PRIMERICA FINANCIAL SERVICES (CANADA) LTD.
RESPONSE TO OSC CONSULTATION PAPER 81-502:
CONSULTATION ON PROPOSED RESTRICTIONS ON THE USE OF DEFFERED SALES CHARGE OPTION FOR MUTUAL FUNDS

July 6, 2020

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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

Dear Sirs / Madams:

Re: OSC Notice and Request for Comment – Proposed Ontario Securities Commission Rule 81-502 Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds

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 6,600 licensed mutual fund representatives.[1] Over 4,200 of these are licensed to sell in Ontario. We administer over $14 billion of securities and segregated fund assets under management (AUM), of which $6 billion is in Ontario.

Our mutual fund dealer has an open shelf, offering a diverse set of funds from well-known fund managers. In addition, we provide a proprietary suite of mutual funds. We often reach middle-income households that are underserved in the financial marketplace, educating them about the importance of planning for their financial futures. Our investment products, principles and personal advice help middle-income Ontarians 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. The products we offer are targeted to the financial needs of our clients. We do not require minimum account sizes. We offer savings programs with contributions as little as $25 per month, with initial investments as low as $100 to $500. This approach allows Ontarians, no matter how small their budget, to participate in the capital markets and set and achieve their financial goals.

General Comments

Primerica commends the Ontario Securities Commission's (OSC) decision not to ban the Deferred Sales Charge (DSC) option on the sale of mutual funds, preserving consumer choice and access to advice. We appreciate that the OSC took into consideration the fund industry's concerns during previous consultations and ultimately decided to propose targeted restrictions rather than an outright ban on the sale of DSC funds in Ontario. Primerica shares the OSC's goals of protecting investors and increasing investment knowledge. While we believe these overarching goals are aligned, we are concerned that some elements of the OSC Proposed Rules, taken as a whole, may create a regulatory environment where the cost of servicing modest investors becomes prohibitive, or where these investors cannot find a representative to service their needs. We believe a careful assessment of the impact of the proposed restrictions, along with commercial realities, is required to avoid what would, in effect, be a *de facto* ban of the DSC option. Furthermore, given the disruptive effect of the current pandemic and the significant changes we are required to make to adapt our business to the current operating environment, we respectfully ask the OSC to consider extending the implementation date of the proposed rules from June 1, 2022, to June 1, 2023.

To create a workable rule that achieves our shared goals of enhanced consumer protection and maintaining consumer choice, we provide our detailed comments and highlight concerns we believe the OSC should take into consideration.

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[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

Making the Case for the DSC Option

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 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 $1.58 trillion.[2] A significant portion of those assets were invested using the DSC option. There are an estimated 4.3 million mutual fund investors among modest income households. In addition, there are 1.7 million people who invested in mutual funds in the past that no longer do so for various reasons, including using the funds for their retirement, education, and similar purposes they intended.[3] We understand the underlying concerns raised by the CSA with respect to the DSC model, and agree that certain restrictions and controls surrounding its use should be in place. Over the past number of years, PFSL has implemented several controls and restrictions similar to those contemplated in your proposal. The DSC option continues to be a viable method to purchase mutual funds. Research conducted by the MFDA[4] found 42% of funds $100,000 and under had a DSC load, 6% had a Low Load (LL)[5], and 32% of funds between $100,000 and $250,000 had a DSC load while 6% had a low load. The DSC model has, and continues to, enable advisors to service middle income investors at a reasonable cost. Without this option, there would not nearly have been the access to advice and growth in investments that occurred.

The DSC option provides some up-front compensation to advisors, which is advanced by fund managers, without reducing the amount available for clients to invest. The DSC model helps to offset the 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. All clients, no matter the amount they have to invest, have certain basic requirements that must be met by their advisor. The 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. It is not surprising, then, that the market already drives advisors to seek clients with greater net worth, often leaving modest investors without the help they need. Research supports this. While 51% of Canadians have a person, who provides them advice and guidance on investments[6], 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).[7] Our concern is that the proposed reforms will exacerbate this dynamic.

Furthermore, middle-income Canadians consider the options offered by the DSC model to be beneficial to their interests. When modest income Canadians were surveyed on their preferred method of paying for their mutual funds[8], the option most preferred (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.

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[2] IFIC Monthly Statistics, May 2020

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

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

[5] A mutual fund purchase option that has a shorter redemption fee schedule (usually 2 to 4 years)

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

[7] *See* Golfdale Consulting and The Brondesbury Group, 2018

[8] *See* Golfdale Consulting and The Brondesbury Group, 2018

In addition, survey results[9] 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%).

Our clients are largely in the middle income market, with small amounts to invest, at the start of their relationship with us. We do not impose minimum account sizes as we wish to foster a long-term investment relationship. The work of our representatives has helped educate modest income families about the importance of investing for the long term and saving for their futures. As explained below, our fear is that the reforms (i) are not economically sustainable, which will result in less access to financial professionals, (ii) will increase costs to investors resulting in fewer funds held by these families, and (iii) will disadvantage seniors with longer time horizons. As a result, the reforms will lead to greater harm overall than the consumer protection they are intended to provide.

Section 3(a)(i): DSC Redemption Schedule

In the consultation paper, the OSC cites the "lock-in"[10] feature associated with the DSC option to justify the policy decision to shorten the DSC redemption schedule from 7 years to 3 years. We respectfully disagree with the OSC's rationale and recommend the OSC consider, at a minimum, increasing the allowable redemption schedule to 5 years for the following reasons.

We believe the regulatory concerns related to the DSC "lock-in" feature arises from the suitability of the investment recommendation rather than the DSC's redemption schedule itself. Firms like ours that make the DSC option available to investors consider factors such as time horizon, age and purpose of investing (retirement or post-secondary education). The DSC encourages a 'buy and hold' strategy, and we believe this compensation model is perfectly suitable for investors with longer time horizons, provided they fully understand the compensation and the potential charges. The model is intended to be used by long-term investors, and 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. Similarly, Low-load funds with declining redemption schedules ranging between 2 to 4 years within the industry offer investors who have a shorter investment horizon with a range of investment options.

We agree with the OSC that it is essential to limit DSC's use to an individual's time horizon. The DSC period should be shorter than the individual's time horizon when they would expect to require their money as this will significantly reduce the potential for DSC fees to be incurred. Typically, 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. Most fund managers offer a wide variety of funds so that if it is appropriate for an investor to move to

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[9] Canadian Investor Survey, The Gandalf Group, 2018

[10] OSC Consultation Paper 81-502: Consultation on Proposed Restrictions on the use of Deferred Sales Charge Option for Mutual Funds. "The "lock-in" feature refers to the redemption fee schedule associated with the DSC option which has the potential to deter investors from redeeming an investment or changing their asset allocation, even in the face of consistently poor fund performance, unforeseen liquidity events, or changes in their financial circumstances."

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 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.

While we recognize we are still in the early stages of the COVID-19 pandemic and things can change, our experience is that our clients have stayed the course and not sold at the wrong time. It is more important now, than ever, that middle-income families have access to financial professionals. We observe that there has not been a spike in DSC fees incurred during this crisis. We believe our advisors working with our clients to focus on their long-term objectives have helped clients make appropriate financial decisions.

We believe that commercial realities also need further recognition in any reforms, and the OSC'S proposed maximum three-year redemption schedule is simply uneconomical. With the DSC model, the up-front compensation is financed by the investment fund manager[11] (IFM) and paid for through a reduced trailer fee paid to the dealer, and in turn, the advisor. The compensation from the IFM to the dealer in the industry is generally 5% on a seven-year schedule, but only 2.5% on a three-year schedule. Taking the OSC's proposed $50,000 account size limit, and after splitting the commissionable amount between the dealer and branch manager, and advisors, the amount earned to service the client's account is not economically sustainable. When considering that the average size of an account is just $13,000 as per OSC estimates[12], and assuming these accounts utilized the three year schedule, the maximum commission the dealer, and the advisor can earn for three years would drop to $520, out of which all the expenses of running a business, including compliance and supervision, must be covered.

Section 3(a)(iii): Separate DSC Series

The stated policy rationale to require a separate DSC series is to "prevent the potential for cross-subsidization by ensuring that investors who purchase on a no-load or front-end sales charge basis do not indirectly incur costs related to financing the upfront commissions typically associated with the DSC option."[13] While we acknowledge that cross-subsidization occurs in mutual funds, we did not see evidence in the consultation paper to suggest that cross-subsidization of costs *due to the DSC model itself* is overly problematic or material to the management fees being charged.

A significant portion of the cost of financing up front commissions in the DSC model is borne by investment dealers through an arrangement whereby, in exchange for an up-front commission from the investment fund manager, the dealer agrees to a 50% reduction in trailing commission from the investment fund manager during the sales charge period. The impact on fund costs is negligible, and in fact, requiring a separate series could lead to higher fund costs for investors.

[11] 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

[12] OSC Consultation Paper 81-502: Consultation on Proposed Restrictions on the use of Deferred Sales Charge Option for Mutual Funds. "The OSC analysis of unpublished data from the 2017 MFDA Client Research. The average account size is at the household level and may overreport the average assets for single-person households."

[13] *See page 3*: OSC Consultation Paper 81-502: Consultation on Proposed Restrictions on the use of Deferred Sales Charge Option for Mutual Funds.

Most of the client servicing costs associated with mutual fund investing are fixed. For example, transfer agency costs, unitholder record keeping, printing, and mailing of confirmations and statements are all fixed costs regardless of transaction or account size, and regardless of compensation model. In addition, fund accounting is required for each fund, also a largely fixed cost. If the unitholders using DSC are removed from a fund, the existing costs will have to spread over fewer unitholders, resulting in an increase in costs for them. As an aside, this argument holds true for the elimination of DSC generally, as other provinces are doing. We believe this will result in fewer investors and those that remain will have to bear greater per unit costs.

There is no evidence to suggest that creating a separate series of funds will reduce unitholder costs. We believe the opposite is true – that costs will increase for all investors. Finally, this proposal is not in keeping with the OSC's Regulatory Burden Reduction Initiative.

Section 3(b)(i): Clients Aged 60 and Over

We share the OSC's concern on the need to protect seniors. Seniors can be more vulnerable than other investors, but not always. In some circumstances it may be necessary to take extra care when advising this demographic. In such instances, having the benefit of a trusted advisor that can consider any special circumstances is important. However, we believe treating seniors as a homogeneous group (age 60 and over) does not reflect the financial requirements of this cohort. Hence, we respectfully suggest the OSC consider allowing the sale of mutual funds with the DSC option to individuals up to at least age 65, subject to considerations such as suitability and investment time horizon.

We are of the view that not every senior is the same and that each senior's situation should be considered individually. When a senior and a representative are choosing products to invest in, features of the product such as cost, performance, types of investment returns provided, and risk are considered. Reviewing these characteristics is part of the ongoing suitability assessment performed by the advisor that is specific to each senior. On the one hand, younger seniors readily invest for a more extended time and well into their retirement. On the other hand, older seniors may have shorter time horizons and a higher chance of needing to redeem their funds sooner. In the latter case, we agree that restrictions on the use of the DSC option for these investors are appropriate to reduce the potential for these fees to be incurred.

Some detractors of the DSC option have suggested 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. The knowledge we have acquired servicing this segment of the population for over 34 years informs us otherwise. Almost two-thirds of our clients that redeem do not incur a sale charge. Of those that do, the amounts are generally small. Seniors incur a sales charge at half the rate of other clients. With lengthening lifespans and a steadily increasing retirement age[14], seniors of different age groups have a different experience with the 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 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.

[14] According to StatsCan, the average age of retirement in Canada in 2019 is 64.3, up from 63.4 in 2015. Source: Statistics Canada: *Retirement Age by Class of Worker*.

Section 3(b)(ii): Maximum Client Account Size

We understand that one of the main goals of the OSC's proposals on the sale of the DSC option is to ensure enhanced investor protection and suitability recommendations. While these are essential goals, we believe the OSC's exceedingly restrictive policy proposals on the sale of the DSC may inevitably disadvantage those modest investors who make up the majority of Ontario's households. Considering the evidence below, we respectfully suggest the OSC increase the maximum account size that can be purchased by the DSC option to $100,000.

According to MFDA research[15], mass-market households, defined as households with financial wealth, including cash and investments of $100,000 or less, have the highest concentration in DSC funds. Figures from the same report indicate that out of over 969,000 households represented thought the MFDA channel in Ontario, about 703,000 (72%) have investable assets of $100,000 or less. Under this Proposed Rule, the OSC notes that investors with an account size of $50,000 or less will be eligible to purchase mutual funds using the DSC option, assuming other restrictions do not apply. According to OSC estimates, in Ontario, only 17% of investors owning securities, including mutual funds, have an account size equal to or less than $50,000. The average value of their account size is $13,000. Furthermore, the OSC acknowledges that 28% of investors owning securities, including mutual funds, have an account size of $100,000 or less, and the average value of their accounts is $68,000[16]. Given these statistics, we firmly believe limiting account sizes to $50,000 for DSC purchases will inevitably exclude over 1/5 of investors that own securities in Ontario from utilizing this payment option. We believe providing the opportunity for more investors to invest 100% of their available capital as opposed to part of it being used to pay an upfront fee is sensible policy-making.

According to research commissioned by the Investments Funds Institute of Canada (IFIC)[17], 80% of mutual fund investors report having used an advisor to purchase a mutual fund. Similarly, 85% agree their advisor is worth their fees and that they encourage them to have better saving and investing habits. In the section 'D' of the *Regulatory Impact Analysis* of the consultation paper, the OSC acknowledges that "14,000 of the 18,000 registered individuals in the MFDA financial advisory channel, with most having a client account size less than $100,000"[18], may be affected by the Proposed Rules in Ontario. Financial advisors are likely to serve their diverse communities. Our mutual fund representatives reflect the face of Ontarians, 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 already makes it difficult to obtain advisory services. Investors with smaller amounts to invest benefit from the personal advice and services provided by their financial advisor - a personalized touch that they may not receive under the current regulatory proposal. Some have simply defined this advice gap as "a loss of access to beneficial advice for small and mass-market investors."[19] This statement fails to address that in addition to meaningful advice, the value of advisors has been shown to compel sustained investment behaviors. We believe the most overlooked benefit of an advisor is the "nudge" factor - helping families overcome

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

[16] *See page 14*: OSC Consultation Paper 81-502: Consultation on Proposed Restrictions on the use of Deferred Sales Charge Option for Mutual Funds.

[17] Pollara IFIC Survey, 14th Annual Pollara – Investment Funds Institute of Canada (IFIC) Canadian & Exchange Traded Fund Investor Survey

[18] *See page 13:* OSC Consultation Paper 81-502: Consultation on Proposed Restrictions on the use of Deferred Sales Charge Option for Mutual Funds.

[19] *See page 3*: Investor Advisory Panel: A Measure of Advice: How Much of it do Investors with Small and Medium-sized Portfolios Receive? July 26, 2019

the inertia of starting an investment plan, instilling a savings discipline and keeping them invested in times of economic uncertainty and market turmoil.

We believe limiting a DSC purchased account size to $50,000 risks disproportionately disadvantaging a significant number of middle income investors in Ontario from potentially accessing much needed personalized financial advice. Research conducted by the OSC's Investment Advisory Panel (IAP) clearly indicates that the advice increases with the value of the portfolio[20]. Restricting DSC to accounts below $50,000 will accelerate the trend of dealers and advisors servicing only higher net worth clients. Discontinuing providing personal advice for accounts under $250,000 is already taking place in the market. It is our recommendation that if a limit be put in place that it be no less than $100,000 to help ensure Ontarians continue to receive the personal financial advice they need.

Conclusion

Primerica supports the OSC'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. To a great extent, and contrary to comments by others on the historical harms of the DSC, it must be acknowledged that $1.54 trillion currently invested in mutual funds was to a great extent reached by using this compensation model. We believe it is incumbent on industry and the OSC to ensure that proposed restrictions ultimately do not hinder the ability to serve modest investors in Ontario. This is more than a regulatory matter; it is a public policy issue relevant to the financial well-being of middle-income Ontarians.

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

[20] *See page 15*: Investor Advisory Panel: A Measure of Advice: How Much of it do Investors with Small and Medium-sized Portfolios Receive? July 26, 2019