Vanguard®

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DELIVERED BY EMAIL: comments@osc.gov.on.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, ON M5H 3S8

Dear Sirs and Madams:

Re: Proposed Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds* and Proposed Companion Policy 81-502 to Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds*

Vanguard Investments Canada Inc. (**Vanguard, we, our or us**) is pleased to provide the Ontario Securities Commission (**OSC**) with feedback on the above-noted proposed rule and related companion policy (together, the **Proposal**).

Vanguard is a wholly owned indirect subsidiary of The Vanguard Group, Inc. (**VGI**) and manages more than CAD $24 billion in assets invested in publicly offered Canadian-domiciled exchange-traded funds (**ETFs**), as of May 31, 2020. VGI is the world's largest mutual fund manager, one of the world's largest investment management companies and a leading provider of company-sponsored retirement plan services. VGI manages USD $ 5.7 trillion in global assets, including over USD$ 1.1 trillion in global ETF assets (as of April 30, 2020). VGI has offices the United States, Canada, Mexico, Europe, Australia, and Asia. Vanguard offers 425 funds worldwide to its more than 30 million investors.

VGI operates under a unique operating structure. Unlike firms that are publicly held or owned by a small group of individuals, VGI is owned by Vanguard's U.S. domiciled funds and ETFs. Those funds, in turn, are owned by VGI clients. This unique mutual structure aligns Vanguard's interests with those of its investors and drives the culture, philosophy, and policies throughout the Vanguard organization worldwide, including in Canada.

Vanguard's mission is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success. The very essence of our firm is that investors' interests must be paramount in all that we do. Our business has been built on the principles of diversification, discipline, low-cost and putting the interests of investors at the forefront of everything we do. Rooted in our mission to put the interests of all investors first, we believe in regulatory initiatives that improve the investment environment for Canadians by lowering the cost of investments and advice, providing greater fee transparency, and minimizing conflicts of interest in the distribution of investment products and advice.

Our principal business is to act as an investment fund manager for ETFs and mutual funds. As an investment fund manager, we do not pay for distribution of our products, meaning we do not pay dealers any fees, commissions or other inducements for fund distribution. As such, we are not directly impacted by the Proposal.

Instead, Vanguard works with fee-based investment professionals who appreciate Vanguard's low cost, high quality and diversified fund range. Vanguard strongly believes in the value of financial advice and supports fee-based advice, as this model ultimately allows investors to benefit from transparency and lower ongoing charges.

Vanguard's View on Embedded Fees

Vanguard supports the decision by the Canadian Securities Administrators (**CSA**) with the exception of the OSC to ban the sale of mutual funds through the use of all forms of the deferred sales charge (**DSC**) option. We agree with the investor protection concerns raised by the CSA, including the significant conflicts of interest created by the DSC structure and liquidity constraints that harm investors. Overall, we believe the decision is an important step towards aligning the sale and distribution of mutual funds with the best interests of Canadian investors.

Vanguard also continues to support a full ban on all forms of embedded commissions in Canada. Our view is that a full ban on commissions would:

- reduce conflicts of interest that create product bias,
- enhance fee transparency and create a more level playing field amongst investment products and services,
- spur competition and innovation in the Canadian asset management industry,
- lead to the availability of a wider range of lower-cost, high-quality investment products and services and
- enhance investor protection and improve the long-term investment outcomes for Canadian investors.

The mutual fund market should operate in the best interests of investors where product providers are transparent and compete on the price and quality of their products for distribution, without undue influence or the perception of undue influence by the payment of embedded commissions.

Embedded commissions can give rise to potential conflicts of interest that misalign the interests of investment fund managers and intermediaries, with those of the investors they serve. The payment of embedded commissions to intermediaries can cause product bias whereby decisions are made based on the commission paid by the investment product rather than on the suitability of the investment product.

In other jurisdictions (e.g., the UK and the Netherlands) where such commissions have been banned, we have directly observed the following[1]:

a. a reduced risk of intermediary conflicts of interest that create a product bias on the part of the dealer and advisor, thereby enhancing investor protection by ensuring investment decisions are based on the suitability of the product rather than the compensation paid to the dealer and advisor;

b. increased fee transparency, product access and competition, leading to the availability of a wider range of lower-cost, high quality investment products and services to investors;

Critics of banning DSC fees or other forms of embedded commissions often allege that the ban will result in a material "advice gap" for retail investors. We and many others would dispute the full validity of this claim. As highlighted above, our experience in other jurisdictions shows that investors and financial advisors are embracing the increased availability of low-cost, high quality investment products, while advice service levels are remaining relatively stable. As well evidenced by the European consumer organization BEUC, studies in both the UK and Netherlands have demonstrated that the vast majority of consumers are willing to explicitly pay for financial advice, if they judge it to be worth its price.[2] Further, a survey carried out as part of the UK's Financial Advice Market Review (FAMR)[3] found that the main reason for people not taking advice "was not having a need for it, or deciding to make decisions on their own, rather than any explicit issues with accessibility." Indeed, evidence gathered as part of the FAMR found that of consumers seeking financial advice, only 9% were concerned that they would not be able to afford to pay the adviser's charges, and only 0.5% said that they were unable to find an adviser willing or able to offer them advice. Admittedly, in the UK, there was an initial decline in adviser numbers following the introduction of a ban pursuant to the Retail Distribution Review (RDR). That was in part driven by higher professional standards for financial advisers introduced as part of the RDR, as well as other

[1] Shortly after the ban, the Netherlands saw service savings of approximately $300 million per year, and some manufacturers reducing their product prices by as much as 50%. Similarly, the UK investors saw product price reductions as large as 75 bps since implementation of RDR

[2] https://www.beuc.eu/publications/beuc-x-2019-046_the_case_for_banning_commissions.pdf

[3] https://www.fca.org.uk/publication/corporate/famr-final-report.pdf

factors. However, there is evidence that the advice market is increasingly delivering the services needed by consumers. In 2019, the FCA's Evaluation[4] of the RDR and FAMR showed that the number of adviser staff at financial advisers firms increased by 3% from 2016 to 2017 and so did the number of intermediary firms. Also, FCA data has shown that since 2017, there has been a statistically significant increase in the number of people taking regulated financial advice, with an additional 1.3 million people taking advice, as well as an increase in the use of guidance services and automated-advice services, to help with financial planning decisions.

In Canada itself, a study in 2019 by the OSC's Investor Advisory Panel showed clear evidence about potential shortfalls in the scope and effectiveness of the advice that is being provided today to some Canadian investors (particularly for investors with smaller accounts). Rather than limiting product and advice options to Canadian investors, we believe eliminating the DSC structure and other forms of embedded commission products will spur competition and innovation in the Canadian asset management industry and lead to the availability of a wider range of lower-cost, high-quality investment products and services.

Vanguard's View on the Proposal

Regarding the Proposal specifically, we have the following concerns:

a. The prohibition on the use of the DSC option extends to certain investor categories (e.g., senior citizens), but not to others (e.g., young investors) that could equally be negatively impacted by these fees.

b. Protection is only provided for large accounts (CAD$ 50,000 and above), however, accounts under CAD$ 50,000 can be equally harmed by these fees. In fact, the DSC structure could be more problematic for these investors who may be the most vulnerable and underserved, living pay cheque to pay cheque.

c. The Proposal will result in a non-harmonized approach at the national level, which creates regulatory uncertainty, complexity and burden. It is also problematic in light of the enhanced conflicts of interest requirements under the recently enacted CSA client focused reforms.

We believe investors in Ontario deserve the same investor protection as other Canadians. Therefore, we strongly encourage the OSC to harmonize its approach with the CSA and ban the sale of mutual funds through the use of all forms of DSC option.

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[4] https://www.fca.org.uk/publication/call-for-input/call-for-input-evaluation-rdr-famr.pdf

Should the OSC fail to harmonize its approach, we would suggest the following additional actions to limit harm to Ontario investors:

a. Expedite timeline for implementation. We see little rationale for linking the OSC's timeline to the CSA's nearly 2 ½ year timeline to ban DSC fees. A quicker implementation will reduce investor harm, particularly at a time when investors are facing financial hardship as a result of the COVID-19 crisis.

b. Increase oversight and enforcement action (e.g., through higher financial penalties for advisors) for improper use of the DSC option on the part of advisors.

c. Mandate that when a redemption schedule matures the investment must be automatically switched to a lower cost series at no charge to the investor.

d. Enhance investor education regarding DSC fees, including the redemption fee schedule, and potential harm caused by the impact of these fees over time.

e. Expand the vulnerable investor category (i.e., health, life events, resilience, and capability).

We appreciate the opportunity to comment on the Proposal and would be pleased to further discuss our comments with OSC staff at your earliest convenience.

Sincerely,

DocuSigned by:
Kathleen C. Bock
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Kathleen C. Bock
Managing Director
Vanguard Investments Canada, Inc.