July 11th, 2022

Attn:
Me. Philippe Lebel - Corporate Secretary and Executive Director, Legal Affairs - AMF
The Secretary - Ontario Securities Commission
Mr. Tony Toy - Policy Manager Canadian Council of Insurance Regulators

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

Re: Commentary on Total Cost Reporting for Investment Funds and Segregated Funds

Dear Me. Lapel, Toy, and Secretary of the OSC:

Please accept the following commentary paper put forth by the Financial Planning Association of Canada in regards to the proposed Total Cost Reporting Framework. We would like to thank you for the opportunity to formally submit to you our views on the subject matter.

If anyone should have any additional questions regarding our submission, we would be happy to discuss the matter further and would welcome any other future opportunities to be of assistance.

Regards,

Jason Pereira
President

The Financial Planning Association of Canada

Official Commentary Submitted to the

Canadian Securities Administrators
and the
Canadian Council of Insurance Regulators

Regarding

Total Cost Reporting for Investment Funds and
Segregated Funds

July 2022

About this Submission

This commentary is submitted to the Canadian Securities Administrators and the Canadian Council of Insurance Regulators in response to their request for commentary on proposed guidance in regards to Total Cost Reporting For Investment Funds And Segregated Funds.

At the Financial Planning Association of Canada, we welcome the opportunity to participate in this process and lend our perspective on this important change within the Canadian financial industry regulatory landscape.

About the Financial Planning Association of Canada

The Financial Planning Association of Canada (FPAC) is a new professional association founded in 2019, dedicated to the professionalization of the Financial Planning industry.

Our goal is to make financial planning a profession with the highest standards of fiduciary responsibility, competency, and practice standards possible. We believe that Financial Planners are uniquely positioned to help improve the lives of Canadians through comprehensive financial planning – and that only when Financial Planners are held to the highest standards, which would, in turn, lead to greater consumer confidence and trust, will FPAC be able to fully achieve its mission of professionalization of the financial planning industry.

Our Position on the Proposed Total Cost Reporting For Investment Funds And Segregated Funds

The success of a nation's financial industry depends on consumer trust in its financial institutions. At FPAC, we believe that transparency is a core tenet required to build trust with the public, especially regarding the core issue of what consumers are paying on investment products and for investment services. Our members feel so strongly about the need for the full and complete disclosure of all costs associated with the financial products and services they offer that the goal of ensuring all costs are reflected – in both percentages and dollars – on client statements is embedded in our founding Charter.

As such the Financial Planning Association of Canada lends its full support to the efforts being undertaken by the CSA and CCIR to ensure clients have full and complete disclosure of costs in both dollars and percentages on their statements, and we thank you for the opportunity to comment.

Response to the Specific Questions Regarding the Proposed Securities Amendments

1. *Do you anticipate implementation issues related to the inclusion of any of the following in the Proposed Securities Amendments,*
    a) exchange-traded funds,
    b) prospectus-exempt investment funds,
    c) scholarship plans,
    d) labour-sponsored funds,
    e) foreign investment funds?

    We are unable to provide specific guidance or commentary on technical issues regarding implementation. However, we will provide the following two comments in regarding to this topic:

    - The lack of full and complete disclosure of costs on client statements, in our view, is nothing short of injustice to investors. The current regime of partial disclosure leads many investors to believe that they already have full disclosure, which is far from the truth. As such we encourage the CSA and CCIR to accept no delay tactics or excuses from the industry and instead to ensure that these changes happen as soon as possible.

    - The comments made to date by the IIAC, IFIC, and Fundserv, namely that they cannot begin work on the technological infrastructure required to fulfill the change in reporting until the reporting guidelines are finalized, should not be accepted. While the guidelines have not been finalized, certain aspects of this proposal, like the inclusion of MERs, and the fact that additional data will have to be transmitted from vendors to dealers via Fundserv are not in question and should be actioned without any further delay.

2. *Would you consider it acceptable if, instead of information about each investment fund's fund expense ratio (MER + TER), the MER alone was disclosed in account statements and additional statements and used in the calculation of the fund expenses for the purposes of the annual report on charges and other compensation?*

    The reporting of MERs and not TERs would not be acceptable to FPAC and its membership. The name of this initiative says it all: TOTAL COST REPORTING. While trading adds no material cost for many funds, others have material fees that are larger than the MER. For example, Horizons Morningstar Hedge Fund Index ETF (HHF) ETF has an MER of 1.26% plus a TER of 2.48% for a total of 3.74%[1]. Failure to disclose

[1] https://www.horizonsetfs.com/horizons/media/pdfs/fundsummary/en/HHF_FundSummary.pdf

trading costs as part of a Total Cost Reporting initiative would constitute, in our view, a material failure to deliver on this promised initiative to investors.

We also believe that both MERs and trading costs should be itemized separately. Trading cost is largely depending on the investment strategy and can vary wildly from year to year, while MERs are more stable and typically only change when funds mandate fee reductions. Given these realities, these items should each be reflected as their own line items. This practice would help ensure that investors do not falsely conclude that fees (and not trading costs) are changing from year to year, but instead would be able to properly attribute cost changes to the underlying strategy, market conditions, or other factors.

3. *For the purpose of subsection 14.14.1(2), is the use of net asset value appropriate, or would it be more appropriate to use market value or another input? Would it be better to use different inputs for different types of funds?*

   We are unable to comment as to any specific reasoning why different inputs would be required for different types of funds. Instead we will simply state that all values should reflect actual market values.

4. *Do you anticipate any other implementation issues related to the Proposed Securities Amendments?*

   We have no knowledge of anything that should delay the implementation of these proposals.

5. *Do you anticipate any issues specifically related to the proposed transition period?*

   The only issues we see in the implementation are those of industry players' willingness to take action in short order. As already stated, the IIAC, IFIC, and Fundserv have, by their own admission, not even begun to start to work on the technology infrastructure changes required to make total cost reporting a reality within the proposed timeline.

   We encourage both the finalization of these changes and strong encouragement of industry players to meet the target deadline.

Response to the Specific Questions Regarding the Proposed Insurance Guidance

1. *Do you anticipate implementation issues related to the inclusion of any of the following in the Proposed Insurance Guidance,*
    a) Segregated Fund Contracts which are no longer available for sale, but to which customers can still make deposits;
    b) Segregated Fund Contracts which are no longer available for sale and to which customers can no longer make deposits;
    c) Segregated Fund Contracts that have the potential to have funds in more than one phase at one time (i.e. Accumulation Phase, Withdrawal Phase, Benefits Phase);
    d) Segregated Fund Contracts that may include insurance fees that are paid both directly (i.e. from money outside a segregated fund, such as where units are cashed out to pay the insurance fee) and indirectly (i.e. from assets held within a fund in which the client holds units)?

    We have one concern about scenario (d) and the issue of indirect payment. To our understanding, in cases where fees are paid indirectly, this scenario would result in fees being detailed on two or more statements. If this is the case, we are concerned that this practice would lead to investor confusion as not all fees would be detailed on one statement.

2. *The Proposed Insurance Guidance does not yet include a method insurers must follow when calculating the fund expenses for each Segregated Fund Contract. Please comment on the advantages and disadvantages of calculating the fund expenses for each segregated fund the client holds each day as follows (not included in this submission).*

    We believe that the fee return calculation for seg funds should be identical to that of other investments. As such we support the use of option A.

3. *Should all insurers be required to use the same formula to calculate the dollar amount of fund expenses? Please comment on the advantages and disadvantages of:*

    - *Requiring all insurers to use the same calculation; or*

    - *Allowing an insurer to use a different calculation method if the insurer can create a more precise approximation.*

We hold that all insurers and product issuers should be using the same default methodology to calculate expenses, and that the most accurate method of doing so should be utilized. We also hold that no issuer should be given the discretion to pick their own methodology for calculating fees unless they can empirically prove the methodology is more accurate than the default method.

4. *For the purpose of the calculation described in question 2, what are the costs, benefits and risks of using the following to calculate fund expense ratio (i.e. MER + TER):*
    - *MER from the most recent Fund Facts document published before the year in question begins and a TER calculated at the same time on similar basis*
    - *MER and TER calculated for the year in question after the year ends; or*
    - *Other estimated MER and TER for the year (please explain how this MER and TER would be calculated if you discuss this option)?*

We recognize that there is a challenge in accurately reporting MERs and TERs on statements given that reporting periods for these numbers do not necessarily correspond to the standard for statements.

We favor whatever approach results in the most accurate approximation of total cost. We favour an approach that utilizes the most recently disclosed costs as per the Fund Facts document, along with some form of methodology for mid-period reporting of any material change in cost.

For example, if a Fund Facts document for a certain fund is updated in June and the issuer announces fee reductions in September, there should be some method for pushing through this updated information for reporting purposes.

5. *For the purpose of the calculation described in question 2, what are the costs, benefits and risks of using:*

    - *365 days;*
    - *The actual number of days in the calendar year in question; or*
    - *Another number that reflects the number of days on which the NAV is calculated for the fund rather than the number of days in the year?*

When considering annual expenditures, it is clear that people see a year as 365 days, with the exception of leap years. Using any other metric as a basis risks confusing the public – and unless a very good reason can be given and articulated to the public, in our view the CCIR should not deviate from a 365-day calculation. This would also establish the calculation on the same basis as the securities calculation.

6. *Would you consider it acceptable if, instead of information about each segregated fund's fund expense ratio (MER + TER), the MER alone was:*

    - *disclosed in annual statements for each fund; and*
    - *used in the calculation of the total fund expenses for the Segregated Fund Contract for the year?*

    What are the costs, benefits and risks of using (MER + TER) versus only using MER?

    We do not consider MER reporting alone acceptable. As per our statements to the CSA, TOTAL COST REPORTING needs to include All COSTS. Failing to do so could lead to a failure to disclose material costs to the client.

    The cost to this is simple: telling clients "this is what you are paying" but then denoting elsewhere that the industry did not count all costs and the client needs to reference another document to get an accurate and complete picture does nothing but erode confidence in the industry.

    There is no legitimate reason to consider excluding the TER.

7. *Might Segregated Fund Contract customers incur significant costs, other than for deferred sales charges, if they withdraw all funds from their Segregated Fund Contracts? If so, what are those costs?*

    We know of no cost for withdrawal other than deferred sales charges.

8. *The guidance describes annual statements. Do you anticipate any issues in connection with the guidance as drafted in cases where an insurer provides semi-annual statements to customers?*

    Ideally, this initiative should seek to include all relevant data to be pushed to custodians by way of Fundserv, including any relevant data surrounding seg fund costs. This will help ensure that in cases where a client holds both forms of investment, consolidated reporting can clearly summarize all costs to clients.

9. *Do you anticipate any other implementation issues related to the Proposed Insurance Guidance?*

We have no knowledge of anything that should delay the implementation of these proposals.

10. *Do you anticipate any issues specifically related to the proposed transition period?*

    As stated earlier, the only issues we see in the implementation are those of industry players' willingness to implement these initiatives in short order. As already stated, the IIAC, IFIC, and Fundserv have, by their own admission, not even begun to start to work on the technology infrastructure changes required to make full total cost reporting a reality within the proposed timeline.

    We encourage both the finalization of these changes and strong encouragement of industry players to meet the target deadline.

Additional Considerations: Proposed Statements

In addition to the questions posed to participants, we have several other concerns that we wish to address as part of this submission.

Arguably the most important aspect of these reforms will be the guidance for client statements. In the end, it is the statements that will communicate cost information to clients. As such we have concerns about the current sample statements provided in the request for comment. These concerns are as follows:

Structure

We find the tables in the sample statements hard to follow. While we appreciate the desire to group costs by recipient, at the same time we feel the current attempt does not effectively do so without confusing the reader.

We recommend that the proposed format be revisited and that an approach more similar to what was proposed by the MFDA be taken. We find the simple, straight froward approach taken by the MFDA proposal is far easier to understand than the table currently presented.

Cost In Dollars

We are aware that other parties have publicly stated that they believe that costs need only be presented in percentages. We vehemently disagree with that stance. Agreeing to provide costs in percentages and not in dollars only inconveniences the client by requiring them to “do the math themselves” as to what they paid, and does nothing but erode trust with the industry.

We urge all regulators to take a hard line on this and ensure total cost reporting appears in dollars, as well as percentages.

Location of Percentage Reporting

In the sample statement provided, we note that MERs are being reported next to the applicable security. We commend this approach but would add that TERs may be a better fit here as they are a better reflection of the total cost of that position.

In addition, we believe that next to each section of the total cost reporting table that details the cost in dollars, the cost should also be stated as a percentage of the total portfolio. This will give investors a better understanding of the portion of their total cost that is attributable to each line item, as well as their total weighted average cost.

Sales Tax

Missing from this discussion entirely has been the disclosure of sales taxes. While these taxes are already included in the MER, we feel that this cost is better broken out individually, given that it is beyond the control of the product provider, and because not separating the tax cost leads investors to believe that providers are charging more than they actually do for their products.

Tax Deductibility

The sample statements would, in our opinion, create a substantial problem for investors. The issue is that the reporting identifies both embedded costs, which cannot be deducted on an investor's tax return, and unembedded costs, which can be deducted for funds held in taxable accounts.

While the table breaks down the individual contributors' cost, in its current iteration clients would have a hard time determining what can be claimed as a deductible fee on their tax returns, which would, in turn, result in incorrect tax filings and a potential epidemic of audits and reassessments.

It is of paramount importance that we do not create any issues for clients and their tax filings as an unforeseen consequence of this initiative. We therefore recommend that a separate line item be added below the total cost disclosure that provides the tax-deductible portion of the disclosed fees.

Explanation of Value

Of equal importance to cost disclosure is the need to provide an understanding of the value provided in exchange for said cost. To date all commentary that we have been exposed to has confused value with investment return, however this completely ignores the value provided by countless registrants who provide comprehensive or modular financial planning services to their clients.

We recognize that not all advisors provide these services and that no one statement would be able to define the value provided by a very diverse set of service offerings. That said we also feel this can be addressed with a statement that encourages the investor to consider what it is their advisor is providing them beyond investing services. The following is a sample of a disclosure that could be added to accomplish this.

> *"Fees paid to your advisor are in consideration for services provided by them, to you, the client. These services vary from advisor to advisor and could include, in addition to investing services: financial planning, insurance, tax, and estate planning services. Be sure to speak with your advisor as to how they can be of service to you."*

We highly recommend that a note to the effect of the above be included in all statements.

Closing Summary

As noted in our opening statement of this submission, we at the Financial Planning Association of Canada see this initiative as nothing short of the correction of an injustice and disservice to investors. We also recognize that opportunities to fix issues like this do not come about often, and as such we encourage all members of the CSA and CCIR to stand true to the promise of this initiative and ensure that costs are reported at TOTAL COSTS. No one in the industry should ever have to point to another document to explain where other costs that do not appear on the statement are, and no investor should ever have to question how much they are paying.

In closing, we thank you for the opportunity to provide commentary regarding this important issue. We hope that you have found our submission to be in keeping with the intended spirit of consumer protection and with our goal of the professionalization of the financial planning industry. It is our hope that you will see fit to implement our recommendations as outlined. We will also continue to make ourselves available for further input and support for this initiative.