



Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

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

The Secretary
Ontario Securities Commission
20 Queen Street West,
22nd Floor
Toronto, ON M5H 3S8
Sent via e-mail to: comments@osc.gov.on.ca

Anne-Marie Beaudoin
Autorité des marchés financiers
Corporate Secretary
800, square Victoria, 22^e étage
C.P. 246, tour de la Bourse
Montréal, Quebec H4Z 1G3
Sent via email to: consultation-en-cours@lautorite.qc.ca

RE: Canadian Securities Administrators (“CSA”) Consultation on Proposed Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* and Related Consequential Amendments

FAIR Canada is pleased to offer comments on the Proposed Amendments to 81-105 Mutual Fund Sales Practices and related consequential amendments (the “Proposed Amendments”) whose object is to prohibit the payment of upfront sales commissions by fund organizations to dealers (such as deferred sales charges) and to also prohibit the payment of trailing commissions by fund organizations to discount brokerages who are not permitted to make suitability determinations (the “Consultation Document”).

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for

Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

I. Executive Summary

1. FAIR Canada, on behalf of Canadians, has pressed for the adoption of a statutory best interest standard and reforms that will prevent or avoid conflicts of interest including the removal of embedded commissions or trailing commissions and deferred sales charges (“DSCs”) paid by investment fund managers.
2. These changes are needed so that Canadian investors can receive professional, objective advice free from damaging conflicts of interest. Advice needs to be focused on what is best for investors, not what is financially best for the investment fund manufacturers, financial services representatives and their dealer firms.

Ban DSCs

3. Canadians need to be able to save towards their retirement and other financial goals effectively and efficiently. At present, the ability of Canadians to achieve financial security in retirement is in doubt. Embedded commissions (also known as “trailing commissions”) and DSC mutual funds have hindered many families and investors in their goal of saving enough for their retirement or other financial goals.
4. Discontinuing DSCs will further the Ontario government’s commitment to making Ontario a more competitive place to invest, grow and create jobs. This holds true for other provinces and territories. DSCs inhibit effective competition and market efficiency (as well as harm investors).
5. The proposed reforms in the Consultation Document are a step in the right direction. **Prohibiting DSCs and prohibiting trailing commissions through discount brokerages or OEO firms, will address two egregious practices that harm investors and we support those proposed changes.**
6. ***DSCs are a form of embedded commission (paid at the point of sale) that needs to be prohibited. They are rife with conflicts of interest, target the most vulnerable investors and there is strong evidence of mis-selling, in addition to the DSC funds themselves being suboptimal investment vehicles for investors.***
7. Recommendations as to the type of payment structure for “advice” (DSC, Front End, Fee-Based, etc.) are not made based on the best interests of the client or what is most suitable or appropriate for the client, but on the revenue or financing needs of the representative. As discussed in CSA Consultation Paper 81-408:

“The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and the representative’s revenue requirements.”¹

¹ CSA 81-408, at page 48.

Investors therefore are not given a “choice” by their dealer, as to whether to choose front load funds, DSC funds or have a fee-based account, but rather have these choices limited and determined by the representative based on representative’s revenue requirements.

8. **Dealer Firms Will Continue to Thrive** – In our view, there will not be any lasting material impact on the ability of dealer firms and their advisors to develop and sustain a business model without DSCs. As they have done ably in the past (e.g. negotiated trade commissions, OEO trading and CRM requirements), firms are resilient, adaptive and will innovate and adjust. Regulators and governments should not be concerned with a business model wherein DSCs are claimed to be needed for the business model to be viable given the serious conflicts of interest with DSCs and resulting harms to investors and other problems. If the government is concerned about the impact on certain advisors who are overly reliant on DSCs for the viability of their business, then transitional assistance could be considered by regulators and the governments if determined to be necessary.
9. In addition, there are many industry players who support a ban on DSCs. For example, Investors Group has announced it will no longer sell investment funds on a DSC basis² and Invesco also supports a ban³ on the basis that DSCs are no longer in the public interest. The Investment Industry Association of Canada also supports a ban⁴ as do Quadras Investment Services Ltd⁵ and RBC⁶. Even the fund industry admits that there are problematic conflicts of interest, that DSCs are sold when not suitable and that there needs to be alignment of services and fees.⁷ RBC correctly points out that removing DSC and LL commission options would prevent conflicts created by large upfront commission payments.⁸

² Letter dated June 9, 2017 from Jeffrey R. Carney, Investors Group Inc. to CSA re Consultation Paper 81-408 at page 3; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_carneyj.pdf.

³ Letter dated June 9, 2017 from Eric Adelson, Invesco Canada Ltd. to CSA re Consultation Paper 81-408 at page 3; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_adelson.pdf.

⁴ Letter dated June 9, 2017 from Michelle Alexander of the Investment Industry Association of Canada to CSA re Consultation Paper 81-408 at page 25; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_alexanderm.pdf.

⁵ Letter dated June 9, 2017 from Michael Campbell, Quadras Investment Services Ltd to CSA re Consultation Paper 81-408; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_quadras-investment.pdf.

⁶ Letter dated June 9, 2017 from Royal Mutual Funds Inc, RBC Global Asset Management Inc., RBC Dominion Securities Inc., RBC Direct Investing Inc., and Phillips Hager and North Investment Funds Ltd. to CSA re Consultation Paper 81-408 at page 7; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_kirkd.pdf.

⁷ Letter dated June 9, 2017 from the Investment Funds Institute of Canada to the CSA re Consultation Paper 81-408 at page 7; available online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_bourquep.pdf.

⁸ Letter dated June 9, 2017 from Royal Mutual Funds Inc, RBC Global Asset Management Inc., RBC Dominion Securities Inc., RBC Direct Investing Inc., and Phillips Hager and North Investment Funds Ltd. to CSA re Consultation Paper 81-408 at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_kirkd.pdf

Mutual Fund Investors at OEO Firms or Discount Brokerages Should Not Be Paying Trailing Commissions

10. FAIR Canada calls for the immediate elimination of embedded commissions from investment products sold at discount brokerages given that IIROC Dealer Member Rules do not permit discount brokerages to provide recommendations.⁹ For years Canadians have incurred significant unnecessary and unjustified charges given they have received no advice or product recommendations of any kind to justify the trailing commissions.
11. FAIR Canada recommends that all firms offering a particular mutual fund be required to offer the “F” class version of the fund at discount brokerages rather than urged to offer trailing commission free versions. If a “F” class exists, it should be required to be offered through the OEO firm for those investors who want to invest without advice.
12. FAIR Canada questions the reasonableness of having any embedded commission (even if reduced such as with “D” series funds) associated with mutual funds purchased through discount brokerages. The CSA should critically assess whether the investor actually receives any services to justify the ongoing trailing commission.
13. It may be possible that the trading costs per individual account at discount brokerages increase modestly due to the removal of embedded commissions from mutual fund purchases. We believe that this is fair as mutual fund investors should not be required to subsidize the costs of other users of the platform.
14. We recommend that the Proposed Amendments be implemented as soon as possible. A timely response to market failures and investor harm is important so that those harms can be redressed.

II. Canadians Need a Statutory Best Interest Standard and Removal of DSCs and Embedded Commissions

1. FAIR Canada, on behalf of Canadians, has pressed for the adoption of a statutory best interest standard and reforms that will prevent or avoid conflicts of interest including the removal of embedded commissions or trailing commissions and deferred sales charges (“DSCs”) paid by investment fund managers.
2. These changes are needed so that Canadian investors can receive professional, objective advice free from damaging conflicts of interest. Advice needs to be focused on what is best for investors, not what is financially best for the investment fund manufacturers, financial services representatives and their dealer firms. Today, Canadians receive product recommendations driven more by payments their advisor and her firm will receive, instead of what would be best for the consumer. The CSA has agreed that the status quo is unacceptable and must change.
3. Canadians need to be able to save towards their retirement and other financial goals effectively and efficiently. At present, the ability of Canadians to achieve financial security in retirement is in doubt. Embedded commissions (also known as “trailing commissions”) and DSC mutual funds have hindered

⁹ See IIROC Dealer Member Rules 3100 and 3200 and, in particular, Dealer Member Rules 3200(3)(a).

many families and investors in their goal of saving enough for their retirement or other financial goals.

CSA's Proposed Approach – Client Focused Reforms + Mutual Fund Fee Reforms = Ban DSCs and Embedded Commissions on Order Execution Only Firms (Discount Brokerages)

4. FAIR Canada's view is that the Client Focused Reforms¹⁰ and the Proposed Amendments set out in the Consultation Document may nudge registrants in their conduct but will not achieve the profound shift necessary to ensure Canadians receive the objective, professional financial advice that is needed and rightfully expected as they do not prohibit compensation structures that misalign the interests of registrants with their clients and instead rely on problematic and untested conflict of interest provisions.
5. Moreover, the decision made by the CSA on mutual fund fees – not to move forward with an outright ban on embedded commissions (including DSCs) - is premised on a set of consultative proposals (the Client Focused Reforms) rather than actual rules. In particular, the CSA decision not to discontinue the option of embedded commissions was arrived at as a result of "...instead pursuing a package of reforms that we expect will respond to each of the investor protection and market efficiency issues we identified...".¹¹ The analysis contained in the Consultation Document and the direction taken by the CSA on reform of mutual fund fees is, therefore, based on assumptions that are not settled and may change.
6. The CSA rejected the path of immediately addressing the market efficiency and investor protection concerns through an outright ban on embedded commissions. However, if the package of reforms, that is, the Client Focused Reforms, do not proceed as drafted and/or do not achieve the changes in behaviour that are expected (as we have discussed in our submission in response to the proposed Client Focused Reforms¹²), then the direction taken to address the investor protection and market efficiency issues that have been identified with respect to mutual funds fees will not be enough and the issue should be revisited.
7. The proposed reforms in the Consultation Document are a step in the right direction. **Prohibiting DSCs and prohibiting trailing commissions through discount brokerages or OEO firms, will address two egregious practices that harm investors and we support those proposed changes.**

¹⁰ June 21, 2018, CSA Notice and Request for Comment, Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms), (2018), 41 OSCB (Supp-1); available online: http://osc.gov.on.ca/documents/en/Securities-Category3/rule_20180621_31-103_client-focused-reforms.pdf.

¹¹ June 21, 2018, CSA Staff Notice 81-330, Status Report on Consultation on Embedded Commissions and Next Steps (2018), 41 OSCB 5041 at 5053, available online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20180621_81-330-status-report.pdf.

¹² October 19, 2018 FAIR Canada Letter to CSA re Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms), available online: <http://faircanada.ca/wp-content/uploads/2018/10/Final-181019-FAIR-Canada-Submission-re-Client-Focused-Reforms-2.pdf>.

III. FAIR Canada Urges Removal of Deferred Sales Charges

8. ***DSCs are a form of embedded commission (paid at the point of sale) that needs to be prohibited. They are rife with conflicts of interest, target the most vulnerable investors and there is strong evidence of mis-selling, in addition to the DSC funds themselves being suboptimal investment vehicles for investors.***

Professor Cumming's Research Shows Both Market Efficiency and Investors Harmed by Embedded Commissions

9. As a result of the CSA commissioned research, we now have undeniable empirical evidence based on *Canadian* investment fund data that embedded commissions impact both investor outcomes and market efficiency negatively. The CSA initiated independent third-party research in late 2013 to assess the impact of commissions and embedded fees on mutual fund flows in Canada. Professor Douglas J. Cumming, Professor of Finance and Entrepreneurship and the Ontario Research Chair at the Schulich School of Business, York University conducted the research and released his findings in October 2015.
10. As explained by CSA Consultation Paper 33-404 (and in the 81-408), Professor Cumming's "...paper found that conflicts of interest specifically sales commissions and trailing commissions paid by fund companies (embedded registrant compensation), dealer affiliation and the use of DSC arrangements materially affect representative/dealer behaviour to the detriment of investor outcomes and market efficiency. While generally, mutual fund flows should (and do) bear a relationship to the fund's past performance, Professor Cumming's research found that:
- **The payment of embedded registrant compensation and the use of DSC arrangements materially reduce the sensitivity of fund flows to past performance and increase the level of fund flows that have no relationship to performance;**
 - **that investments under the DSC option have the least sensitivity to past performance out of all purchase options¹³;**
 - The converse is also true: fund flows for mutual fund series that do not pay embedded registrant compensation (fee-based series) are more sensitive to past performance;
 - as embedded registrant compensation increases there is an associated reduction in future outperformance before fees; and
 - fund flows from affiliated dealers of the investment fund manager show little to no sensitivity to past performance, and this lack of sensitivity is also associated with reduced future outperformance before fees."¹⁴
11. In other words, trailing commissions and DSCs charges distort investment flows by letting something other than what's best for the investor drive sales, and this channels many investors toward

¹³ CSA Consultation Document 81-408 at 100.

¹⁴ Consultation Paper 33-404, *supra* note 6 at 3951.

suboptimal funds. Trailing commissions and DSCs harm investors and market efficiency by facilitating deteriorations in fund performance. Professor Cumming findings were consistent with previous empirical studies done on US data.

Market Data on DSCs and Implications

12. It is estimated that Canadians are charged over \$5 billion in trailing commissions annually¹⁵, with Canada being amongst the highest mutual fund fee jurisdictions in the world.¹⁶

13. **Market Share Declining** - The amount of mutual funds held in DSCs (back end load or low load funds) has been declining over the past 10 years¹⁷:

	Dec 2006	Dec 2011	Dec 2015	Dec 2016
Percentage of Mutual Fund Assets held in DSCs (including Low Load)	31.2%	23.9%	19.5%	18%

This level of mutual fund assets held in DSC funds by Canadians compares unfavourably to Europe and the United States where such funds represent only 1% of all mutual fund assets.¹⁸ The difference suggests that investors are not making an informed decision about this “choice” but rather the Canadian distribution system is skewing investors towards DSCs unknowingly.

14. **Assets Going into DSCs Continue to Grow** – Although falling in terms of market share, assets in DSCs continue to grow. For the 5 year period to December 2015, DSC assets grew 19%.¹⁹

¹⁵ Douglas Cumming, “Blowing smoke on trailer fees: Fees harm investors. Here are the facts” (5 October 2016), online: <<http://www.moneysense.ca/save/investing/blowing-smoke-on-trailer-fees/>>.

¹⁶ As noted in the Consultation Document 81-408, such studies include: B.N. Alpert and J. Rekenhaller, “Morningstar Global Fund Investor Experience 2011 (March 2011), online: <<https://corporate.morningstar.com/us/documents/ResearchPapers/GlobalFundInvestorExperience2011.pdf>>; A. Khorana, H. Servaes, and P. Tufano, *Mutual Fund Fees Around the World* (July 23, 2007), online: <<http://faculty.london.edu/hservaes/rfs2009.pdf>> and more recently B. Alpert, P. Justice, A. Serhan, and C. West “Global Fund Investor Experience Study” (June 2015), online: <<https://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf>>.

¹⁷ Consultation Document, at footnote 26 (2018), 41 OSCB 7208.

¹⁸ Footnote 71 of CSA 81-408 at page 46; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf.

¹⁹ CSA Consultation Paper 81-408, at page 46.

15. **Large Upfront Commissions Earned on DSC/LL (approx.)** – Based on information available, the annual amount of commissions earned by investment dealers from the sale of DSCs is as follows (assuming a 5% upfront commission on gross sales amounts of back-end load funds sold and a 3% commission on gross sales amount of low-load funds):

	2012	2013	2014	2015	2016
DSC option (5% upfront commission)	\$710 million	\$755 million	\$790 million	\$755 million	\$470 million
Low-load option (3% upfront commission)	\$273 million	\$318 million	\$327 million	\$321 million	\$183 million
TOTAL	\$983 million	\$1.073 billion	\$1.117 billion	\$1.076 billion	\$653 million

These amounts are indirectly paid for by all investors in the fund out of the management expense ratio (MER) of the mutual fund and/or by the redemption fees they pay if the DSC invested investors sell the fund prior to the expiration of the redemption schedule (7 years for a back-end load and 3 years for a low load fund).

16. **Redemption Amounts are Significant** – The annual amount of DSC and low-load funds redeemed are large:

	2012	2013	2014	2015	2016
Back-end Load option (5% upfront commission)	\$19.1 billion	\$20.0 billion	\$19.0 billion	\$18.6 billion	\$13.4 billion
Low-load option (3% upfront commission)	\$4.5 billion	\$5.6 billion	\$6.2 billion	\$7.4 billion	\$6.2 billion
TOTAL	\$23.6 billion	\$25.6 billion	\$25.2 billion	\$26.0 billion	\$19.6 billion

17. **Canadians Pay Significant Amounts in Redemption Fees** - If investors on average paid 3% to redeem these amounts, then the following would be the amount investors pay in redemption fees:

	2012	2013	2014	2015	2016
TOTAL Amount of Fund Assets Redeemed	\$23.6 billion	\$25.6 billion	\$25.2 billion	\$26.0 billion	\$19.6 billion
Back-End Load Redeemed	\$19.1 billion	\$20.0 billion	\$19.0 billion	\$18.6 billion	\$13.4 billion
Low-Load Redeemed	\$4.5 billion	\$5.6 billion	\$6.2 billion	\$7.4 billion	\$6.2 billion
Estimated Amount in Redemption Fees for Back-End Load (assume 3% average redemption fee)	\$573 million	\$600 million	\$570 million	\$558 million	\$402 million
Estimated Amount in Redemption Fees for Low-Load Funds (assume 1% average redemption fee)	\$45 million	\$56 million	\$62 million	\$74 million	\$62 million
Total Estimated Redemption Fees Paid	\$618 million	\$656 million	\$632 million	\$632 million	\$464 million

The actual amount Canadians pay in redemption fees annually is not information that is publicly available (but should be).

18. **Investors Are Often Not Aware of the Redemption Fees** - Redemption fees apply to DSC funds if sold before the end of the redemption schedule period (normally 7 years for back-end funds and 3 years for low-load funds). Until recently, there was no regulatory obligation to inform investors when they purchased the fund that if they redeemed before the end of the 7 year period, they would incur redemption fees! Many investors are still not being advised at the time of purchase about the redemption fees that they may incur.²⁰ In addition to paying the upfront commission indirectly through the management fee, if the investor sells the fund before the end of the redemption schedule period, they will pay redemption fees which, when added to the amount paid through the MER, will equal and will likely exceed the amount of upfront commission that was paid to the dealer/representative initially.
19. **Non-Deposit Taking Firms More Reliant on DSCs** - The sale of mutual funds on a DSC basis varies widely across distribution channels. Non-deposit taker dealer firms (includes dealers with an insurance company-owned investment fund manager or other investment fund manager as well as independent dealers) and non-deposit-taker investment fund managers have a much higher reliance on DSCs. As noted in the Consultation Document, at the end of 2016, 31% of non-deposit taker IFM assets were held under the DSC option compared to 2% for deposit taker IFMs. In the MFDA channel, this rises to 48% versus 2%.²¹ Moreover, in the MFDA channel, most of the DSC assets held are in DSC funds (\$106 billion) rather than low load funds (\$9B).²²
20. **Advisors with Small Book Most Reliant on DSCs** – As noted in the 2017 MFDA Client Research Report, advisors with a book size of less than \$2 million are most reliant on DSC commissions to finance their operations with 53% of their book in DSC funds. As the size of an advisor’s book increases, the amount of DSC within the book decreases and assets shift to front end or non-embedded funds.
21. **Client Interests Not Paramount, Rather Advisors’ Interests Are** – The above two paragraphs indicate that recommendations as to the type of payment structure for “advice” (DSC, Front End, Fee-Based, etc) are not made based on the best interests of the client or what is most suitable or appropriate for the client, but on the revenue or financing needs of the representative. As discussed in CSA Consultation Paper 81-408:

“The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and the representative’s revenue requirements.”²³

Investors therefore are not given a “choice” by their dealer, as to whether to choose front load funds, DSC funds or have a fee-based account, but rather have these choices limited and determined by the representative based on representative’s revenue requirements.

22. **No Obligation to Provide Advice** – Despite the client paying ongoing commissions and fees, there is no obligation on the dealer or representative to provide the client with any on-going advice beyond

²⁰ See paragraph 24 below.

²¹ See footnote 27 of the Consultation Document at page 7208.

²² May 23, 2017 MFDA Bulletin #0721-C, MFDA Client Research Report at page 12, online: <http://mfda.ca/wp-content/uploads/Bulletin0721-C.pdf>.

²³ CSA 81-408, at page 48.

the suitability obligation at the time the fund is recommended, or in respect of any subsequent suitability triggers that may exist as regulatory requirements.

23. ***If you Eliminate DSCs, MERs Will Be Lower*** – With the elimination of DSCs, the cost of the up-front commission that is financed by the investment fund manager would no longer be passed on to all of the investors in the fund and, as a result, the MER should be somewhat lower for funds that previously offered the DSC option.²⁴
24. ***Many investors are unaware of Indirect Fees/Commissions and Rely on their Advisor and Don't Understand Importance of Costs***- Many investors are unaware of the indirect fees (such as trailing commissions and deferred sales charges) they are paying:
- (i) Only one-third of investors who took part in a study in 2012 were aware of trailing commissions before taking the study²⁵.
 - (ii) The third panel study of investors by Innovative Research Group for the British Columbia Securities Commission dated July 24, 2017 indicates that only 41% agree that they know the total amount of fees and commissions paid to their firm by other companies because of the investments that were purchased or held in the previous 12 months.²⁶ This a longitudinal study done with a panel of investors over several years and the CRM2 reports and trailing commissions are specifically discussed with them. Even the industry lobby group's own research shows that only just over half of those with advisors say their advisors had discussed each of the areas related to compensation and fees. 53% had a conversation about compensation, 58% about fees/commissions or fees paid to the firm and 59% about the management expenses ratio of the fund.²⁷
 - (iii) There is poor compliance with regulatory requirements regarding disclosing information about fees and commissions.²⁸ Many advisors do not disclose at the time of purchase the transaction charges such as redemption fees and trailing commissions that apply to the fund (let alone the upfront commission they receive). For DSC funds, the majority of

²⁴ Consultation Document at page 7192.

²⁵ The Brondesbury Group, Investor behaviour and beliefs: Advisor relationships and investor decision-making study (2012) (prepared for the Investor Education Fund), at page 27, online: <https://www.getsmarteraboutmoney.ca/wp-content/uploads/2017/06/Adviser-relationships-and-investor-decision-making-study-2012.pdf>

²⁶ July 24, 2017 Innovative Research Group "Investor Readiness for Better Investing 2016-2017 Panel Study: Part 3 and Final Report at page 36; available online: https://www.bcsc.bc.ca/uploadedFiles/About_Us/Publications/Wave_3_-_Survey_Report/Innovative_Research_-_2016-2017_Panel_Study.pdf?t=1544115228224.

²⁷ July, 2018, Pollara Strategic Insights, Canadian Mutual Fund Investor Survey (for The Investment Funds Institute of Canada) at page 31; available online at <https://www.ific.ca/wp-content/uploads/2018/09/2018-Pollara-Mutual-Fund-Investor-Survey-September-2018.pdf/20751/>.

²⁸ OSC Staff Notice 31-715, IIROC Notice Number 15-0210 and MFDA Bulletin #0658-C; Mystery Shopping for Investment Advice; online: <http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf>.

the MFDA members were only disclosing redemption fees to clients through the trade confirmation, which is only received after the purchase has been made.²⁹

- (iv) If aware, investors trust and rely on their dealer and its representatives, with most believing the “advisor” will recommend what is best for them even at the expense of their own commission.³⁰ In addition, a significant number of investors do not know the importance of costs.³¹

25. **DSCs and Proprietary Mutual Funds** - Investors may be unaware that they cannot move certain proprietary mutual funds in kind from one dealer to another and will be forced to sell the funds if they wish to move dealers. If they are DSC funds, redemption charges will be incurred. This impacts investors negatively, impedes investor choice and deters effective competition.

Regulators’ Compliance Reports, OBSI Statistics and Enforcement Cases Support Banning DSCs

26. **Unsuitable Leveraging Strategies and Churning** - DSCs can financially incent unsuitable recommendations³² and can incent dealers and their representatives to promote unsuitable leverage strategies or churning. In a recent *MFDA Review of Compensation, Incentives and Conflicts of Interests*, the MFDA identified compensation and incentive practices that increased the risk of mis-selling funds under the DSC option.³³ The CSA did an analysis of MFDA enforcement files and found “...that the DSC option can attract dealers/representatives promoting unsuitable leverage strategies on their clients or churning the client accounts.”³⁴

27. **OBSI Complaints Show Problems with DSCs** – OBSI’s annual reports show persistent issues with DSC funds. The 2017 Annual Report shows that fee disclosure issues such as DSCs are one of the top 3 investment issues that consumers complain about.³⁵

²⁹ MFDA Bulletin #0670-C, MFDA Bulletin 2015 DSC Sweep Report: Supervision, Suitability and Disclosure of Funds with Sales Charges, online: <http://mfda.ca/bulletin/bulletin0670-c/>.

³⁰ The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (prepared for the Investor Education Fund), at page 2, online: <https://www.getsmarteraboutmoney.ca/wp-content/uploads/2017/06/Adviser-relationships-and-investor-decision-making-study-2012.pdf>.

³¹ The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (Prepared for the Investor Education Fund), at page 2 found that cost of buying a factor for 2 out of 10 investors, online: <https://www.getsmarteraboutmoney.ca/wp-content/uploads/2017/06/Adviser-relationships-and-investor-decision-making-study-2012.pdf>. The July 24, 2017 found that only 9% of investors thought that the fees they pay are the most important consideration when making an investment decision (page 22) and 54% were correct in knowing that a 1% difference in fees would make a difference to their returns over time: July 24, 2017 Innovative Research Group “Investor Readiness for Better Investing 2016-2017 Panel Study: Part 3 and Final Report at page 36; available online: https://www.bsc.bc.ca/uploadedFiles/About_Us/Publications/Wave_3_-_Survey_ReportInnovative_Research_-_2016-2017_Panel_Study.pdf?t=1544115228224.

³² See *Ibid*, Appendix A, at 103 to 104.

³³ MFDA Bulletin #0705-C, Review of Compensation, Incentives and Conflicts of Interest, December 15, 2016.

³⁴ CSA Consultation Paper 33-404, Appendix A, at 103 to 104, and footnote 174.

³⁵ OBSI’s Annual Report 2017 at page 33. OBSI’s 2015 Annual Report identified it in the top 3 and as the largest secondary issue consumers complain about, at page 50.

28. **Unsuitable Recommendations and DSCs Sold to Seniors** - The MFDA's 2017 Client Research Report identified issues leading to unsuitable recommendations, particularly with respect to seniors, with DSCs³⁶. Such issues include:

- (i) The time horizon of the investor being shorter than the redemption schedule period.
- (ii) Dealer firms not considering the suitability of DSC purchases for accounts that are at the withdrawal stage. Most MFDA Members did not have policies and procedures or guidance regarding suitability of DSC purchases in RRIF accounts.
- (iii) The liquidity needs of the investor.
- (iv) Redemption charges being incurred as a result of not being able to transfer funds in-kind or due to the liquidation of an estate.
- (v) Not disclosing at the time of purchase, the transaction charges ie redemption fees and trailing commissions that apply to the fund. The majority of the MFDA members were only doing this through the trade confirmation, which is only received after the purchase has been made.³⁷ This is not acceptable. In addition, a requirement to tell the investor about the redemption charges at the time of purchase only arose as of July 15, 2014.

29. **Dealer Firms Will Continue to Thrive** – In our view, there will not be any lasting material impact on the ability of dealer firms and their advisors to develop and sustain a business model without DSCs. As they have done ably in the past (e.g. negotiated trade commissions, OEO trading and CRM requirements), firms are resilient, adaptive and will innovate and adjust. Regulators and governments should not be concerned with a business model wherein DSCs are claimed to be needed for the business model to be viable given the serious conflicts of interest with DSCs and resulting harms to investors and other problems. If the government is concerned about the impact on certain advisors who are overly reliant on DSCs for the viability of their business, then transitional assistance could be considered by regulators and the governments if determined to be necessary.

Ontario Government's Statement on the CSA's Proposal

30. The Honourable Vic Fedeli, Ontario Minister of Finance, issued a statement that the government does not agree with the proposal regarding the mutual fund industry as currently drafted and would work with other provinces and territories and stakeholders to explore other potential alternatives. FAIR Canada submits that securities regulators should address the issues identified in the Consultation Document in a manner consistent with their mandate to provide investor protection and foster fair and efficient capital markets. FAIR Canada respectfully believes that discontinuing the DSC payment option, for the reasons set out above, will be beneficial to families and investors that are saving toward their retirement or other financial goals and discontinuing DSCs will further the government's

³⁶ MFDA Bulletin #0721-C, at 19.

³⁷ MFDA Bulletin #0670-C, MFDA Bulletin 2015 DSC Sweep Report: Supervision, Suitability and Disclosure of Funds with Sales Charges, online: <file:///C:/Users/mpassmore/Downloads/BULLETIN%20%230670-C.pdf>.

commitment to making Ontario a more competitive place to invest, grow and create jobs. DSCs inhibit effective competition and market efficiency.

31. Competition in the financial services industry does not require regulators and governments to prop up business and sales models which inherently harm retail investors. If the smaller MFDA dealer firms and their registrants cannot compete in the absence of DSCs they can adapt and evolve their business model so as to be competitive.
32. In addition, there are many industry players who support a ban on DSCs. For example, Investors Group has announced it will no longer sell investment funds on a DSC basis³⁸ and Invesco also supports a ban³⁹, on the basis that DSCs are no longer in the public interest. The Investment Industry Association of Canada also supports a ban⁴⁰ as do Quadras Investment Services Ltd⁴¹ and RBC⁴². Even the fund industry admits that there are problematic conflicts of interest, that DSCs are sold when not suitable and that there needs to be alignment of services and fees.⁴³ RBC correctly points out that removing DSC and LL commission options would prevent conflicts created by large upfront commission payments.⁴⁴ These attractive payments incent dealers and their representatives to place investors in DCS funds but provide little incentive for any work thereafter or for consideration of the liquidity needs of the investor in the future, which for many Canadians may include the unexpected due to health changes or other unforeseen events.

³⁸ Letter dated June 9, 2017 from Jeffrey R. Carney, Investors Group Inc. to CSA re Consultation Paper 81-408 at page 3; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_carneyj.pdf.

³⁹ Letter dated June 9, 2017 from Eric Adelson, Invesco Canada Ltd. to CSA re Consultation Paper 81-408 at page 3: online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_adelone.pdf.

⁴⁰ Letter dated June 9, 2017 from Michelle Alexander of the Investment Industry Association of Canada to CSA re Consultation Paper 81-408 at page 25: online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_alexanderm.pdf.

⁴¹ Letter dated June 9, 2017 from Michael Campbell, Quadras Investment Services Ltd to CSA re Consultation Paper 81-408; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_quadras-investment.pdf.

⁴² Letter dated June 9, 2017 from Royal Mutual Funds Inc, RBC Global Asset Management Inc., RBC Dominion Securities Inc., RBC Direct Investing Inc., and Phillips Hager and North Investment Funds Ltd. to CSA re Consultation Paper 81-408 at page 7; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_kirkd.pdf.

⁴³ Letter dated June 9, 2017 from the Investment Funds Institute of Canada to the CSA re Consultation Paper 81-408 at page 7; available online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_bourquep.pdf.

⁴⁴ Letter dated June 9, 2017 from Royal Mutual Funds Inc, RBC Global Asset Management Inc., RBC Dominion Securities Inc., RBC Direct Investing Inc., and Phillips Hager and North Investment Funds Ltd. to CSA re Consultation Paper 81-408 at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20170609_81-408_kirkd.pdf

IV. Mutual Fund Investors at OEO Firms or Discount Brokerages Should Not Be Paying Trailing Commissions

33. FAIR Canada calls for the immediate elimination of embedded commissions from investment products sold at discount brokerages given that IIROC Dealer Member Rules do not permit discount brokerages to provide recommendations.⁴⁵ For years Canadians have incurred significant unnecessary and unjustified charges given they have received no advice or product recommendations of any kind to justify the trailing commissions. FAIR Canada and other investor advocates pointed out this abuse on investors in 2011 and 7 years later we finally have the Proposed Amendments out for consultation.
34. FAIR Canada recommends that all firms offering a particular mutual fund be required to offer the “F” class version of the fund at discount brokerages rather than urged to offer trailing commission free versions. If a “F” class exists, it should be required to be offered through the OEO firm for those investors who want to invest without advice.
35. FAIR Canada questions the reasonableness of having any embedded commission (even if reduced such as with “D” series funds) associated with mutual funds purchased through discount brokerages. The CSA should critically assess whether the investor actually receives any services to justify the ongoing trailing commission.
36. Our understanding is that most mutual fund investors do not pay a transaction fee/trading commission at the time of the purchase.⁴⁶ The embedded trailing commission is intended to cover all trading and servicing costs. Since mutual fund investors tend to be “buy and hold” investors for the most part, and do not trade very often, the embedded trailing commissions are more than sufficient to cover any trading and account servicing costs, and most likely the revenue earned helps to cross-subsidize the trading costs on the equities side. This has assisted with low equities trading costs such as advertised \$10/trade arrangements. It may be possible that the trading costs per individual account increase modestly due to the removal of embedded commissions from mutual fund purchases. We believe that this is fair as mutual fund investors should not be required to subsidize the costs of other users of the platform.

V. Some Technical Comments On the Proposed Amendments

Definition of Trailing Commission

37. FAIR Canada asks the CSA to take a hard look at the definition of trailing commission to be used in NI 31-103 and/or 81-105 and ensure that the definition does not encourage dealers to pass on fixed costs of their businesses to their mutual fund clients through the alleged provision of “services” in connection with their ownership of mutual fund securities. The CSA should assess what “services”, if any, are provided to mutual fund clients by dealers and their representatives to clients who hold

⁴⁵ See IIROC Dealer Member Rules 3100 and 3200 and, in particular, Dealer Member Rules 3200(3)(a).

⁴⁶ Our understanding is that the one exception is Questrade. Questrade offers a rebate of the trailing commission, subject to a monthly account servicing fee of \$29.95/month (i.e. any trailer earned in excess of that monthly fee is rebated to the client). In addition to that monthly fee, Questrade charges a trading commission of \$9.95/trade for mutual fund trades.

mutual funds. The definition of trailing commission should capture what the investor is specifically paying for and should not justify payments by an investor for continuing to hold the fund but not receiving any services or advice in respect of continuing to own the fund. We, therefore, do not support the proposed definition for NI 81-105 in section 1.1.

Amendments to NI81-105 and NI81-105CP

38. Section 3.2(4) should be amended to make it clear that no member of a mutual fund organization shall pay a trailing commission to a participating dealer if the participating dealer is not permitted by securities legislation or rules of an SRO to make a suitability determination and that the participating dealer shall not accept such trailing commissions in respect of such mutual funds. NI 81-105CP should be amended accordingly. As OEO firms are not permitted to provide suitability recommendations, there should be no need to confirm to the members of the organization of the mutual fund as to whether it has made a suitability recommendation.

We thank you for the opportunity to provide our comments and views in this submission. We welcome the public posting of this submission and would be pleased to discuss this letter with you at your convenience. Feel free to contact Frank Allen at 647-256-6693/frank.allen@faircanada.ca or Marian Passmore at 416-214-3441/marian.passmore@faircanada.ca.

Sincerely,



Frank Allen
Executive Director
Canadian Foundation for Advancement of Investor Rights

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