investors may not always know this (and many firms may simply not do this). Mutual fund investors may lack knowledge about the types of fee structures for mutual funds or which structure might be most appropriate for them given their investment objectives. They may not be aware of products or services that could help meet their needs at a lower cost, or the fact that, for some investors, making fewer, larger transactions might reduce fees without compromising returns.

We have identified several simple tactics that might address this knowledge gap. As always, we note that the desire to educate investors needs to be balanced against the cognitive load requirements that providing more information entails.

Tactic 9A

List actions that investors can take to reduce their investment firm fees or increase the level of service they receive for those fees. Providing investors with a simple list of potential actions could help close the knowledge gap in a way that imposes little cognitive burden. One of the Annual Fee Report options that we developed and tested used this idea, illustrated in Fig. 5 below. To our surprise, adding this information did not significantly increase investors' likelihood of describing one or more actions that they would take after reading the report (nor did it decrease the likelihood). This may be because investors are able to identify potential actions without a prompt, although we also acknowledge methodological limitations in testing this through an online simulation rather than in the "real world" (see "Testing our ideas" for more information).

Talk to us about whether lower-fee investment options might be right for you**.** Call us at (555) 123-4567, or reach us by email at advisor@investmentdealerabc.com

Go to our website to learn more. For example, learn what questions you might want to ask us to start a conversation about our charges.

If it is right for you, **consider making fewer transactions in your account.**

Figure 5: A screenshot of the action steps nudge used in BIT's online predictive trial.

The approach that we tested represented a simple, generic approach to increasing awareness of the steps that investors can take. However, investment firms could take this idea much further by providing **personalized recommendations** that reflect the investor's strategy, goals and holdings. Personalization can make the recommended actions more relevant *and* more compelling. There is strong evidence that even modest elements of personalization, like the inclusion of a first name, can make recipients of a communication more likely to engage with and respond to it.[26,27] Investment firms would be wise to personalize their recommended action steps and make clear that they are personalized (e.g. by noting that the actions have been specifically recommended for them). They could also make an *appeal to identity* by writing a message that speaks to the self-image that investors have of themselves: for example, telling Annual Fee Report recipients that *informed* investors tend to take the actions listed in the report.[28]

Tactic 9B

Link fees to the actions that triggered them. Today, Annual Fee Reports provide a relatively detailed list of direct and indirect charges, but they do not explicitly link those charges to the choices that investors have made or services that they have received. In some cases that link may be relatively intuitive (e.g. in transaction fees) but in other cases it may be quite opaque (e.g. trailing commissions or redemption fees). As noted above, without a clear understanding of the link between their actions and charges incurred, it may be less likely that investors will act. One of the Annual Fee Report options that we developed and tested sought to address this by adding a description for each type of fee that linked the fee to an investor choice (e.g. buying, selling, or holding a security). This version of the report was the most effective in boosting comprehension but did not have a significant impact on investors' likelihood of describing an action that they would take when prompted to do so (see Testing our ideas for further context on this result).

Transaction Charges	**$233**	
Trading Fees	$29	Charged for three mutual fund transactions.
Sales Charges	$204	Charged for purchasing ABC Mutual Fund, which has a front-load sales charge.

Figure 6: A screenshot of a segment of the "Summary + Detail" Annual Fee Report version BIT developed and tested for this report. It includes short descriptions that explain what actions generated each set of charges.

10) Investors may be uncomfortable speaking with their investment representative about their fees

Talking to one's investment representative is often going to be a critical first step in making better-informed choices. Investment representatives can provide more clarity and context on fees than the Annual Fee Report. But speaking with a financial professional can be intimidating for many investors, just like talking to a doctor. They are professionals with specialized knowledge and training, and sometimes it feels like they speak a whole other language. This can lead people to avoid having discussions. Our discomfort can be heightened in situations where we're asking for something, like renegotiated, lower fees. While this is a tough barrier to overcome, we have one recommended tactic that applies to investment firms and other stakeholders. We also note that Tactic 10A, providing a list of potential actions, can help by "normalizing" taking actions like calling your investment representative.

Tactic 10A

Create a "script" or recommended set of questions for investors to use in discussions with their investment representative. These questions could focus on shedding more light on fees (especially indirect fees, which are harder to understand), services that the investment firm offers, and options for reducing fees where appropriate based on the investor's goals and strategy. The questions could be included in the Annual Fee Report, but we think they might be better communicated separately. We also think that it would be helpful if the suggested questions were provided on the website of a trusted third party like a regulator, rather than from investment firms themselves. Potential questions could include:

- What services does your firm provide in return for these fees?
- What should I be doing differently to take better advantage of the services you offer?
- What actions could I take to reduce these fees without compromising my investment goals?
- Are there other, more cost-effective investing strategies that I should be considering based on my investment goals?
- Are you able to reduce any of these fees or charges for me?

11) Investors may intend to act, but fail to do so because of the "hassle factor" involved

Even the smallest moments of friction can have a significant impact on behaviour. Just think about the last time you wanted to read an article or buy something online, then dropped out because you had to create an account! In one of BIT's simplest interventions, we removed a single click from the process of filing an online tax form and saw a 22% increase in the completion rate.[29]

Many of the actions that investors may want to take once they've reviewed and understood their Annual Fee Report involve potential friction points, from simply finding out how to contact one's investment representative to more complex actions like considering alternative investment firms. We have recommended some specific tactics below. They focus primarily on the fundamental step of discussing options with one's investment representative but cannot be comprehensive given the diversity of potential actions an investor could take based on their needs and circumstances. We encourage all key stakeholders to spend time identifying and addressing the moments of friction that they are asking investors to work through.

Tactic 11A

Prominently include contact information for the investment representative (or other relevant investment firm contact information) on the Annual Fee Report itself. While this idea may be so obvious that it goes without saying, many of the reports that we reviewed in the course of this project failed to do so. It is a simple first step in reducing the friction associated with better-informed decision-making. Ideally this would be both a phone number and an email address.

This information should include a specific, named individual that the investor can reach out to, a desire raised by several of our research participants. As noted previously, personalisation of communications improves their effectiveness, and having someone specific to contact is likely to provide the impression of a more personalised service.

Tactic 11B

When sending the Annual Fee Report, investment firms could pre-book a brief call with the investor to discuss investment fees and performance. Investment firms could go further than providing contact information—they could actually pre-book a meeting with their clients and communicate the time and date of that meeting in the Annual Fee Report (giving clients an option to reschedule or cancel, of course). By doing so, having that discussion would become the "default option"—it would occur if the investor does not make a decision. Default options are one of the most powerful and effective behavioural insights tactics across a very wide range of behaviour change goals.

Tactic 11C

On the Annual Fee Report, **include space for investors to make a specific plan regarding how and when they will speak to their investment representative or take other appropriate actions**. This type of prompt to make a specific plan is called a *implementation intention* tactic, and there is a rich literature on their impact.[30] In past work, BIT has found success in asking recipients to set a date for when they plan to complete the desired behaviour (see Figure 7).[31]

In the Annual Fee Report context, this could be a statement that investors would fill in such as: "At [time] on [date], I will book a meeting with my investment representative."

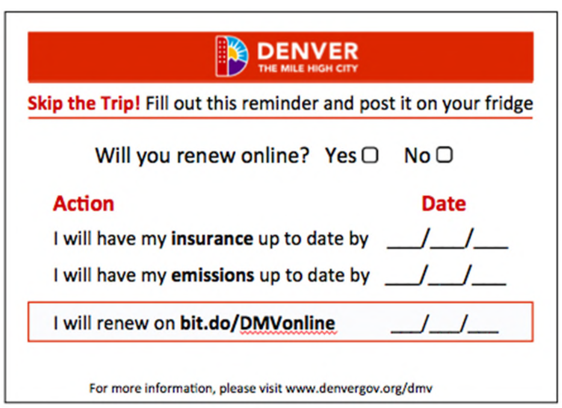

Figure 7: BIT's implementation intentions postcard to increase take-up of online DMV registrations

Tactic 11D

Facilitate "comparison shopping" of investment firms by **creating a website that allows investors to more easily compare charges across investment firms.** This tactic, which could be implemented by stakeholders that aren't affiliated with a particular firm, would be specifically effective for encouraging behaviours around switching and negotiating fees. Comparison sites are commonplace for some financial services companies such as credit card companies.[32] Incorporating the lessons from other popular comparison sites and from behavioural science, the site should try to minimize friction as much as possible (e.g. by automatically populating the comparison site with the investor's info). We recognize that this is an ambitious idea and that it may not be possible in the near term. Simplifying, standardizing, and publishing fee structures would mitigate the challenges. If not feasible on an industry-wide basis, comparison sites could be developed for certain segments of the investment sector offering similar services. We note that comparison sites covering some of these sectors (in particular, online discount brokerages and online investment advisers) were already available online as of the date of this report.[viii]

12) Disclosure of certain fees may "backfire" and have a negative impact on investor decision-making and investment representative advice

There is a significant body of research into how the disclosure of misaligned incentives (e.g. conflict of interest disclosure) can, *in some cases*, "backfire" and undermine consumer decision making. As discussed further below, it is challenging to situate this research within the Annual Fee Report context, but we think it is worth flagging and considering.

There are at least three reasons why a disclosure of misaligned incentives may "backfire": *moral licensing*, *reluctant altruism*, and *insinuation anxiety*.[33]

- When potentially misaligned incentives between a representative and a client are disclosed, the representative may feel that it has become less morally wrong for them to provide biased (self-interested) advice now that the consumer is aware of the incentives at play. In behavioural science terms, the representative now feels that they are *morally licensed* to provide more self-interested advice.

- The disclosure of misaligned incentives can sometimes result in *increased* compliance with biased advice. This is because clients may interpret the disclosure as a description of the personal aims of their representative, and then may feel social pressure to assist their representative in achieving those aims. This phenomenon is sometimes referred to as *reluctant altruism.*

- After they learn of potentially misaligned incentives, clients may feel that if they reject or question their representative's advice, the representative will think the rejection is because they are untrustworthy. If clients do not want to insinuate that their representative's advice may be biased, they might avoid rejecting or questioning the

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[viii] As of the date of this report, the CSA had published proposed rules that would require registered firms to make information on their charges and other costs to clients publicly available. If implemented, these rules could facilitate the creation of new comparison sites covering the investment sector. CSA Notice and Request for Comment, Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (2018), 41 O.S.C.B. (Supp-1), p.11.

advice they receive. Thus, clients may become *more* likely to follow their representative's suggestions—a concept referred to as *insinuation anxiety*.

These "backfire effects" of misaligned incentive disclosure have been found in lab experiments that simulate a variety of relevant contexts, including the relationship between a homebuyer and his or her real estate agent,[34] and the relationship between a patient and a doctor.[35]

It is not obvious whether this research can be extended to the Annual Fee Report context. First, the investment firm/investor context may be different than the relationships that have been studied previously. Second, we are not aware of any research related to the form of implicit misaligned incentive disclosure reflected in the Annual Fee Report. We also note that these concerns may be most relevant to investors who have a close, longstanding relationship with their representative. Reluctant altruism and insinuation anxiety may be more common where such a relationship exists.

Given the uncertainty, we recommend further research to determine whether this risk is significant for Annual Fee Report recipients.

Testing our ideas

What did we test and why?

We had the opportunity to test four versions of an Annual Fee Report. We wanted to see if we could improve investor comprehension of key information by incorporating several of the tactics described above. We also used this opportunity to explore several other questions, including whether certain changes to the report could increase investors' self-reported intent to act on the information in the Annual Fee Report. The four versions we tested were:

1. Control

The *Control* version was our best effort at mirroring what a typical Annual Fee Report looks like today. We modelled the report off of the CSA's sample fee report, then incorporated common elements from other sample reports we obtained.

2. Simple

In this version of the Annual Fee Report, we focused on addressing "information overload" by minimizing the volume and complexity of the information provided while emphasizing the most essential information. We used an attention-grabbing "header" that emphasized the importance of the report, reduced the number of fee categories presented, and highlighted the total amount of charges. It was an application of the ideas articulated in Tactics 2A, 4A, 4B, and 4C.

3. Summary + Detail

Our *Summary + Detail* version took the *Simple* version and added a second page with a more thorough breakdown of the fees. This breakdown contained the same amount of information as the *Control* but presented it in a layout we thought would be clearer. For each category of fee, we provided a description that explained why the fee was incurred. We hoped to improve comprehension and increase intent to act on the report by highlighting the link between the investor's actions and their corresponding fees (see Tactic 9B).

4. Action

The *Action* version was designed to encourage recipients to take action on the basis of the report. We took the *Simple* version and added a list of three actions that investors might want to take (Tactic 9A): calling their advisor for information about lower-fee options, going to their advisor's website to learn more, and considering passive as well as active investment strategies. This version also included investment firm contact information (Tactic 11A).

Pictures of each of those options are available in the Appendix to this report.

How did we test it?

We tested the impact of these Annual Fee Report versions through a randomized controlled trial (RCT). This RCT was conducted using Predictiv, an online platform developed by the Behavioural Insights Team.

We recruited roughly 1,900 current investors from across Canada, with most (60%) residing in Ontario. There were an approximately equal number of men and women. Each investor received some basic information about the task and the scenario—that they were an investor receiving a report on fees from their investment firm (which, in this scenario, was a registered dealer). Then, they were shown one of the four versions of the Annual Fee Report. The version they saw was decided at random, with about the same number of people seeing each one. After viewing the report, participants were asked seven multiple choice questions intended to test their understanding of the key information in the Annual Fee Report. We measured their comprehension based on how many questions they got right. We adopted this approach as it provides a more reliable measure than self-reported understanding.[36]

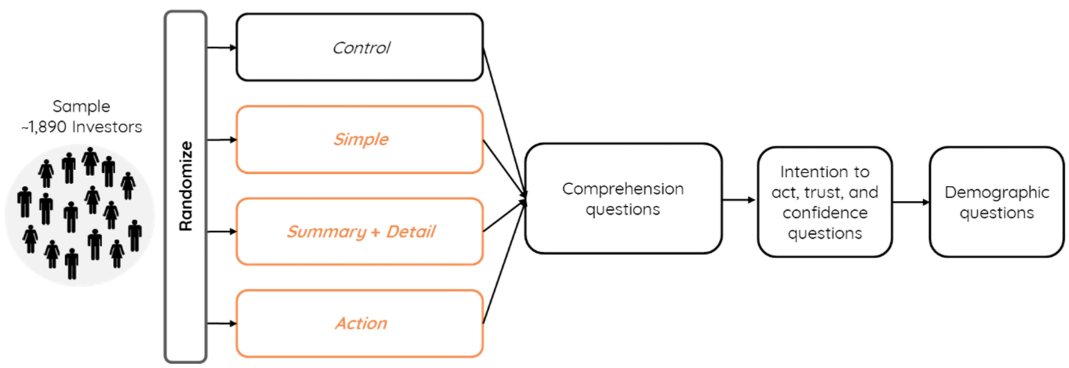

Figure 8: Key stages of the Predictiv trial

Our primary focus was the comprehension score, but we asked several other types of questions. We wanted to see how the different versions of the Annual Fee Report might impact investors' intention to act on what they read. While this is quite difficult to assess in a simulated scenario, we attempted to do so by asking investors what actions they might take, if any, after reading a report like the one they saw. We then took a random subset of 500 free-text responses to this question and manually determined whether the investor had indicated an action or not. We also asked several questions related to trust[37] in the hypothetical investment firm that was sending them the Annual Fee Report and about their level of confidence in their understanding of the information in the Annual Fee Report. Lastly, we asked basic demographic questions. The participants were financially compensated for completing the task, with a small additional reward for each answer they got right.

What were the results?

To evaluate the results of our trial, we conducted statistical analyses on our comprehension measure while controlling for certain demographic variables (i.e. gender, age, income, education, and region) through multiple regression.

Investors who saw the *Summary + Detail* version of the Annual Fee Report had the highest comprehension scores, answering 4.4 out of 7 questions correctly on average. This was "significantly" higher than the *Control* version, which had an average of 4.1 out of 7 questions answered correctly. "Significantly" means that it is unlikely that the difference in score was the result of chance. The *Simple* and *Action* versions also had higher comprehension scores than the *Control* but these results were not statistically significant. This was somewhat surprising to us, as we had hypothesized that the *Simple* treatment would have the highest comprehension scores.

These results suggest that simplifying overall information and providing a more detailed breakdown of fees can help increase understanding of the information contained in Annual Fee Reports.

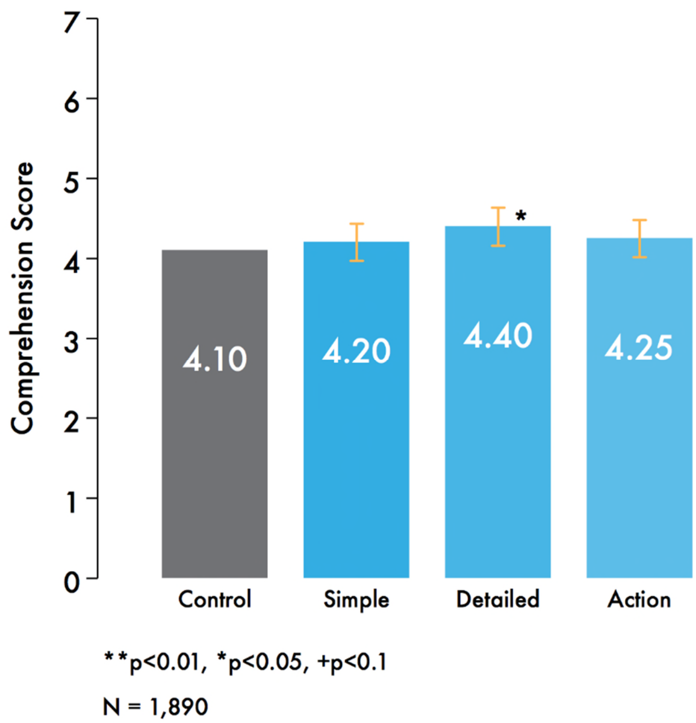

Figure 9: The impact of each version on comprehension

Regardless of which version they saw, participants struggled to answer questions about indirect fees. Only 42% of people were able to select the correct definition of indirect fees, and only 36% of people understood the types of indirect fees that were detailed in the sample Annual Fee Report. The other five questions focused on the purpose of the report, direct charges, the impact of fees, and the total amount of compensation received. Investors answered these questions correctly 59%–77% of the time, for comparison.

When we analyzed the actions that people said they might take after receiving this type of report, we did not find any statistically significant differences. In other words, none of the report versions that we developed increased investors' likelihood of describing an action that they would take. This was quite surprising to us, as we thought that the *Action* version would increase the likelihood of listing one or more potential actions. It may be that the people do not require these prompts because the potential actions are self-evident. Alternatively, helpful prompts may be insufficient to address other barriers, like friction costs or aversion to having difficult discussions with one's adviser.

We did not find any significant differences in participants' trust in their investment firm or in their confidence about their level of understanding.

The Predictiv platform collected information on how long the investors spent reviewing the Annual Fee Report. People who were presented with the *Control* or *Summary + Detail* option spent about 65 seconds reviewing it, while people who saw the *Simple* or *Action* versions spent about 47 seconds. This difference is not surprising given that the *Simple* and *Action* versions had less information, but the overall low level of time spent does reinforce just how limited our attention is! Further, we observed high variance in the amount of time people spent reviewing the reports, which suggests that the Annual Fee Report needs to be designed for a range of audiences.

This was an online trial where investors were presented with a sample Annual Fee Report, and it is important to consider how the impact might be different if implemented in practice. We note the following key considerations:

On comprehension: We are confident that the approach represented by the *Summary + Detail* treatment is effective at increasing comprehension, and that the results would hold in practice. We believe that the baseline level of comprehension might be lower in the "real world" than it was in our trial, given that the participating investors had an immediate financial incentive to try hard to understand the information. We also believe that the impact (i.e. "treatment effect") of the three new approaches we tested may be higher in practice, because they were partially designed to address the barrier of limited attention, which we think would be heightened in the real world.

On action: We did not find any differences in intent to act based on which version of the report investors saw. Further, it can be challenging to assess the extent to which intent to act translates to follow-up action. This means that we cannot say whether the Annual Fee Report versions we developed and tested would encourage investors to learn more about their fees, negotiate those fees, or take other actions after reviewing their report. We recommend further testing in the "field" to determine whether changes to the Annual Fee Report like the ones in the *Action* version might be effective in encouraging investors to learn more and make better-informed choices.

On engagement: Our literature review and qualitative research identified barriers to engagement. Investors may not open the report or may simply glance at it once opened. Given the nature of our trial, which required engagement with the content, we cannot say whether any of the versions we developed would increase engagement in practice. We hypothesize that the versions we developed, and the *Simple* version in particular, might help address these barriers by making the Annual Fee Report appear easier to review on first glance. This is another area where we believe further testing would be valuable to investors.

Recommendations based on trial results

Based on our experiment, we recommend that **investment firms adopt Annual Fee Reports with a simple summary page that includes only the most critical information, with additional information provided on a subsequent page** (or two). This would apply to both paper and electronic Annual Fee Reports. We also suggest that they **help investors understand the more detailed information by providing descriptions of why each type of fee was incurred**. These were the two key elements of *Summary + Detail* version of the Annual Fee Report, which had the highest comprehension scores. Our experiment does not allow us to determine which of these elements was most important.

The *Summary + Detail* version, which performed best, had a relatively modest impact on comprehension (the increase from 4.1 to 4.4 is about 7%). Other potential versions of the report that we did not test might have a much greater impact, but our sense is that there are significant limitations to the impact that changes to the Annual Fee Report can have on investor comprehension. **Investment firms, regulators, and other stakeholders should continue to pursue supplementary avenues to build investor understanding of these fees.** In particular, they should help investors understand indirect fees. There are many ways that this could be accomplished, and several of our proposed tactics address this imperative.

About Predictiv

Predictiv (www.predictiv.co.uk) is an online research platform that was built by the Behavioural Insights Team to run randomized controlled trials with online populations. It enables governments and other organisations to test new policies and interventions before they are deployed in the real world. Predictiv provides access to millions of individual participants in over 60 countries and has the functionality to run a range of online experiments.

Conclusion

Enabling a better understanding of fees should place investors in Ontario and across the country in a better position to make informed decisions about investment products and services. However, our research uncovered significant barriers to investors engaging with, understanding, and acting on the important information provided in Annual Fee Reports.

People are deluged with information and communications, and Annual Fee Reports may fail to stand out among the other documents people receive related to their investments and finances. The information people receive in the Annual Fee Reports is complex. These reports cover multiple categories of fees and may use inconsistent terminology or terminology that is unfamiliar to most people. Indirect fees in particular are hard to grasp, requiring an understanding of the relationships between various participants in the industry (e.g. fund managers and dealers/advisers). This complexity impedes understanding, but the challenges go even deeper. Moving from a baseline understanding of what investors pay to evaluating the appropriateness of what they pay is a critical challenge, and reference points or other guidelines to support such an evaluation are not readily available. Finally, the impact of fees *over time* is both critical and difficult to understand – our brains are hardwired to focus on short-term considerations.

If there is one key takeaway that we want industry and regulators to take from this report, it is that the challenges do not stop with comprehension. To capitalize on the promise of CRM2, the sector needs to consider how to support investors in moving from understanding to action. This is an even more significant challenge with Annual Fee Reports than with most disclosures, because the information included in these reports, by its nature, would not be available at the "point of sale"—it can only become available *after* fees are incurred. Supporting investors in making better-informed choices will mean helping them understand their options and reducing the friction in taking action.

Based on our research, this report includes 24 suggested tactics for addressing the identified barriers. Most of these tactics are "nudges," low-cost ideas that do not require regulatory or operational changes. We hope that investment firms, regulators and other key stakeholders in the investment sector review and consider these ideas. Where possible, we encourage them to test them empirically before rolling them out at scale.

We had an opportunity to test several of these tactics through an innovative online trial. We recruited about 1,900 investors in Canada and randomly selected them to receive one of four different Annual Fee Report options. We then asked them seven key questions to test their comprehension. We found that the most effective approach combined a simple, one-page summary that included only the most critical information *and* a second page with more detail about the fees the investor incurred and what those fees were for. We recommend that investment firms consider adopting this approach for their clients.

We note, however, that while the increase in comprehension was meaningful, it was not dramatic. Other design choices and other options may have a larger impact—only further testing can identify whether this is the case. We believe that our results do point, however, to the critical importance of additional avenues—including conversations between investment representatives and their clients, and investor education resources—to work alongside Annual Fee Reports to help investors understand investment fees.

Acknowledgements

The Behavioural Insights Team would like to thank our qualitative research participants, the OSC Investor Office (and Doug Sarro in particular), as well as Susan Silma of PureFacts for their invaluable assistance with our research and this report.

Appendix: Report options

Control

Investment Dealer ABC Inc.

Annual Charges and Compensation Report

Sam Doe
123 Pleasant St.
Your Account Number: 123-4567

Dear Sam,

This report summarizes the compensation that we received directly and indirectly in 2017. Our compensation comes from two sources:

1. What we **charge you directly**. Some of these charges are associated with the operation of your account. Other charges are associated with purchases, sales and other transactions you make in the account.
2. What we **receive from third parties.**

Charges are important because they reduce your profit or increase your loss from investing.

Charges you paid directly to us		**Totals**
RRSP Administration Fee	$100	
RRSP Withdrawal Fees	$50	
Total charges associated with the operation of your account		**$150**
Commissions on purchases of mutual funds with a sales charge	$204	
Trading fees	$29	
Total charges associated with transactions we executed for you		**$233**
Total charges you paid directly to us		**$383**
Compensation we received through third parties		
Commissions from mutual fund managers on purchases of mutual funds[1]		$407
Trailing commissions from mutual fund managers[2]		$111
Total compensation we received through third parties		**$518**
Total charges and compensation we received in 2018		**$901**

Notes:

1. **Commission from deferred sales charge investments**: When you purchase units of mutual funds on a deferred sales charge basis, we receive a commission from the investment fund manager.
2. **Trailing Commission**: Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions for the services and advice 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

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Investment Dealer ABC Inc.

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.

If you need an explanation of the charges described in this report, your representative can help you.

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Simple

Investment Dealer ABC Inc.

IMPORTANT: ANNUAL REPORT ON OUR FEES

Sam Doe
123 Pleasant St.
Your Account Number: 123-4567

Dear Sam,

This report describes the fees we received in 2017 for the services we provide to you. These fees come from two sources:

1. What we **charge you directly**. Some of these charges are for the operation of your account (e.g. account administration fees). Other charges are associated with purchases, sales, and other transactions you made.

2. What you are **indirectly charged**. Investment dealers like us can receive payments from third-parties, such as fund managers, when our clients have investments in their funds.

Both direct charges and indirect charges are important because they reduce the value of your investments.

Summary of Direct and Indirect Charges

Total Direct Charges	$383
Operating Charges	$150
Transaction Charges	$233
Total Indirect Charges	$518
Total Charges	**$901**

If you need an explanation of the charges described in this report, your representative can help you.

Summary + Detail

Investment Dealer ABC Inc.

IMPORTANT: ANNUAL REPORT ON OUR FEES

Sam Doe
123 Pleasant St.
Your Account Number: 123-4567

Dear Sam,

This report describes the fees we received in 2017 for the services we provide to you. These fees come from two sources:

1. What we **charge you directly**. Some of these charges are for the operation of your account (e.g. account administration fees). Other charges are associated with purchases, sales, and other transactions you made.

2. What you are **indirectly charged**. Investment dealers like us can receive payments from third-parties, such as fund managers, when our clients have investments in their funds.

Both direct charges and indirect charges are important because they reduce the value of your investments.

Summary of Direct and Indirect Charges

Total Direct Charges		$383
Operating Charges	$150	
Transaction Charges	$233	
Total Indirect Charges		$518
Total Charges		**$901**

➔ More detail about your direct and indirect charges is provided on the following page.

Investment Dealer ABC Inc.

Detailed Breakdown of Direct and Indirect Charges

Account #: 123-4567

Direct Charges	Amount	Description
Operating Charges	**$150**	
RRSP Administration Fee	$100	Charged on 12/31/2017 for maintaining your RRSP Account.
RRSP Withdrawal Fees	$50	Charged for two withdrawals of funds from your RRSP account.
Transaction Charges	**$233**	
Trading Fees	$29	Charged for three mutual fund transactions.
Sales Charges	$204	Charged for purchasing ABC Mutual Fund, which has a front-load sales charge.
Total Direct Charges	**$383**	

Indirect Charges	Amount	Description
DSC Fund Purchase Commissions	$407	When you purchased units of XYZ Mutual Fund on 04/12/17 on a deferred sales charge basis, we received a commission from the investment fund manager, XYZ Inc.
Trailer Fees (1)	$111	Commission we receive because you hold ABC Mutual Fund and XYZ Mutual Fund. We receive 1.20% of the amount you hold in each of these funds each year as a trailer fee in return for the service and advice that we provide you.
Total Indirect Charges	**$518**	

Notes:

(1) Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing

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Investment Dealer ABC Inc.

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.

If you need a further explanation of the charges described in this report, your representative can help you.

Page 1 of 3

Action

Investment Dealer ABC Inc.

IMPORTANT: ANNUAL REPORT ON OUR FEES

Sam Doe
123 Pleasant St.
Your Account Number: 123-4567

Dear Sam,

This report describes the fees we received in 2017 for the services we provide to you. These fees come from two sources:

1. What we **charge you directly**. Some of these charges are for the operation of your account (e.g. account administration fees). Other charges are associated with purchases, sales, and other transactions you made.

2. What you are **indirectly charged**. Investment dealers like us can receive payments from third-parties, such as fund managers, when our clients have investments in their funds.

Both direct charges and indirect charges are important because they reduce the value of your investments.

Summary of Direct and Indirect Charges

Total Direct Charges		$383
Operating Charges	$150	
Transaction Charges	$233	
Total Indirect Charges		$518
Total Charges		**$901**

Here are some of the **steps you might take to reduce your fees:**

Talk to us about whether lower-fee investment options might be right for you**.** Call us at (555) 123-4567, or reach us by email at advisor@investmentdealerabc.com

Go to our website to learn more. For example, learn what questions you might want to ask us to start a conversation about our charges.

If you think it might be right for you, **ask your advisor about investment strategies that include passive as well as active investments**.

Endnotes

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