



PRIMERICA FINANCIAL SERVICES
RESPONSE TO CSA CONSULTATION PAPER 81-105:
CONSULTATION ON PROPOSED AMENDMENT TO NI 81-105 MUTUAL FUND SALES
PRACTICES AND RELATED CONSEQUENTIAL AMENDMENTS

DECEMBER 13, 2018

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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, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax: 514-864-6381
consultation-en-cours@lautorite.gc.ca

Dear Sirs / Madams:

Re: CSA Notice and Request for Comment on Proposed Amendments to National Instrument 81-105
Mutual Fund Sales Practices and Related Consequential Amendments.

About Primerica

Primerica is a leading distributor of basic savings and protection products to middle-income households throughout Canada. Our Canadian corporate group includes a mutual fund dealer (PFSL Investments Canada Ltd.), a mutual fund manager (PFSL Fund Management Ltd.) and a life insurance company (Primerica Life Insurance Company of Canada). Primerica has been serving Canadians since 1986. PFSL Investments has the largest sales force of any independent mutual fund dealer in the country, with over 6,800 licensed mutual funds representatives.¹ It administers over \$13 billion of

¹ We have used the terms “representative” (which is how we refer to our advisors) and “advisor” (which is how the industry and the public refer to mutual funds representatives) interchangeably

securities and segregated fund assets under management (AUM), the majority of which serve the savings needs of middle-income Canadians.

Our mutual fund dealer has an open shelf, offering a diverse set of funds from well-known fund managers. In addition, we offer a proprietary suite of mutual funds. All funds are vetted to ensure they meet the needs of the clients we serve. Over 85% of our assets under management are in registered accounts. Our investment products, principles and personal advice help middle-income Canadians establish a long-term savings plan for retirement, education and other financial goals. Our representatives nudge their clients at life's critical points, helping them avoid the pitfalls of saving and investing: starting late, not saving enough, neglecting tax-advantaged opportunities, and buying and selling at the wrong times. We do not require minimum account sizes and offer savings programs with contributions as little as \$25 per month, with initial investments as low as \$100 to \$500. This approach allows Canadians, no matter how small their budget, to participate in the capital markets and set and achieve their financial goals. Our monthly contribution plans establish a savings discipline and better prepare our clients for their retirement and other life events. We often do this with our representatives conducting face to face meetings with clients at their kitchen table. Our representatives take a holistic approach to their clients' financial situation; it is far more than just making a fund purchase and sale recommendations.

General Comments

Primerica shares the CSA's goals of protecting investors and increasing investment knowledge. That is why our response will primarily focus on the investors we have served well for over 30 years – middle-income families who need the advice and coaching of a personal advisor without the upfront cost. A wholesale ban on the Deferred Sale Charge (DSC) compensation as proposed is not warranted and that it would result in unintended but predictable consequences, hurting the very people the CSA proposals seek to protect. The following facts have guided our detailed comments and recommendations in the subsequent sections of our response:

- Our clients typically start by investing small amounts in registered accounts, without an upfront sales fee, using a Deferred Sales Charge (DSC) model. This model enables them to put all of the cash they have to invest to work immediately. Our representatives spend a significant amount of time and effort identifying their clients' needs and establishing their financial objectives, contributing to their personal financial knowledge in the process.
- The vast majority of our clients never incur a sales charge – deferred or otherwise – as they are by and large long-term investors. During their DSC schedule, clients can withdraw 10% a year without a charge and can also move to any other fund from the same fund manager without triggering a DSC fee, offering sufficient flexibility should their circumstances or goals change. Once their initial DSC schedule is completed, their funds are free from DSC offering even more flexibility in their future investments at our firm.
- MFDA data reveals that complaints related to mutual funds fees and compensation are minimal – for example, last year the MFDA pursued 27 fee-related complaints out of 15.6 million mutual funds accounts serving 8.9 million households. In other words, 1 out of 577 thousand accounts or 1 out of 330 thousand households had a regulatory issue worth investigating.
- Even though mass market households own only 6% of financial wealth in Canada, they are a significant segment of mutual funds' client base both in terms of assets and number of households, accounting for 28% of assets and 83% of households. MFDA research demonstrates

that mutual fund dealers provide the most accessible advisory service to retail investors in the securities industry today.

- Numerous research reports continue to show that Canadian investors trust mutual funds over other investment vehicles, trust and value their advisor and many continue to prefer the DSC option for paying for their mutual funds' purchases. (4, 5, 6, 16)
- Research also continues to confirm that few Canadians, only 3%, have invested in mutual funds through robo-advice, with the majority preferring to rely on the personal service of an advisor.
- The cumulative effect of drastic regulatory changes, including bans on embedded fees, led to swaths of abandoned investors in the UK. Similar outcomes were experienced in other jurisdictions such as Australia and the US, where minimum account sizes well in excess of affordability for the average Canadian became a norm.

Creating a regulatory environment where the cost of servicing modest investors becomes prohibitive, or where these investors cannot find a registrant² to service their needs, will marginalize many who need and deserve personal financial advice. We firmly believe the regulatory impact of a ban on the DSC option will be felt disproportionately by middle-income Canadians. Many investors of modest means — those without a large amount to invest who rely on commissioned advice without an upfront fee — will likely not be able to receive the helpful and much-needed advice of an advisor.

There are many targeted ways to address the concerns that regulators express about the DSC model, without banning it outright. A ban will impact almost half of mass market mutual funds investors and the advisors who serve them and is a risky experiment that Canadian investors cannot afford. To create a workable rule that achieves our shared goals of enhanced consumer protection and maintaining consumer choice, we respectfully provide our detailed comments on the importance of preserving this option and offer alternative solutions to address concerns with the sale of mutual funds with DSC.

Mutual Funds Are Highly Regulated

According to Investment Institute of Canada (IFIC)³, Canada has one of the strongest regulatory frameworks for investment funds in the world. Mutual funds and their distribution are highly regulated through the rules and regulations of provincial and territorial securities commissions and self-regulatory organizations (SRO), the Mutual Fund Dealers Association of Canada (MFDA) and Investment Industry Regulatory Organization of Canada (IIROC). Mutual funds representatives and investment advisors are subject to licensing and market conduct regulations and oversight by regulators. Further, they are also subject to supervision by their respective dealer firms, which are also highly regulated. Current CSA, MFDA and IIROC rules already contain significant provisions to protect investors. Existing regulations for the disclosure and management of conflicts in the distribution of mutual funds are extensive. A complex set of rules already require that Registrants and advisors put the client's interests ahead of their own anytime that a conflict of interest exists. Regulatory changes over the last several years such as the Fund Facts document and CRM2 have focused on increased transparency and disclosure to help further protect and inform investors.

In an effort to better understand and explain the effect of the CRM2 annual reports on knowledge, attitudes and behaviour of investors over an extended period of time, the British Columbia Securities

² For the purpose of this paper, we refer to a "registrant" to mean a registered firm, a registered dealer, a registered advisor, or a registered investment fund manager

³ IFIC, [Advisor Insight: Global Regulatory Developments in Investor Protection](#), May 2018

Commission commenced a 4-part research project on December 2016 entitled Investor Readiness for Better Investing. By re-surveying the same investors over an extended period of time, this longitudinal study attempted to track changes in individual respondents' answers over time and seek to explain not just how much, but also why investors' knowledge, attitudes and behaviour changed following CRM2 disclosures. Results⁴ of the fourth and last phase of this research survey indicate that there has been an increase in both general and specific fee knowledge among advised investors. More now know the total fees they pay and the third-party fees associated with their account. The same study shows long-term improvements were prevalent in groups that need it most – those with lower investment confidence, lower market competence, and lower investment knowledge, as well as those who talk to their advisor twice a year or less. For example, among those who received their CRM2 reports, 53% of investors with lower levels of confidence and knowledge saw long-term improvements to their specific fee knowledge, compared to 50% of those with higher confidence and knowledge. Similarly, 55% of those with lower market competence saw a long-term improvement to their general fee knowledge, 6% points higher than those with higher market competence to begin with (49%). It is clear that the impact of significant consumer protection and overall fee-knowledge initiatives such as CRM2 are yielding positive results and should be given time before regulators embark on additional reforms.

Other recent comprehensive research that we commissioned on the topic validated these findings. On investor confidence in their mutual funds meeting their needs:

- Fully 89% of Canadian mutual fund holders⁵ overall, and 85% of modest income Canadians⁶ express confidence in mutual funds.
- Modest income Canadians rank themselves as knowledgeable (78%) of mutual funds, slightly higher than the national average (76%).⁷
- As for specific confidence in their knowledge of mutual fund fees, 73% of Canadians overall⁸ and 69% of modest income Canadians⁹ are confident, the latter percentage dropping due to the high percentage of modest income Canadians who buy through their bank representatives (45%) with whom they have significantly lower fee knowledge confidence (60%).¹⁰

Income does play a role with respect to receiving the help of an advisor in making financial decisions. While 51% of Canadians have a person who provides them advice and guidance on investments¹¹, this percentage drops to 46% among the 2nd economic quartile (\$60,000 - \$100,000 household annual income) and further still to 41% among the bottom quartile (< \$60,000).¹²

The Success of Mutual Funds – and Mutual Fund Investors

Mutual funds make it possible for people of more modest means to participate in a professionally managed, well-diversified investment plan with the potential for increased returns – something that at

⁴ BSCS Longitudinal study: [Investor Readiness for Better Investing 2017-2018 Panel Study: Part 4](#), October 3, 2018

⁵ [Pollara IFIC Survey](#), 13th Annual Pollara – Investment Funds Institute of Canada (IFIC) Mutual Fund Holder Survey

⁶ Golfdale Consulting and The Brondesbury Group: [2018 Mutual Fund Investments Among Modest Income Canadians](#), December 6, 2018

⁷ See Pollara IFIC Survey, 2018

⁸ See Pollara IFIC Survey, 2018

⁹ See Golfdale Consulting and The Brondesbury Group, 2018

¹⁰ See Golfdale Consulting and The Brondesbury Group, 2018

¹¹ See Pollara IFIC Survey, 2018

¹² Golfdale Consulting and The Brondesbury Group, 2018

one time only the wealthy could access. Mutual funds have successfully served investors for many years. The introduction of the DSC model in the late 1980s helped fuel access to and the growth of mutual funds in Canada. The combined assets of Canada's mutual fund industry currently total \$1.46 trillion.¹³ There are currently an estimated 4.3 million mutual fund investors among modest income households and another 1.7 million who invested in the past.¹⁴ Mutual funds are purchased through a variety of channels, including direct from fund firms, discount brokerages, banks and independent advisors.

The 13th annual Pollara¹⁵ survey of mutual fund investors in Canada, commissioned by IFIC, found that mutual funds continue to attain significantly more confidence (89%) of investors than other investment vehicles such as stocks, GICs, bonds, and ETFs.

- According to the same study, retirement is the dominant motivation for people who purchase mutual funds.
- 76% of mutual fund investors report having used their advisor in the last year for investment planning, financial planning, or retirement planning. A vast majority agree their advisor is worth their fees and that they encourage them to have better saving and investing habits.
- The majority of investors with advisors continue to prefer to pay their advisor through mutual funds fees. This proportion has increased slightly from 53% last year to 59% this year.

On May 23, 2017, the MFDA released its "MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients"¹⁶ which demonstrated the importance of mutual funds and the advisory sales channel to the middle-income market (Note that this does not include mutual funds sold through other channels). 80% of the 15.8 million Canadian households had \$100,000 or less financial wealth which includes financial investments. Of those households, 8.9 million are represented through the MFDA channel and 83% of those have \$100,000 or less financial wealth. 27% of these households are represented through the independent advisory channel – firms such as ours – and 89% of the households in this channel have \$250,000 or less financial wealth. This data shows that changes in regulation have the potential to disproportionately impact middle market investors.

The DSC Option – Serving Investors of Modest Means

The DSC model generally works well, particularly for those with smaller amounts to invest. There is significant time and effort that goes into an advisor/client relationship, particularly up-front when an advisor is getting to know a new client and their personal and financial situation. An advisor must explain his or her services to clients, educate the client on financial concepts, understand the clients' circumstances and needs, make recommendations for the way forward, and complete all the documentation required to satisfy regulatory and dealer requirements.

In the majority of cases, investors *do not* incur a sales charge with this compensation model as they generally hold their funds long enough to avoid these charges. The benefit of the DSC model is that it provides some up-front compensation to advisors, which is advanced by fund managers, without reducing the amount available for clients to invest. It allows modest investors the ability to invest 100%

¹³ [IFIC Monthly Statistics](#), October 2018

¹⁴ See Golfdale Consulting and The Brondesbury Group, 2018

¹⁵ See Pollara IFIC Survey, 2018

¹⁶ Compliance Bulletin #0721-C - [MFDA Client Research Report](#), May 23, 2017

of the amount to be invested in mutual funds, whereas with the front-end load, the commission comes out of the initial investment, meaning less money is actually invested in the funds.

With the DSC model, the up-front compensation is financed by the investment fund manager¹⁷ (IFM) and paid for through a reduced trailer fee paid to the dealer, and in turn, the advisor. As an example, on a \$10,000 initial trade, the compensation from the IFM to the dealer in the industry is generally 5% or \$500. The dealer keeps in the range of 20% of this for its operation, 20% will go to the Branch Manager supervisor, and the remaining \$300 will go to the advisor, out of which must be paid expenses such as office rent, supplies, travel, tax and similar costs. Without up-front compensation, there is generally a 1% trailer fee which, on a \$10,000 account, provides a total of \$100 of compensation to the dealer, Branch Manager and advisor spread over the first year. There is far less incentive to take on this client without the up-front compensation.

When modest income Canadians were surveyed on their preferences¹⁸, given the exact above scenario involving a \$10,000 mutual fund investment with three transparent fee options, the most preferred option (four out of 10) was avoiding paying out of pocket (DSC). Their second choice was a fee proportional to the size of the purchase (commission). The third preferred investment fee option was an upfront fee.

Survey results¹⁹ published on December 12, 2018 by The Gandalf Group show that:

- Based on what they know, as well as a description provided, the majority of all investors (62%) agreed advisors should have the option of offering funds with a DSC.
- Only 20% of investors considered these an unacceptable approach to advisor compensation.
- Those who recall purchasing a fund with a DSC were more likely than others to say they were acceptable (84%).

In its Request for Comments document, the CSA points out that the DSC option continues to be a popular purchase option as it still forms a significant component of Canadian mutual fund assets. Research conducted by the MFDA²⁰ found that 42% of funds \$100,000 and under had a DSC load, 6% had a Low Load, and 32% of funds between \$100,000 and \$250,000 had a DSC load while 6% had a low load. Such findings, we believe, clearly show this model continues to have a significant role in the market.

We believe the unintended consequence of a DSC ban is those smaller investors – which make up the majority of Canadian households - will face significant increases in the cost of financial advice or simply be ignored altogether, an outcome which has significant public policy implications. There is already evidence in the marketplace of these outcomes when looking at the offerings of non-DSC based investment dealers.

One segment of the market – the bank branch network – has a significant share of mutual fund sale, charge an up-front fee or use the DSC compensation model. Banks use salaried employees, with the additional costs such as benefits that go with employees. The extent of personal service may vary with

¹⁷ For the purpose of this paper, we refer to an investment fund manager to mean a mutual fund manager registered under the securities legislation of a jurisdiction of Canada

¹⁸ See Golfdale Consulting and The Brondesbury Group, 2018

¹⁹ [Canadian Investor Survey](#), The Gandalf Group, 2018

²⁰ Compliance Bulletin #0721-C - [MFDA Client Research Report](#), May 23, 2017

the size of the account. In fact recent research commissioned by us shows that modest income mutual fund owners who use robo and bank representatives as their purchase channel are least aware of mutual fund fees. Bank representatives are also the least likely (38%) to offer clarity on mutual fund fees. “Bricks and mortar” branches – where they remain – must be paid for out of fund fees. With the number of branches being reduced, the opportunity for investors to receive even minimal personal service is being negatively impacted.

Renewing and Expanding the Number of Advisors

When considering the case for the DSC option, one significant point is rarely raised – the recruiting and development of much needed new advisors. Our business model is based on bringing in new representatives and coaching them to be competent and productive. They come from all walks of life and very diverse backgrounds. Over half of the representatives entering our business are women. We are attracting millennials who are looking for an alternative to a job with a large corporation (which are becoming scarcer). Not only does this help renew an ageing financial advisor force in Canada with an average age in the 50’s²¹, but it also helps Canadians of all backgrounds access much needed financial advice and products. The report from PwC also highlights that “more than two out of every five financial advisors have been in the industry for over 20 years, potentially suggesting challenging conditions for newcomers”. New financial advisors face barriers to building a customer base, including competitive pressures from established advisors. Consequently, new financial advisors often exit the industry after a few years.²²

Financial advisors are likely to serve their communities. Our mutual fund representatives reflect the face of Canadians and we are proud of their diversity. They also have broad coverage of smaller, rural and remote communities. Just the distance involved in serving investors in these communities makes it difficult to obtain advisory services even now. A ban on DSC would disproportionately disadvantage middle-income Canadians in these communities.

In the consultation paper, the CSA asserts that “some firms rely on the upfront sales commissions received on sales made under the DSC option to fund the on-boarding and turnover costs of staff recruitment” and “consequently clients in such firms, holding a mutual fund under the DSC option assume some part of the firm’s risk in taking on new staff”. While it is difficult to isolate what source of dealer revenue funds particular activities, the advantage of the up-front compensation is not funding the costs referred to by the CSA; it is providing upfront compensation for the efforts of representatives, particularly new representatives, providing advice to those with smaller amounts to invest.

A new advisor, under the supervision of someone more experienced, is more likely to put in the effort on a smaller account in order to gain experience and build the foundation of a book of business. Established advisors are far less likely to put in the effort to do this. Still, new advisors need to be compensated for their efforts.

Some, including the CSA, have suggested that the discontinuation on the DSC option will encourage dealers and their representatives to adopt more transparent compensation arrangements which will require them to better demonstrate and justify their value proposition, and thus improve the alignment between the services provided and their cost to investors. We believe, unlike the CSA, with no way of compensating an advisor and dealer for their efforts upfront, except through an initial fee taken out of the amount the client has to invest, the proposed DSC ban will lead to higher minimum account

²¹ PwC (2014). [Sound Advice: Insight into Canada’s Financial Advice Industry](#). Report commissioned by Advocis

²² Advisor.ca. “Training Programs Help Rookies,” January 1, 2010

balances and will make the type of personalized advice we provide unaffordable to the average Canadian. We are already seeing this trend – having to cope with the increase in regulatory cost, many registrants have put in minimum account sizes of upwards of \$100,000 for their advice channel. Most Canadians simply do not have that amount of money available to invest.²³

The DSC model works well for all concerned. The investors, who do not have large sums of money, to begin with, are not put in a position of needing a significant percentage of the amount they have to invest to pay for advice, or not having access to advice at all; they are provided with the advice and the products that they need, and the advisors are compensated for their efforts. What is at stake is not only the ability to serve smaller investors but the environment to attract new advisors and renew a rapidly ageing advisory force.

DSC Misconceptions

We acknowledge that the DSC option is not perfect. Later in our submission, we provide constructive suggestions on reducing the potential for investors to pay a deferred sales charge. However, it is clear from public comments that there are a number of misconceptions and a lack of factual information about the extent of such charges actually being incurred, and the extent of the harm arising from the model. In making these comments we are drawing from our own company's experience. This may not be representative of industry experience as we have in place controls that others may not and we represent a segment of the market that many others have already abandoned and therefore cannot speak to.

Are Sales Charges Only “Deferred”?

The misconceptions begin with the label “DSC”, particularly the word “deferred”. Deferred suggests something, in this case a sales charge, *will* happen later. In fact, in the majority of cases, investors *do not* incur a sales charge with this compensation model or, if they do, it is small. It is intended to be used for investors with a long-term time horizon, well past the time at which a sales charge would be incurred. A more accurate label would be “Deferred or Waived Sales Charge”.

“Locking In” Investors

In an attempt to address the issue of “awareness and control of costs” according to the Request for Comments document, the CSA notes the proposed ban of the DSC option “will eliminate the penalizing ‘lock-in’ effect of the redemption fee schedule and the applicable redemption fees, and no longer deter investors from redeeming an investment or changing their asset allocation in the face of poor fund performance, unforeseen liquidity events, or a change in their financial circumstances”. Similarly, detractors of the model state that investors are harmed as they are “locked in” to a particular fund and cannot move when they should. These views are not entirely correct.

Generally, a sales charge is incurred if there is a redemption in the DSC period only if the funds are moved outside of a particular fund manager. Transfers to other funds available at that mutual fund manager can be done without incurring a sales charge. Most fund managers offer a wide variety of funds so that if it is appropriate for an investor to move to another type of fund, the switch may be done without incurring a charge. In addition, fund managers generally allow 10% of the units to be redeemed annually free of charge. Many also allow 10% of the units to be transferred annually free of charge to

²³ According to Investor Economics, Household Balance Sheet, 2017 (2016 Data), 79% of Canadians with investable assets have under \$100,000 to invest

the front end (non-DSC) version of the funds and accumulate there; making them available without charge should the investor wish to redeem them. This significantly reduces the potential exposure to a sales charge. The DSC option encourages longer holds and we believe this payment is perfectly suitable for investors provided they fully understand the payment and the potential charges.

Despite these opportunities to avoid paying a sales charge, we acknowledge more can be done to help ensure this will, in fact, happen. We have provided some constructive suggestions later in our paper to help ensure this will be the case.

Seniors

The MFDA's 2017 Client Research Report indicates it has identified seniors as a particular concern with respect to DSCs. We share the regulators' concern with the protection of seniors. Seniors can be more vulnerable than investors generally, and it is appropriate that extra care is taken when advising this demographic. However, treating seniors as a homogeneous group may not be appropriate. Detractors suggest that seniors have a greater probability of needing funds on short notice and as a result, they should not be sold mutual funds using the DSC option. We have found that, with lengthening lifespans, seniors of different age groups have a different experience with DSC. The majority of funds that we have sold to seniors are in RRIF accounts. These investors have a low incidence of incurring a deferred sales charge. We assume the reason for this is that the younger age seniors want to leave as much as possible in their RRIF accounts for as long as possible in order to minimize income taxes. RRIF accounts have minimum withdrawal requirements mandated by legislation. These requirements can be met without incurring sales charges through the 10% DSC-free redemption allowance described previously. Older seniors may have shorter time horizons and a greater chance of needing to redeem their funds sooner. We agree that restrictions on the use of the DSC option for these investors are needed.

Emergency Funds

Some detractors note that the DSC option is inconsistent with an emergency fund. If investors are faced with an emergency, having them incur a sales charge to get at their funds would make a difficult situation worse. We agree. However, this is not a problem with DSC itself; rather, it is an issue with the suitability of the recommendation made to the client in consideration of their time horizon and liquidity needs. Similar to making a recommendation to have emergency savings in products with less risk, these savings also should not be put into products using the DSC compensation model.

Development of Advisors

We have seen a comment that the DSC option is really paying for the development of new advisors. We would like to add some points to those made earlier in our submission under "Renewing and Expanding the Number of Advisors". Advisors entering the business may be new but they are fully trained and licensed, meeting the entry standards prescribed by regulators. Their activities are supervised at the Branch Manager and at the Dealer level. New advisors are more willing to take on small accounts, even with some modest upfront compensation, as they are keen to grow their client base. They also know that those small accounts have the potential to become sizable ones. Modest investors benefit from the personal advice and service - a personalized touch that they likely will not receive if advisors do not receive some up-front compensation. The benefits are complementary to investors and advisors.

Detractors note that robo-advisors are available to meet the needs of those with smaller amounts to invest. The fact is that very few investors are willing to try the robo-channel at this stage. Robo advice is not holistic and is not personal. They do not provide the depth and breadth of advice of that an investor

receives from a personal financial advisor. Research shows that investor usage and interest in tools such as robo-advisors remains very low; with 23% of mutual fund investors aware of robo-advisory services and only 18% having utilized one²⁴. But perhaps the most overlooked benefit of an advisor is the “nudge” factor - helping families overcome the inertia of starting an investment plan, instilling a savings discipline and keeping them invested when the markets are rocky. The robo channel cannot replicate this human touch. While the expenses and potential conflicts of the advisory model have been scrutinized beyond any other product or service, we find it interesting that regulators and investor advocates do not question expenses or conflicts in the robo channel. Who pays for the very expensive advertising campaigns? Ultimately the cost has to be borne by investors. Who is supervising the algorithms and the recommendations? Are clients recommended products that offer a better profit margin for the robo company or do all product placements offer equal profit for them? None of this is known or transparent. Yet there seems to be an over-zealous interest in pushing the mass market towards this largely untested channel, without the same level of regulatory supervision that exists for other channels.

Our model is structured to develop advisors that directly help middle-income Canadians, through a well-regulated, transparent and supervised distribution channel.

Churning

A recent IIROC case found an advisor had misused the DSC model by redeeming seniors’ mutual funds, having them incur a DSC fee, and having them reinvested, resulting in new commissions be paid to the advisor. This is a version of the misuse of any commission sales model, referred to as account churning. We certainly do not condone this practice and agree with the significant sanction that the advisor received. However, this is not an indication that the DSC model was the problem; rather, it was the misuse of the model. Later in our submission, we propose a practice that would significantly reduce the likelihood for account churning to occur.

Proportionate Use of DSC

A commenter has suggested that if DSC use was truly a matter of choice, then then it would be more proportionately represented no matter whether account sizes and advisor book sizes are large or small. He expressed the view that since it is not representative, with mostly small accounts served by advisors with smaller book sizes using the DSC, then it is really not a choice issue. What this interpretation fails to take into account is that advisors with larger books of business are not willing to put in the time and effort for small accounts – it is not worth it for them.

Advisors with larger book sizes don’t need a DSC model as they often negotiate a fee based arrangement that pays for their effort. They receive larger sum trailer fees or have an ongoing asset based fee arrangement. Some may also charge a financial planning fee upfront. Those with larger amounts to invest have more options available to them and have the ability to negotiate fees. We acknowledge that a different compensation model may be appropriate for those larger accounts.

Similarly, the DSC model is needed to support small accounts where the same type of economics doesn’t exist. After considerable time and effort assessing the needs of a client, providing a recommendation, putting in place the account and trade, the upfront commission on a \$5,000 investment, for example, is \$250 split between the advisor and the dealer. The ongoing “trailing” commission on this account would be around \$50 a year split between the advisor and the dealer. Without some upfront compensation, no

²⁴ See Pollara IFIC Survey, 2018

dealer and no advisor would be able to afford to serve this client. And most modest investors in this category would benefit from a DSC model, where they would avoid paying a sales fee or commission entirely if they stay invested for the period of their DSC schedule versus paying that amount upfront. Even if this client should withdraw their full investment in year 1, which happens extremely rarely, the DSC fee they would incur after their 10% DSC-free portion would be \$248. It is hard to imagine what lower rate they would be able to negotiate as the cost of serving a small account is not much different than serving a large account where the rewards would be substantially larger.

Eliminating the DSC option means that those with smaller amounts to invest will not have access to the advice they need.

Firms that have Eliminated the DSC Option

Normally we would not comment in a submission such as this on the practices or business model of other companies. However, the recent public statements of some industry participants, regulators (CSA)²⁵ and even media commentators extolling the virtues of eliminating the DSC model without weighing the cost of such moves needs to be addressed. We believe incorrect conclusions were drawn from their discontinuance and we wish to provide another point of view. To be clear, we are not critical of firms eliminating the DSC use in their businesses - it is their prerogative to pursue the business model of their choosing. Having said this, elimination of the DSC model altogether from the market will benefit those who have moved their business in that direction by eliminating a source of competition and should be viewed as a conflicted view.

Many who have eliminated the DSC compensation model have done so by also eliminating smaller accounts and either putting in minimum account sizes or giving those smaller clients notices of termination. While shedding smaller account, many also eliminated advisors who serve such accounts. Thousands of modest investors lost the benefits of personal advice over the last few years with many firms pursuing higher asset accounts and many thousands more will if the use of DSC is banned.

Rather than support the case for a DSC ban, these new wealth oriented models support our case of the importance to retain DSC.

Commission Fee-Related Complaints

We have provided suggestions later in our submission which we believe will help address concerns raised by the CSA. We would, however, like to put some perspective on complaints. The following table provides the number of complaints over the past few years made to the MFDA and OBSI regarding investments. While ideally there would be no complaints, the industry serves millions of investors every year. According to MFDA data²⁶, there are 15.6 million client accounts; 8.86 million households and 37.7 million individual investment positions reported in client accounts. Considering this, the number of complaints is extraordinarily small. Even if all the fee-related complaints related to DSC, they would be a very small percentage of the total number of transactions. There are, of course, more complaints made to dealers and advisors. However, regulation requires that there be a process in place to properly handle these complaints. Complainants that are not satisfied with the dealer process are directed to the option of raising their issue with the MFDA and/or OBSI.

²⁵ See page 74 on [CSA Consultation Paper 81-408 – Consultation on The Option of Discontinuing Embedded Commissions](#), January 10, 2017

²⁶ Compliance Bulletin #0721-C - [MFDA Client Research Report](#), May 23, 2017

	Ombudsman for Banking Services and Investments (OBSI)		Mutual Fund Dealers Association of Canada (MFDA)	
	Total Investment Complaints	Fee Disclosure Related Complaints	Total Opened Complaint Cases	Commission and Fee Related Complaints
2017	351	29	469	27
2016	350	34	446	17
2015	298	37	444	12
2014	345	58	418	23
2013	434	45	426	20

Data Source: MFDA Enforcement Department Annual Report 2013, 2014, 2015, 2016 and 2017
OBSI Annual Report 2013, 2014, 2015, 2016 and 2017

Guidelines and Restrictions on the Sale of DSC Funds

As noted earlier, the DSC model works particularly well for investors with lower amounts to invest and supports new entrants into the industry. However, we acknowledge that the model is not perfect. Investors may not understand the model as it is not as transparent as paying a fee directly. As a result, the payment of a fee may be a surprise. There may be situations where the likelihood of paying a deferred sales charge is higher than it should be. The intent of the model is that it is to be used by long-term investors and that generally a charge should not be incurred.

Rather than ban the model, investor protection can be enhanced, and the negative aspects can be largely eliminated through the implementation of certain controls and disclosures. Following are some suggested requirements when the DSC option is being used.

- **Enhanced disclosure.** While there is already significant disclosure of DSC fees in Fund Facts and other documents, given the potential for such a fee to be incurred it may be warranted to provide a separate disclosure of the DSC schedule to clients, and to have it acknowledged by them in writing or some other positive action such as a computer check box. Focusing on this important item should reduce the potential for surprises at a later date, should deferred sales charges be incurred.
- **One commission policy.** Once a DSC schedule has been completed on an account, the amount invested through a dealer is not put into a new DSC schedule at that dealer. A fee model with a 0% front-end commission is to be used. This achieves several things. It removes the incentive to churn accounts, unnecessarily moving investors to other products solely to generate a commission for the advisor. The advisor is still being paid a trailer fee to provide advice as needed. It limits the amount of time that an investor can be subject to a deferred sales charge, reducing the potential for investor “surprises” resulting in potential complaints. It maintains compensation for the extensive up-front work required of advisors to establish a relationship with new clients to get to point of making recommendations.
- **Seniors.** We recommend limiting the use of DSC fees at ages which are appropriate to reduce the potential for these fees to be incurred. We note, however, that funds generally provide an annual withdrawal free of charge of 10% of the assets invested. Our experience has shown that

for those investors relying on their funds for ongoing income, or where minimum withdrawals are required (such as in RRIF accounts), this withdrawal feature provides them with sufficient funds to meet their needs without incurring fees.

- Time Horizon. Limit the use of DSC to an individual's time horizon. The DSC period should not be longer than the individual's time horizon when they would expect to require their money. This would significantly reduce the potential for DSC fees to be incurred. Similarly, Low-load funds with declining redemption schedules ranging between 2 to 4 years within the industry offer middle-term investors who have a shorter investment horizon with a range of investment options. These funds also offer an annual withdrawal free of charge of 10% of the assets invested.
- Emergency funds. Require advisors to ensure clients consider establishing an emergency fund that is not subject to a DSC charge.

We believe these additional controls and procedures would significantly reduce the negative aspects of the DSC compensation model. There may be other such procedures and we would be open to discussing those with the CSA.

Conclusion

Primerica supports the CSA's efforts to pursue enhanced investor protection where needed. The mutual fund industry and the independent advice channel are highly regulated and provide significant investor protection. The CSA should not underestimate the potential harm to existing and potential investors from a ban on the DSC option. To a great extent, the \$1.46 trillion currently invested in mutual funds was reached by using this compensation model. We believe it is incumbent on industry and its regulators to ensure that it continues to serve this segment of the market well, with a real choice to help them achieve their financial goals.

We appreciate the opportunity to comment on this important issue and look forward to participating in any further public discussion on this topic. Should you have any questions or wish to discuss these comments, please feel free to contact us.

Sincerely,

[Original Signed by]

John A. Adams, CPA, CA
Chief Executive Officer

APPENDIX I – Responses to Consultation Questions

CSA Questions	Primerica Response
<p>4. We do not expect that the repeal of section 3.1 of NI 81-105 will have any impact on the availability and use of other sales charge options, including the front-end load option as it currently exists today.</p> <p>a) Are there any unintended consequences on the front-end load option with the repeal of section 3.1 that we should consider?</p> <p>b) Are there any other types of sales charge options that will be impacted by repealing section 3.1?</p>	<p>There are three significant unintended consequences. First, it will drive customers away from the independent advice distribution channel. Eliminating this option is not in the best interest of investors. Second, overall costs to investors will increase. Rather than have the possibility of incurring a sales charge under the DSC option, investors are likely to incur such a cost where some up-front compensation is needed for the investor to receive personal financial advice. Third, the front-end load option reduces the amount available to be invested by the customer.</p>
<p>Transition Period</p> <p>We anticipate that a transition period of 1 year from the date of publication of the final amendments is sufficient time for registrants to operationalize the Proposed Amendments.</p>	
<p>7. Are there any transitional issues for fund organizations and participating dealers with implementing the Proposed Amendments within the proposed 1-year transition period? If so, please provide details of the relevant operational, technological, systems, compensation arrangements or other significant business changes required, and the minimum amount of time reasonably required to operationalize those changes and comply with the Proposed Amendments.</p>	<p>There are no affordable alternatives to the DSC model that would preserve personal advice for modest investors, without charging an upfront fee or reducing their initial investment to pay for the advice and service. Any other alternatives would require negotiating with third party mutual fund companies, new product design, operational and systems changes, regulatory approval, documentation and client communications to mention some of the challenges. At a minimum, we would like to see a 3 year transition period from the time the Proposed Amendment to NI 81-105 come into effect, to properly implement an alternative to the DSC compensation model.</p>

10. At this time, the CSA is allowing redemption schedules on existing DSC holdings as of the effective date of the Proposed Amendments to run their course until their scheduled expiry, and fund organizations to continue charging redemption fees on those existing holdings that are redeemed prior to the expiry of the applicable redemption schedule. Should the CSA propose amendments to require existing DSC holdings as of the effective date of the Proposed Amendments to be converted to the front-end load option or other sales charge option? If so, are there any transitional issues for fund organizations and participating dealers with converting existing DSC holdings to another sales charge option? What would be an appropriate transition period?

There are significant financial implications for cutting off the deferred sales charge period. Fund managers recover the up-front advances through reduced trailer fees paid to dealers. If the time to recover the advances is cut short, it will likely result in significant financial losses being incurred by fund managers.