

August 24, 2018

Open Letter to the CSA on embedded commissions and DSC

"There is nothing so useless as doing efficiently that which should not be done at all." - Peter Drucker

As we have publicly disclosed, Kenmar Associates will no longer respond to any CSA consultation regarding, Best interests, DSC or embedded commissions. Our team has spent hundreds of person-hours dedicated to regulatory reform with no positive result over the last decade. The CSA has announced that it will conduct another consultation on embedded commissions in September. This Open letter therefore should be viewed as a reaction rather than a response.

In the planned consultation the CSA will be proposing to prohibit the payment of trailing commissions to dealers, such as discount brokers, who do not make a suitability determination (presumably, this is equivalent to banning the offering of products such as mutual funds with embedded commissions being paid to dealers, including discount brokers, for services they cannot and knowingly will not provide). This can be likened to Health safety regulators consulting on whether poison should be prohibited from retail grocery shelves. Consulting on such an obvious case of financial assault on investors is disrespectful of retail investors. The CSA should be ashamed to admit that for well over a decade hundreds of millions of dollars have needlessly been diverted from the retirement savings of Canadians despite numerous pleas from consumer groups.

The basic securities law of dealing honestly, fairly and in good faith with clients has been brazenly breached with not a whimper of regulatory enforcement or concern for retail investor protection. Further, the CSA has not warned investors via Alerts and education that it is permitting this broad daylight robbing of their hard earned money.

The CSA is in effect going to be asking for comments on an issue that is clearly unlawful and harmful to investors. It is treating common sense and basic morality as sidebars to the discussion. It is well aware that Fund Facts which states that trailers are for the provision of services (albeit unspecified) and personalized investment advice. The CSA therefore knows there are elements of misrepresentation involved when discount brokers offer A series of mutual funds with embedded trailer commissions.

The CSA is also aware that even the trade Association for the investment funds industry has called on them to establish rules to ensure that mutual funds carrying an embedded advisor fee are sold only in channels where advice is permitted.

"Investors who buy funds directly, for example through a discount broker, should be confident that they are not inadvertently overpaying by selecting a series that includes fees for services that are not available through that platform," - Paul C. Bourque, Q.C., IFIC's president and

CEO. Source: <https://www.ific.ca/en/news/limit-series-a-sales-to-channels-that-permit-advice-ific/>

The CSA has not yet addressed the enabler of these abusive trailer payments, the mutual funds. The mutual funds are knowingly reducing fund assets by paying discount brokers (sometimes even related parties) for nothing. These assets aren't some intangible collection of cash. They are the retirement savings of millions of Canadians. Are there provisions in NI1-107 that exempt funds from protecting unitholder assets? If not, why isn't the CSA prosecuting those entities for a breach of fiduciary duty? Why must investors have to resort to Class Actions for such an in-your-face attack on their life savings?

Earlier this month IIROC abruptly suspended Section 2 from its notice that accompanies guidance for order-execution-only (OEO) services and activities, published in April this year. The section says IIROC expects OEO firms to make available, whenever possible, series of funds that don't pay trailing commissions for ongoing advice. When no such series is available and an OEO firm offers a series with a trailing commission, IIROC says in the section that it expects the firm to address the conflict—by rebating to the client the portion of the trailing commission or by “taking other similar steps.” So for now, those expectations are on hold and investors will continue to be exploited. In the meantime, OEO firms remain subject to IIROC's rules concerning conflicts-of-interest, including the requirement to address conflicts considering the best interest of the client, says the IIROC Notice. That may be, but will IIROC protect investors by enforcing its rules with its Member discount brokers? Will the practice of unduly collecting trailers cease? Will there be rebates?

The Canadian Foundation for Advancement of Investor Rights (FAIR) has criticized IIROC's decision. Frank Allen, Executive Director of FAIR was "*dismayed that IIROC cites the upcoming CSA rule proposal prohibiting the payment of trailing commissions to online brokerage firms (discount brokerages) as the reason for the suspension.*" SIPA, individual investors and ourselves support FAIR in being critical of the IIROC action. The suspension leaves affected Retail investors subject to mitigation risk and one can reasonably argue that the statute of limitations time clock is already ticking.

Even if the CSA were to ban discount brokers from offering products with embedded service commitments we are concerned that such a ban might include exceptions or be open to future regulatory exemptions. There is even the possibility a cost-benefit analysis will be required, again delaying affirmative action. Kenmar are therefore calling for a cancellation of the consultation and an immediate banning of any dealer from offering a product or security that contains an obligation to provide a service or function that it cannot and/or will not provide. That would be common sense- it is the right thing to do and it will save people hundreds of person- hours of wasteful activity.

As to the planned consultation re a proposed ban on the DSC-sold fund, there is the same question. Why? Does the CSA not have enough data to make a decision? Has

it not heard the voice of consumers pleading for a prohibition? Were Roundtable conclusions unclear? Is the client complaint data ambiguous? Is there any research that supports not banning DSC-sold funds? Is there any identifiable benefit to clients of a DSC-sold fund? Does the CSA buy the feeble arguments from a small minority of industry participants on the benefits of DSC? The CSA knows the answers and yet it continue to consult , dragging out the agony for investors for another year or two and more if there is a extended transition period.

Several responsible firms and Dealing Reps have stopped selling DSC Funds even as the CSA waffles on making a definitive decision. As with many CSA regulations we fear there will be carve outs or exemptions so that even a ban is nothing more than an illusion. Accordingly, Kenmar respectfully request that the CSA cancel this planned consultation since it clearly knows the answer. The CSA should make a decision- ban the sale of DSC-sold funds while defining the rules regarding unitholders currently holding such toxic funds. Such a positive action would help restore confidence in the CSA and definitely would be in the Public interest.

If despite all logic and fairness, the planned consultation proceeds, we draw the CSA's attention to a public statement from the Ontario Securities Commission's Investor Advisory Panel (IAP). The IAP is calling on the CSA to prevent possible further investor abuse by making their [proposed bans on deferred sales charge \(DSC\) mutual funds and the payment of trailer fees to discount brokers](#) retroactive to the launch of a consultation slated for September. The IAP says that it's concerned about the possible risk to investors while the consultation plays out. It says that "In proposing the elimination of DSCs and the discontinuance of trailing commission payments to discount brokers, the CSA has noted that these fee practices are problematic, inappropriate and harmful."

Kenmar fully support this backup choice approach and respectfully again request that the CSA immediately issue an educational pamphlet and Investor ALERT on the harmful effects of DSC-sold Funds and products with embedded trailing commissions offered by IIROC regulated discount brokers.

The CSA website states: ***The CSA protects Canadian investors from unfair, improper, or fraudulent practices and fosters fair and efficient capital markets.*** By cancelling the upcoming consultation and making the necessary decisions, the CSA can demonstrate that it is serious about protecting investors. This is an incredible opportunity that should not be missed.

Sincerely,
Kenmar Associates